Date: 11/15/2023

2023 Fall National Meeting
Orlando, Florida

Statutory Accounting Principles (E) Working Group
Friday, December 1, 2023
10:00 AM - 12:00 PM ET

OVERVIEW AGENDA

HEARING AGENDA

	Hearing Page Number	Attachment
1. SAPWG Hearing – Adoption of Minutes—*Dale Bruggeman (OH)*	1	1-5
2. SAPWG Hearing – Review of Comments on Exposed Items—*Dale Bruggeman (OH)*		
• Ref #2019-21: Principles-Based Bond Definition	2	6-7
• Ref #2022-12: Review of INT 03-02: Modification to an Existing Intercompany Pooling Arrangement	6	8-9
• Ref #2022-14: New Market Tax Credits	9	10-13
• Ref #2023-14: SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve	14	14
• Ref #2023-15: IMR and AVR Specific Allocations	15	15
• Ref #2023-16: Schedule BA Reporting Categories	20	16
• Ref #2023-17: Short-Term Investments	23	17
• Ref #2023-22: Actuarial Guideline 51 and Appendix A-010 Interaction	24	18
Comment Letters	25	19
3. SAPWG Hearing 2 – Review of Comments on Exposed Items—*Dale Bruggeman (OH)*		
• INT 23-04: Life Reinsurance Liquidation Questions	TBD	TBD
• Ref #2023-23: Residuals in Preferred Stock and Common Stock	TBD	TBD
Comment Letters	TBD	TBD

OVERVIEW AGENDA

MEETING AGENDA

	Meeting Page Number	Attachment
4. SAPWG Meeting – Maintenance Agenda – Pending List—*Dale Bruggeman (OH)*		
• Ref #2023-24: ASU 2016-13, Measurement of Credit Losses on Financial Instruments,	1	A
• Ref #2023-25: ASU 2023-03, Amendments to SEC Paragraphs	3	B
• Ref #2023-26: ASU 2023-06, Codification Amendments in Response to the SEC's Disclosure Update	3	C
• Ref #2023-27: ASU 2023-04, Amendments to SEC Paragraphs—Cryptocurrency	4	D
• Ref #2023-28: Collateral Loan Reporting	4	E
• Ref #2023-29: IMR / AVR Preferred Stock	5	F
• Ref #2023-30: Admissibility Requirements of Investments in Downstream Holding Companies	6	G
• Ref #2023-31: Model 630 Mortgage Guaranty Insurance	6	H
5. Consideration of Items on the Active Maintenance Agenda		
• Ref #2023-03: New C-2 Mortality Risk Note	7	I
6. SAPWG Meeting – Any Other Matters Brought Before the Working Group —*Dale Bruggeman (OH)*		
• Review of U.S. GAAP Exposures	7	J
• Life Actuarial (A) Task Force Coordination Memo	7	K
• IAIS Audit and Accounting Working Group	8	None

- **Comment Deadline for Ref #2019-21 – Monday, January 22, 2024**
- **Comment Deadline for all other items – Friday, February 9, 2024**

Statutory Accounting Principles (E) Working Group
Hearing Agenda
December 1, 2023

ROLL CALL

Dale Bruggeman, Chair	Ohio	Judy Weaver	Michigan
Kevin Clark, Vice Chair	Iowa	Doug Bartlett	New Hampshire
Sheila Travis	Alabama	Bob Kasinow	New York
Kim Hudson	California	Diana Sherman	Pennsylvania
William Arfanis/Michael Estabrook	Connecticut	Jamie Walker	Texas
Rylynn Brown	Delaware	Doug Stolte/David Smith	Virginia
Cindy Andersen	Illinois	Amy Malm/Elena Vetrina	Wisconsin
Melissa Gibson/Stewart Guerin	Louisiana		

NAIC Support Staff: Julie Gann, Robin Marcotte, Jake Stultz, Jason Farr, Wil Oden

Note: This meeting will be recorded for subsequent use.

The Statutory Accounting Principles (E) Working Group met in regulator-to-regulator sessions on Nov. 27. This regulator session was pursuant to the NAIC Open Meetings Policy paragraph 3 (discussion of specific companies, entities or individuals) and paragraph 6 (consultations with NAIC staff related to NAIC technical guidance of the *Accounting Practices and Procedures Manual*). No actions were taken during these meetings as the discussion previewed to preview the Fall National Meeting agendas and discussed other items with NAIC staff pursuant to the NAIC open meeting policy.

REVIEW AND ADOPTION OF MINUTES

1.	Summer National Meeting	**(Attachment 1)**
2.	Sept. 21, 2023	**(Attachment 2)**
3.	Oct. 23, 2023	**(Attachment 3)**
4.	Oct. 24, 2023, E-Vote	**(Attachment 4)**
5.	Oct. 31, 2023, E-Vote	**(Attachment 5)**

REVIEW of COMMENTS on EXPOSED ITEMS

The following items are open for discussion and will be considered separately.

1. Ref #2019-21: Principles-Based Bond Definition
2. Ref #2022-12: Review of INT 03-02: Modification to an Existing Intercompany Pooling Arrangement
3. Ref #2022-14: New Market Tax Credits
4. Ref #2023-14: *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*
5. Ref #2023-15: IMR and AVR Specific Allocations
6. Ref #2023-16: Schedule BA Reporting Categories
7. Ref #2023-17: Short-Term Investments
8. Ref #2023-22: Actuarial Guideline 51 and Appendix A-010 Interaction

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-21 SSAP No. 21R (Julie)	**Principles-Based Bond Definition**	**6 – SSAP No. 21R 7 – Issue Paper**	**Comments Received**	**IP – 2**

<u>*Summary:*</u>
During the 2023 Summer National Meeting, the Working Group exposed revisions to *SSAP No. 21R—Other Admitted Assets* to provide guidance for debt securities that do not qualify as bonds as well as to detail the accounting for residual tranches.

The exposure also included the bond issue paper to detail the historical discussions on the bond project.

<u>*Interested Parties Comments:*</u>
The Working Group exposed revisions to SSAP No. 21R for debt securities that do not qualify as bonds, including the accounting for residual tranches, as well as an Issue Paper to detail historical discussions on the bond project. Interested parties have no comments on the Issue Paper.

Interested parties met with NAIC Staff to discuss SSAP No. 21R issues, other than the accounting for residual tranches, and agreed there are issues that need clarification and/or consistency between SSAP No. 21R, SSAP No. 26R, SSAP 43R, and the recently adopted language on the definition of residual tranches in SSAP No. 48.

As these are nuanced and interrelated changes still subject to the best approach in achieving clarification and/or consistency, it was agreed it was most efficient to work through the changes collaboratively especially given the significant agreement on the end results that are trying to be achieved. As part of this collaboration, interested parties would also like to discuss with NAIC staff and regulators the concept of audit requirements for residual tranches. The remainder of interested parties' comments relate to the proposed accounting for residual tranches.

In response to the residual accounting proposal forwarded by regulators, interested parties understand concerns about accreting investments above this initial cost, but also believe there may be a more reasonable accounting method for these investments versus the proposed cost recovery method.

Residual Tranche Accounting Alternatives (Paragraph 31)
Interested parties noted that the example provided by regulators showed a risky asset accreting high yields for multiple periods even if no cash is received, which is concerning from the point of view of accounting conservatism. While this example may raise alarms to regulators, it may not be representative of residual tranche investments in the industry currently. Many residual tranche investments generate positive cash flows period after period, by design and in practice. Additionally, since the risk of residual tranches is already being addressed through risk-based-capital regulation, we hope that accounting may be formulated to be reasonable on its own, without attempting to address risk through a second channel.

Interested parties initially proposed the effective yield method of accounting, which regulators rejected, noting in some cases it could lead to income generation which was deemed to be aggressive or premature. Regulators then proposed cost recovery method of accounting, which interested parties believe is too punitive in cases where healthy cash generating assets would be written down to zero before recognizing any income.

We hope that a third alternative can be reached which incorporates these two principles:

- Assets cannot be accreted above original (or subsequent) consideration paid; and

- Assets may use a systematic approach to record investment income to the extent cash is received.

In industry discussions it became clear that variety and complexity exists which impacts this topic including:

- Underlying collateral assets span from loans to mortgages to real estate to equity to lease backed assets, each case which may suggest a different expected earnings and cash flow pattern.

- Certain servicers clearly delineate the amount of principal vs. interest cash flows generated by the collateral that are allocated to each tranche of investment. Interested parties are currently reaching out to investment advisors to understand whether some servicers do not provide this same level of granularity.

- Certain investments accounted for currently under the equity method, may prospectively be classified as residuals. Currently under the equity method, distributions are allocated between return of capital and return on capital.

Interested parties have been discussing several alternatives, two of which are described below: servicer reports and capital statements and an effective yield method with a cap. Both alternatives will also use a lower of adjusted cost or fair value concept and appropriate treatment for other than temporary impairments (OTTI). Interested parties would like the opportunity to discuss these alternatives with the Working Group to determine whether one or both of these approaches may be considered a reasonable alternative to the cost recovery method.

Servicer Reports or Capital and Distribution Statements

Servicer reports generally attribute every cash distribution into cash receipts from the interest payment on the collateral versus principal paydowns on the collateral. These cash distributions are allocated to each tranche of investment (including the residual) based upon a priority of payments schedule formalized in the operative documents for the respective securitization. Similarly, capital and distribution statements schedule out the return on capital and the return of capital. Insurers applying the equity method are accustomed to the appropriate timing to record a distribution as a dividend on the income statement under the equity method of accounting.

One alternative is to guide companies to refer to servicer reports or capital and distribution statements to recognize income equal to the portion of the residual interest's cash disbursements generated from interest receipts on the collateral pool. This method is simple, reliable and supportable.

Effective Yield Method with a Cap

Another alternative which could be applied is an effective yield method with a cap on income, such that income could only be recognized to the extent that there is a receipt of cash. As part of this alternative, the carry value of this asset may not be accreted above the cost of consideration paid. A detailed example of how this method would compare to effective yield method and cost recovery method has been drafted, noting that this third alternative would generally – if not always – result in a period-over-period carry value which is lower than the effective yield method and higher than the cost recovery method, meaning it represents a middle road, as expected. For this proposal, initial draft language has been presented for discussion as well.

We would like to offer the following principles for discussion, with the intent of replacing paragraph 31 in its entirety. Should this concept be acceptable to regulators, interested parties could also suggest actual SSAP language to accomplish what is described below.

Each period the book adjusted carrying value and interest income would be determined in the following manner:

1. At the beginning of the period, calculate the book yield as the discount rate that equates the then current best estimate of cash flows projections to the cost basis of the asset.

2. The maximum amount of interest income will be the product of the book yield and beginning of period book adjusted carrying value.

3. If cash distributed to the asset is less than the maximum amount of interest income:

    - Interest income equals total amount of cash distributions.

    - Book adjusted carrying value of the asset is not decreased.

4. If cash distributed to the asset is greater than the maximum amount of interest income:

    - Interest income equals the maximum amount calculated above.

    - Book adjusted carrying value is decreased by the amount of cash distributions in excess of the maximum amount of interest income.

Both a servicer report/capital and distribution statement method and an effective yield method with a cap would ensure that the carrying value is not accreted above cost and would allow for income recognition which is supported by cash receipts.

Comment on OTTI (Paragraphs 30 and 32)
It appears that the most recent draft of residual tranche guidance was adjusted to depart from standard lower of cost or market (LOCOM) accounting to automatically record any decrease of fair value below adjusted cost to be an other-than-temporary impairment, rather than capturing temporary reductions as unrealized losses. Interested parties generally would expect that LOCOM and OTTI processes would remain consistent for this asset class as it would be applied to other asset classes. We believe the following language, currently in SSAP 43R paragraph 26.c., should be moved to this standard:

> "For residual tranches or interests captured in scope of this statement, all reporting entities shall report the item on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value. Changes in reported value from the prior period shall be recorded as unrealized gains or losses. For reporting entities that maintain an AVR, the accounting for unrealized gains and losses shall be in accordance with SSAP No. 7-Asset Valuation Reserve and Interest Maintenance Reserve."

Additionally, the language from SSAP No. 48 paragraphs 18 and 19 addresses the impairment process of an equity method investment and SSAP No. 43R, paragraphs 34 and 36, addresses the impairment process of a residual interest in a beneficial interest.

As noted, many alternatives are being discussed by interested parties. We have shared examples of our latest thinking above in order to continue a productive discussion with regulators on this important topic. We look forward to continuing to engage with regulators and stand ready to answer any questions you may have on this topic.

Recommendation:
NAIC staff has had interim discussions on the measurement method for residual tranches and recommends that the Working Group expose a revised SSAP No. 21R to incorporate the "Effective Yield with a Cap" method proposed by industry as the measurement method for residuals along with a practical expedient that allows use of the "Cost Recovery Method". This is proposed to have a shortened comment period deadline of Jan. 22, 2024, to allow for adoption consideration prior to the Blanks (E) Working Group adoption consideration of the Schedule BA revisions from the bond proposal.

Industry initially recommended the effective yield method, however, pursuant to the subsequent discussions with industry, it was identified that some companies would prefer the "cost recovery method" (where are distributions received reduce the BACV prior to the recognition of interest income) due to the extensive work and non-automation that would be required for the "Effective Yield with a Cap" method. As the cost-recovery method is a more conservative method, NAIC staff has proposed revisions to SSAP No. 21R to incorporate the "Effective Yield with a Cap Method" but to also provide a practical expedient that companies

can elect to use the "Cost Recovery Method." The revisions detail limitations if electing the practical expedient, which require its use for all residual holdings and a prospective approach for new acquisitions only, if a company wanted to move away from the cost recovery method once its elected.

With this revision, other aspects of the residual guidance, including the other-than-temporary impairment guidance, (which was also noted by interested parties') has been revised.

Although the cost-recovery method is more conservative in balance sheet / asset recognition, it does fail to recognize income from the investment holding until the cost basis has been recovered, which is an approach that is not followed for most investment holdings. As such, the general recommendation supports industry's proposed "Effective Yield Method with a Cap" for the following reasons:

1) It eliminates the practice in which the BACV for residuals increases beyond original consideration.

2) It incorporates a process that allows for recognition of interest income based on the calculated effective yield, with amounts received in excess of the effective yield will be reflected as a return of capital, reducing the BACV of the residual interest.

The effective yield method with a cap is supported over the use of servicer reports / capital distribution statements as not all investors may receive reports and the reports may have various calculations in determining whether the amount received reflects interest or capital distributions. With the effective yield with a cap method, a consistent calculation shall be in place for all reporting entities.

As noted in the recommendations, with subsequent discussions with industry, it was noted that there were some companies that would prefer the "cost-recovery" method (detailed in past exposure) as the process to complete the "effective yield method with a cap" would require extensive work and non-automation, particularly when reporting entities only held a limited number of residuals.

In addition to the measurement method, revisions have been proposed to the other-than-temporary impairment guidance. The original guidance proposed an OTTI to be recognized when fair value was below amortized cost. This was drafted with the presumption that a decline in the fair value of the residual represented defaults in the underlying collateral that would be assumed by the residual tranche. However, in considering industry's comments and that market factors could influence fair value, the guidance has been revised to require OTTI to be assessed on an ongoing basis and shall be considered to have occurred if the present value of expected cash flows is less than the BACV, with a realized loss recognized for the difference between the two. This language is consistent with provisions in SSAP No. 43R.

NAIC staff also notes that no comments were received on the bond project issue paper. As discussions on SSAP No. 21R are still ongoing, NAIC staff does not recommend formal action to adopt at this time, but rather, that NAIC staff be directed to continue to update the issue paper with the SSAP No. 21R discussion and subsequently exposed.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-12 (Robin)	**Review of INT 03-02: Modification to an Existing Intercompany Pooling Arrangement**	**8 – Agenda Item 9 – INT 03-02**	**Comments Received**	**IP – 5 IP Org chart – 18**

<u>*Summary:*</u>
On Aug. 13, 2023, the Working Group re-exposed the intent to nullify INT 03-02 and directed NAIC staff to work with industry regarding some of their comments and examples to be submitted by industry.

The nullification is proposed as INT 03-02 is inconsistent with *SSAP No. 25—Affiliates and Other Related Parties* guidance regarding economic and non-economic transactions between related parties. The guidance in INT 03-02 can result with, in essence, unrecognized gains (dividends) or losses through the using the statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements. Treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions.

<u>*Interested Parties' Comments:*</u>
The Working Group re-exposed the intent to nullify INT 03-02 and directed NAIC staff to work with industry regarding some of their comments and examples to be submitted by industry.

In response to the Working Group's request for examples of a modification to an existing intercompany pooling arrangement, interested parties identified the two most common modifications to intercompany pooling arrangements:

- the combination of two intercompany pooling arrangements following the acquisition by an insurance group of another insurance company (or group of companies), and
- the removal of an insurance subsidiary from an intercompany pooling arrangement in preparation for the sale of the subsidiary (discontinued line of business)

These two types of modifications may involve the movement of a significant amount of assets and liabilities to re-balance the capital and surplus of the insurance subsidiaries involved to manage the impact to a targeted RBC for the members of the intercompany pooling arrangement. A less common modification is the re-capitalization of the members of the pooling arrangement to adjust for changes in investment strategy over time. Because this latter type of transaction usually involves the movement of cash, not assets and liabilities, we are not including an example as the effects are fairly straight forward.

For purposes of the Example 1 below, please see the attached Organization Chart – Pre-Acquisition.

Example 1 is the combination of <u>two intercompany pools following the acquisition of a group of companies:</u>

- Insurance Group (Holdco) A acquires Insurance Group (Holdco) B.
- Insurance Group A and Insurance Group B have the following intercompany pools:

<u>Intercompany Pool A:</u>	<u>Pool participation percentage:</u>
Entity A1	70%
Entity A2	26%
Entity A3	4%

<u>Intercompany Pool B:</u> <u>Pool participation percentage:</u>

Entity B1	60%
Entity B2	22%
Entity B3	18%

Upon completion of the acquisition, the acquired companies are owned by a common holding company for this example (please see attached Organizational Chart Post Acquisition – Example 1).

- Intercompany Pool A modifies its pooling arrangement, brings Intercompany Pool B into Intercompany Pool A and resets the pool participation percentages retroactive to January 1 of the current year as follows:

Intercompany Pool A:	Pool participation percentage:
Entity A1	40%
Entity A2	20%
Entity A3	3%
Entity B1	22%
Entity B2	8%
Entity B3	7%

- In this example, each entity's pool participation percentage have been reset in order to balance future capital needs, with consideration of risk-based capital and other financial measures (e.g., IRIS ratios).

- As a result of the pooling modification, the three former Intercompany Pool B entities must transfer net assets to each of the Intercompany Pool A entities. For purposes of this example, entity B1 transfers bonds totaling $9,000,000 to entity A1 in order to support the $9,000,000 of reserves[1] transferred to entity A1.

Scenario 1:

- If bonds with a market value of $9,000,000 and an amortized cost of $8,000,000 are transferred from entity B1 to entity A1 at market value, entity B1 may or may not have to defer its gain resulting from the transfer. This will depend on whether entity A1 and entity B1 have a common insurance entity parent. For example, if entity B1 is under entity A1's ownership chain or vice-versa as shown in the attached Organizational Chart Post Acquisition – Example 1, the gain will be deferred; otherwise, the gain will be realized. In the example provided, B1 would realize the gain on the transfers of assets to A1 as the two entities are not owned by the same insurer. However, if A3 transferred assets to A1, the gain in this instance would be deferred.

- More importantly, because insurers generally hold most bond investments to maturity, the cash flows from the contractual payments over the term of the bonds will be aligned with the bonds' amortized cost, not the market value at a point in time. Because entity B1 transferred bonds with an amortized cost of $1,000,000 less than that needed to support the reserves transferred (at book value) to entity A1, entity A1 will have received a deficient amount of assets (future cashflows) as part of the modification of the intercompany pooling arrangement. This will result because entity A1 will realize cash flows closer to the $8,000,000 amortized cost of the bonds rather than the market value at the time of the pooling modification of $9,000,000.

- In addition, if entity B1 has recorded a gain in surplus as a result of the transfer of the bonds as part of the intercompany pooling modification transaction, entity B1 must treat the intercompany pooling as retroactive reinsurance pursuant to paragraph 36d of SSAP No. 62R as provided in the example.

[1] The reserves transferred would typically include loss and loss adjustment expenses and other underwriting expense reserves, net of any premiums receivable subject to the pooling arrangement.

Scenario 2:

- If bonds with a market value of $9,000,000 and an amortized cost of $10,000,000 are transferred from entity B1 to entity A1 at market value, entity A1 will have received excess assets of $1,000,000 above the reserves transferred (at book value) to entity A1, as entity A1 will realize cash flows from the $10,000,000 amortized cost of the bonds rather than the market value at the time of the pooling modification of $9,000,000. Therefore, if entity B1 is required to transfer the assets at fair value, it has essentially sent a dividend of $1,000,000 to entity A1.

Example 2 is the removal of an insurance subsidiary from an intercompany pooling arrangement in preparation for the sale of the subsidiary (discontinued line of business). For this example, please see attached Organizational Chart – Example 2:

- Entity A6 is removed from the Intercompany Pool comprised of 6 insurance subsidiaries under Holdco A (as the insurance group is discontinuing A6's lines of business and selling the entity A6).

- The intercompany pooling arrangement is modified and the pooling percentages are reset such that entity A1 absorbs A6's pooling participation (retroactive to January 1 of the current year).

- Prior to the modification, the intercompany pooling percentages are:

Intercompany Pool participant:	Pool participation percentage:
Entity A1	37%
Entity A2	14%
Entity A3	2%
Entity A4	28%
Entity A5	10%
Entity A6	9%

- After the modification, the intercompany pooling percentages are:

Intercompany Pool participant:	Pool participation percentage:
Entity A1	46%
Entity A2	14%
Entity A3	2%
Entity A4	28%
Entity A5	10%

- As a result of the pooling modification, entity A6 must transfer net assets to entity A1. For purposes of this example, entity A6 transfers bonds totaling $27,000,000 to entity A1 in order to support the reserves[2] transferred to entity A1 for the business retained by the intercompany pool.

Scenario 1:

- If bonds with a market value of $27,000,000 and an amortized cost of $26,000,000 are transferred from entity A6 to entity A1 at market value, the implications of such a transfer are the same as in Example 1. Entity A6 may or may not have to defer its gain resulting from the transfer. This will depend on whether or not entity A1 and entity A6 have a common insurance entity parent (the attached Example 2 assumes that the entities do not have a common insurance entity parent). For example, if entity was a subsidiary of entity

[2] The reserves transferred would typically include loss and loss adjustment expenses and other underwriting expense reserves, net of any premiums receivable subject to the pooling arrangement.

A1, the gain will be deferred; otherwise, the gain will be realized. In the example provided, A6 would realize the gain on the transfers of assets to A1 as the two entities are not owned by the same insurer. However, if A3 transferred assets to A1, the gain in this instance would be deferred.

- Because entity A6 transferred bonds with an amortized cost of $1,000,000 less than that needed to support the reserves transferred (at book value) to entity A1, entity A1 will have received a deficient amount of assets (future cash flows) as part of the modification of the intercompany pooling arrangement. This will result because entity A1 will realize cash flows closer to the $26,000,000 amortized cost of the bonds rather than the market value of $27,000,000 at the time of the pooling modification.

- In addition, if entity A6 has recorded a gain in surplus as a result of the transfer of the bonds as part of the intercompany pooling modification transaction, entity A6 must treat the intercompany pooling as retroactive reinsurance pursuant to SSAP No. 62R.

Scenario 2:

- If bonds with a market value of $27,000,000 and an amortized cost of $28,000,000 are transferred from entity A6 to entity A1 at market value, entity A1 will have received excess assets of $1,000,000 above the reserves transferred (at book value) to entity A1, as entity A1 will realize cash flows from the $28,000,000 amortized cost of the bonds rather than the market value of $27,000,000 at the time of the pooling modification. Therefore, if entity A6 is required to transfer the assets at fair value, it has essentially sent a dividend of $1,000,000 to entity A1.

Recommendation:

NAIC staff notes that the examples provided by interested parties have been helpful. NAIC staff recommends that the Working Group defer action and direct NAIC staff to continue to work with interested parties on a proposal for discussion at the 2024 Spring National Meeting.

Discussions with interested parties have highlighted: 1) that they share the intent that the prior guidance in INT 03-02 should have a very limited scope; 2) differences in pricing exists for some intercompany pooling contracts; and 3) both NAIC staff and interested parties agree that the guidance is not intended to require some members of the same intercompany pool to account for the contract differently (that is some members applying retroactive accounting and some applying prospective accounting). However, more discussions are needed to resolve some of the identified issues.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-14 (Wil)	**New Market Tax Credits**	**10 – Agenda Item 11 – SSAP No. 93R 12 – SSAP No. 94R 13 – Other SSAPs**	**Comments Received**	**IP – 9**

Summary:

On August 13, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 93—Low-Income Housing Tax Credit Property Investments* and *SSAP No. 94R—Transferable and Non-Transferable State Tax Credits*. On September 29, 2023, Interested Parties provided NAIC staff with a comment letter on the exposed revisions to SSAP No. 93 and 94R which is detailed below.

Interested Parties' Comments:

The Working Group exposed additional revisions made to SSAP No. 93 and SSAP No. 94R. Additionally, the Working Group directed NAIC staff to work with interested parties to draft revisions to the annual statement instructions and reporting updates.

Revisions to SSAP No. 93 – *Low-Income Housing Tax Credit Property Investments* and SSAP No. 94R – *Transferable and non-transferable State Tax Credits* and updates were made in response to comments received from interested parties.

Interested parties appreciate the opportunity to comment on the substantive revisions exposed by the Working Group for SSAP No. 93 – *Low Income Housing Tax Credit Property Investments* and SSAP No. 94 - *Transferable and Non-Transferable State Tax Credits* under item Ref #2022-14 *New Markets Tax Credits* (the Exposure). As stated in our prior comment letter on this topic, interested parties agree with having uniformity in accounting and reporting for equity and debt investments for which the return is earned primarily through tax credits. Interested parties agree that the proportional amortization method is an appropriate method to use for any type of investment (debt or equity) where the return is primarily earned through tax credits. However, we have concerns regarding the proposed adoption and scope provisions of the Exposure along with concerns that certain aspects of the Exposure could be misinterpreted which are outlined in the comments below:

SSAP No. 93 Admissibility Requirements for Ownership Interests in Tax Credit Investments
Paragraph 18 requires reporting entities to annually assess the future utilization of the unallocated tax credits associated with an entity's ownership interest in a tax credit investment project to determine if the investment can be admitted. Interested parties agree with the requirements of this paragraph to the extent that a tax credit investment meets **<u>both</u>** of the following criteria:

1) a reporting entity is not permitted to sell its ownership interest in a tax credit investment project to a 3rd party, and
2) the tax credits generated by the investment are not transferrable post allocation by the tax credit investment project.

If both of these criteria are met, a reporting entity's ownership interest in a tax credit investment can only be converted into allocated tax credits for use by the reporting entity and therefore, evaluation for admittance based on a reporting entity's ability to utilize the tax credits is appropriate.

Interested parties do not believe that the admissibility criteria within paragraph 18 should apply to ownership interests in tax credit investments that are unrestricted for sale (regardless of the type of tax credits that it generates and allocates) **<u>or</u>** for ownership interests in tax credit investments that are restricted but generate transferrable tax credits. Ownership interests in these types of tax credit investments represent investments that can be directly liquidated to satisfy policyholder obligations either through sale of the reporting entity's ownership interest in the investment (i.e., the future rights to receive tax credits that have not yet been generated and allocated by the tax credit investment) *or* sale of the transferrable tax credit post allocation. Therefore, we believe that these types of tax credit investments represent admitted assets and are fundamentally different from nonsaleable ownership interests in tax credit investments that only allocate non-transferrable tax credits.

Interested parties acknowledge that paragraphs 18(a) and 18(b) appear to provide an exception to the admissibility requirements in paragraph 18 for these types of investments:

> *18(a). Tax credit investments which allocate tax credits which are certificated or transferable in accordance with permitted IRS or state tax provisions may admit up to the lesser of the proportional amortized cost, or fair value of the tax credits. If the fair market value is not determinable, then the reporting entity may only admit the amount calculated in paragraph 18.*
>
> *18(b). Tax credit investments which allocate tax credits eligible for direct payment may admit up to the lesser of the proportional amortized cost, or the estimated proceeds.*

With respect to paragraph 18(a), interested parties disagree with the concept that if the fair value of a tax credit investment is not determinable, a reporting entity must apply the admissibility criteria within paragraph 18 because this conflicts with the impairment requirements in paragraph 25 of SSAP No. 93R, which provides guidance to ensure that a reporting entity's ownership interest in a tax credit investment would never exceed its fair value. We believe paragraph 25 of SSAP No. 93R appropriately addresses admissibility for these scenarios and therefore the language in paragraph 18(a) should be removed from the Exposure. Further, paragraph 25 requires a reporting entity to test its investment in tax credit projects for impairment annually and permits a reporting entity to estimate fair value as the present value of the future tax credits and other tax benefits that are expected to be generated by the tax credit investment discounted at a risk-free rate of return. Interested parties believe that this method provides a reasonable approximation of the fair value of a reporting entity's ownership interest in a tax credit investment, as it is based on assumptions that would be used by market participants when determining the purchase price of a similar investment (i.e., fair value is directly tied to the tax credits/benefits expected to be generated by the investment). As these types of tax credit investments are unrestricted for sale, we believe these ownership interests should be considered admitted assets and that admissibility is appropriately captured by the impairment testing requirements of paragraph 25. In addition, interest parties believe paragraph 25 also addresses admissibility for ownership interests in tax credit investments that may be restricted for sale if they allocate transferrable tax credits. This is because of the direct link between a tax credit investment's fair value and the value of the tax credits it allocates. Accordingly, in these circumstances because the tax credit allocated by the investment can ultimately be sold to a 3rd party, the impairment testing requirements of paragraph 25 also appropriately address admissibility considerations related to the tax credit investment.

With respect to paragraph 18(b), interested parties believe the meaning of "estimated proceeds" has the same meaning as fair value and represents the price that would be received by the reporting entity for its ownership interest in a tax credit investment in an orderly transaction between market participants and that wording should therefore be stricken from paragraph 18. We believe that ownership interests in tax credit investments that allocate tax credits eligible for direct payment (i.e., non-transferrable tax credits) are no different from those that allocate transferrable assets because a reporting entity can sell its ownership interest in the tax credit investment (i.e., the rights to receive tax credits that have not yet been generated and allocated by the tax credit investment). Similarly, we believe that admissibility of these tax credit investments is appropriately addressed by the impairment requirements of paragraph 25 because the fair value of a reporting entity's ownership interest in these tax credit investments is directly tied to the future tax credits and other tax benefits that are expected to be generated by the tax credit investment project.

Given these considerations, interest parties suggest the following revisions to paragraph 18; note that the proposed revisions below do not contemplate changes that may arise from the other comments discussed in this letter:

<u>*Reporting entities are required to annually assess the future utilization of the investment's current portion of unallocated tax credits against the estimated tax liabilities for both the tax year in which the tax credits can be initially utilized as well as any applicable carryback periods for a reporting entity's ownership interest in tax credit investments that meet both of the following criteria:*</u>

a. <u>*the ownership interest in the tax credit investment is legally restricted for sale, and*</u>
b. <u>*the tax credits allocated to the reporting entity by the tax credit investment are not transferrable post allocation.*</u>

~~Based on this assessment,~~ <u>For tax credit investments that meet both of these criteria</u>, ……………………………..

.... ~~As an exception to the admittance assessment detailed above, if the tax credit investment allocates tax credits with the following features the reporting entity may perform a secondary assessment to determine if additional amounts of the tax credit investment may be admitted~~:

~~a. Tax credit investments which allocate tax credits which are certificated or transferable in accordance with permitted IRS or state tax provisions may admit up to the lesser of the proportional amortized cost, or fair~~

~~*value of the tax credits. If the fair market value is not determinable, then the reporting entity may only admit the amount calculated in paragraph 18.*~~

~~b. *Tax credit investments which allocate tax credits eligible for direct payment may admit up to the lesser of the proportional amortized cost, or the estimated proceeds.*~~

SSAP No. 93 Paragraph 18 Clarifications

Interested parties also suggest clarification of key terms in paragraph 18. Based on previous dialog with the Working Group, we propose the following definitions:

1) "unallocated tax credits" - the portion of tax credits expected to be earned and allocated to the reporting entity through the investment structure.
2) "current portion" - the credits allocated within one year of the reporting period.

In addition, to avoid misinterpretation we propose that instead of assessing if the unallocated tax credits will be used over the life of the investment, that the assessment should occur over the life of the tax credit. This language aligns with the next sentence, which references if the unallocated tax credits will exceed what can be utilized under IRS or state tax provisions, the reporting entity must non-admit a portion of the investments. IRS and state tax authorities generally provide that if tax credits allocated or generated in the current year cannot be used to offset the current tax liability, they are carried forward for a specified number of years.

> "...if the reporting entity does not expect to substantially utilize the current portion of unallocated investment tax credits, the reporting entity shall perform an expanded assessment to determine the extent that it will be able to utilize all of the investment's unallocated tax credits over the life of the tax credit ~~the life of the investment~~. If assessment projections identify that the investment's unallocated tax credits will exceed what can be utilized under IRS or state tax provisions (current and carryforward periods ~~other applicable tax periods~~), the reporting entity shall nonadmit investments as necessary so that investments in scope of this statement (in aggregate) are only admitted to the extent tax credits are expected to be utilized within carryforward periods. Additionally, if the assessment indicates that the next three years of investment tax credits cannot be substantially utilized within the carryforward periods then the entire investment shall be nonadmitted."

Paragraph 18 disallows reporting entities from assuming that future operations will increase as support for the utilization of tax credits. However, interested parties assume that tax planning strategies are required when assessing the utilization of unallocated tax credits, similar to the valuation allowance requirements under SSAP No. 101. Explicitly providing this requirement prevents misinterpretation and avoids unintended fluctuations in surplus in the year credits are allocated and assessed under the guidelines in SSAP No. 101.

Retrospective Versus Prospective Adoption

Interested parties believe that applying the requirements under the revised standards upon transition should be done on a prospective basis so that no adjustments to surplus are recorded at the date of adoption. Under the prospective method, companies will analyze which of their investments meet the criteria under each standard. For SSAP No. 93 investments, the carrying book value at the date of adoption will become the starting balance, which will be used to determine future amortization under the proportional amortization method based on future tax credits and other tax benefits to be earned. Under SSAP No. 94, the requirement to record the credits at their face value should be applied to future purchases only. Otherwise, we would have to adjust the book value of those credits upon adoption due to the change in accounting for SSAP No. 94 purchased tax credits that requires recording these credits at face value rather than actual cost.

Adoption Date

Due to the level of work required to review investments for which tax credits are received to determine if they meet the criteria under SSAP No. 93, we believe that having an effective date of 1/1/25 would be more reasonable. In addition, we understand that changes to Schedule BA along with review by the NAIC's Capital Adequacy Working Group will need to take place to report the new investments in the appropriate section of the schedule. Since this will require additional time as well, 1/1/25 seems reasonable. Although the FASB ASU has an adoption date of 1/1/2024 for many insurers, many other insurers do not apply US GAAP and/or meet the requirements to adopt the ASU after 1/1/2024. Additionally, the accounting requirements for the new FASB ASU are different than those under the Exposure and thus, additional time to adopt the Exposure is warranted.

For SSAP No. 94 tax credits, since the adoption of this standard requires minimal changes to the annual statement as these are reported as other-than-invested assets and not as investments, an effective date of 1/1/25 with early adoption allowed will be beneficial for industry. Early adoption will allow insurers that purchase federal tax credits to apply the proposed accounting under SSAP No. 94. Otherwise, there may be questions of admissibility for new instruments purchased, since today's SSAP No. 94 only addresses state tax credits.

SSAP No. 94 Scope

There have been some questions about whether there is enough clarity about the types of tax credits that fall within SSAP No. 93 versus SSAP. No. 94. Interested parties' understanding is that SSAP No. 93 relates to debt and equity investments where the return on the investment is predominantly from tax credits and other tax benefits whereas SSAP No. 94 addresses tax credit "vouchers" that are purchased outright from any party, which are not considered investments (but instead represent receivables). To that end, we want to suggest the following edits to the SSAP No. 94 scope:

> "This statement establishes statutory accounting principles for state and federal tax credits that are purchased1 by the reporting entity without being ~~an~~ bond or equity investor in the entity from which the tax credit were purchased."

Recommendation:

NAIC staff recommend that the Working Group expose additional revisions described below to SSAP No. 93 and SSAP No. 94R. Staff also recommends that the Working Group expose changes to *SSAP No. 34—Investment Income Due and Accrued* and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, which detail miscellaneous changes which update the scope of each statement for the proposed updates to SSAP No. 93 and SSAP No. 94R. The following are key revisions to SSAP No. 93R and 94R are proposed for exposure:

- *SSAP No. 93R—Investments in Tax Credit Structures* – NAIC staff recommends the following revisions in response to comments, from interested parties, public comments and NAIC staff internal review:
  - Various editorial changes to the admittance test described in paragraph 18 to clarify technical aspects of the assessment.
  - Addition of a Glossary of key terms at the end of the SSAP.
  - Revised guidance effective date to be 1/1/2025, applied prospectively without option to early adopt.
  - Added a new paragraph to the Impairment of Tax Credit Investments section to provide guidance on tax credit programs which allocate variable amounts of tax credits.
  - Clarified in footnote 4 that tax credit strips derived from tax equity investments are not an example of an investment structure exempt from the audit requirement.
  - Added disclosures for unused tax credits allocated from tax credit investments as these tax credits would not be within the scope of SSAP No. 94R disclosures.

- *SSAP No. 94R—State and Federal Tax Credits* – NAIC staff recommends the following revisions in response to comments, from interested parties, public comments and NAIC staff internal review:
  - Revised guidance effective date to be 1/1/2025 with early adoption permitted.
  - Added language to clarify that awarded tax credits (neither purchased nor allocated from an investment) are not within the scope of SSAP No. 94R.
  - Added commitment and contingency guidance to the Accounting and Disclosure sections.

- Other SSAPs – In response to the proposed revisions to SSAP Nos 93 and 94R, NAIC staff recommends the following:

- *SSAP No. 34—Investment Income Due and Accrued* – Staff proposes revisions to clarify that tax credits earned or purchased are not within the scope of SSAP No. 34.
- *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* – Staff proposes revisions which update paragraph 2 for the new tax credit investment language.

Interested parties' comment letter recommended revisions which would narrow the scope of the paragraph 18 admittance test to only tax credit investments which allocate non-transferable tax credit and prohibit the sale of ownership interests. NAIC staff did not revise the SSAP No. 93R draft for these recommendations but intends to continue working with industry to address their concerns that the new guidance may non-admit previously admitted tax credit investments.

Additionally, NAIC staff requests comments on the annual statement reporting categories for tax credit investment RBC. The current RBC categories are LIHTC Investment specific and are mapped to the real estate grouping.

Further discussion details are in the status section in agenda item 2022-14. NAIC staff appreciates the interested parties' comments and would like to continue discussions on these proposed revisions in the interim period.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2023-14 (Julie)	***SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve***	**14 – Agenda Item**	**Comments Received**	**IP – 14** **ACLI – 26**

<u>*Summary:*</u>
The Working Group exposed this agenda item as a new SAP concept, with the intent to establish a long-term project to capture accounting guidance for AVR and IMR in SSAP No. 7. Although revisions may be considered and adopted to allow focus on specific discussion aspects, ultimately, the movement of the accounting guidance to SSAP No. 7, and any revisions from the annual statement instructions when incorporating SAP guidance, is proposed to be captured as a new SAP concept with a corresponding issue paper to detail the revisions. The agenda item identifies discussion topics to be included in this project.

<u>*ACLI Comments:*</u>
The American Council of Life Insurers (ACLI) appreciates the continued thoughtful and timely attention the Statutory Accounting Principles Working Group is dedicating to this important topic.

ACLI is very appreciative and supportive of the IMR Technical Working Group. ACLI stands ready to continue working with the NAIC to ensure the most appropriate long-term treatment of the IMR can be applied and a company's surplus and financial strength are properly reflected, all while not disincentivizing the prudent management practices that are in the best interest of all.

We are supportive of efforts to capture guidance for the IMR and AVR in SSAP No. 7. We further appreciate NAIC staff's efforts to create an initial list of topics to be addressed, noting that the interconnectedness and complexity of the IMR and AVR will result in robust, detailed discussions at the Technical Working Group.

<u>*Interested Parties' Comments:*</u>
Interested parties support the comments made by the ACLI in its comment letter.

<u>*Recommendation:*</u>
NAIC Staff recommend that the Working Group establish a long-term project to capture accounting guidance for AVR and IMR in SSAP No. 7. NAIC staff notes that revisions will be impacted by the IMR Ad Hoc Group discussions and timeframe.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2023-15 (Julie)	**IMR and AVR Specific Allocations**	**15 – Agenda Item**	**Comments Received**	**ACLI – 27**

Summary:
The Working Group exposed this agenda item as a new SAP concept, to remove guidance from the Annual Statement instructions that permits the allocation of non-interest related losses to IMR. The proposed revisions intended to address situations that focused on the change in NAIC designations as the catalyst for reporting losses as AVR in situations in which investments were sold in response to known credit events before the designation downgrade was reflected (evidenced with PG&E on the wildfires and the recent regional bank failures) as well as the mortgage loan guidance that permitted impaired mortgage loan losses to be taken to IMR as long as they were sold before the loan was 90 days past due or in foreclosure.

ACLI Comments:
The American Council of Life Insurers (ACLI) appreciates the opportunity to comment on the above referenced exposure. The ACLI believes the exposure can essentially be separated into three components, all of which NAIC staff believes will result in a more correct allocation of gain/losses to IMR. Specifically, 1) where a mortgage loan has been sold at a loss while subject to a valuation allowance, 2) where an acute credit event occurred with the security sold at a loss prior to the event being reflected in CRP ratings or on the SVO feed, and 3) the current notch rule potentially allows inappropriate credit losses going to IMR. ACLI is supportive of ensuring the appropriate treatment of interest and credit related gains and losses and committed to working with NAIC to address regulator concerns.

Mortgage Loans Sold at a Loss While Subject to A Valuation Allowance

ACLI is supportive of the proposed IMR changes related to mortgage loans.

An Acute Credit Event Occurred But Is Not Yet Reflected in CRP Ratings/SVO Feed

ACLI appreciates the NAIC's concern that the current notching criteria for an IMR eligible gain/loss does not pick up situations where there is an acute credit event (e.g., wild fires and lawsuits related to PG&E or Silicon Valley Bank) and where an insurance company may want to exit security holdings at a loss, but where the acute credit even is not yet reflected in a CRP downgrade and/or the SVO feed.

Most insurance companies subject to IMR utilize the SVO feed for both risk-based capital purposes and IMR, and have an automated process to utilize the SVO feed where applicable (i.e., not all securities are included in the SVO feed at time or purchase and/or sale and therefore insurance companies have procedures to take the second lowest available CRP rating, or internal rating if CRP ratings do not exist at the time, that subsequently get automated).

While ACLI is supportive of what the NAIC is trying to achieve, the ACLI has struggled to think of a way to operationalize it. The concept of a "reasonable period of time" presents the following challenges:

- The concept itself is ambiguous, and even in a principles-based rule is difficult to operationalize,
- What is a reasonable period of time for a sale in January could be the remaining 11 months of the year, albeit with inter-quarter adjustments, but in December could need to be much shorter,
- Each sale in December, which could be a substantial number, would require insurance companies to keep their books open and potentially rerun and revise all internal and external reporting through their annual statement filing date.

- CRP ratings and/or the SVO feed could be delayed beyond even that period, requiring inter-year changes.

- Certain companies utilize CRP ratings directly, instead of the SVO feed, to more appropriately capture the second lowest CRP rating where the SVO feed does not appropriately capture.

Rather than support the "reasonable period of time" concept, ACLI proposes an alternative which it believes better captures the NAIC's goals.

Include realized capital gains(losses) on:

Debt securities (excluding loan-backed and structured securities) and preferred stocks whose National Association of Insurance Commissioners (NAIC)/Securities Valuation Office designation at the end of the holding period is ~~NOT~~ different from its NAIC designation at the beginning of the holding period by <u>*one or less*</u> *~~more than one~~ NAIC designations*. <u>However, if the security sold also includes the following, it should not be included:</u>

- <u>Between the purchase and sale date there was an acute credit event (a known event that significantly impacts the price of the security), that was not yet reflected in CRP ratings and/or the SVO feed at the time of sale, where the resulting gain/loss from the sale was predominantly credit related.</u>

The ACLI looks forward to working with the NAIC to more appropriately tailor this concept if needed, to achieve the NAIC objectives, and so it can be adopted so as to be effective as early as January 1, 2024, which may be the earliest it can be operationalized.

The Current Notch Rule Allows Inappropriate Credit Losses Going to IMR

Embedded within the proposed changes in this exposure is the concept of changing the term NAIC Designation to NAIC Designation Category, as can be understood by the chart below. Essentially, this drastically changes the granularity by utilizing the 20 NAIC Designation Categories versus the 6 NAIC Designations.

NAIC Designation	NAIC Designation Category
1	1A
	1B
	1C
	1D
	1E
	1F
	1G
2	2A
	2B
	2C
3	3A
	3B
	3C
4	4A
	4B
	4C
5	5A
	5B
	5C
6	6

The ACLI suspects this change was intended to more precisely allocate gains/losses to IMR and AVR. The ACLI notes several challenges with this approach.

Most importantly, such an approach may result in unintended consequences that could be concerning to regulators. This can best be illustrated with the following.

	1A	1B	1C	1D	1E	1F	1G	2A	2B	2C	3A	3B	3C	4A	4B	4C	5A	5B	5C
1A	0	-1	8	10	20	32	47	71	85	127	205	221	250	316	372	465	644	777	1367
1B		0	9	10	20	32	48	72	86	128	206	221	251	317	373	465	644	778	1367
1C			0	2	12	24	39	63	77	119	197	212	242	308	364	457	636	769	1359
1D				0	10	22	37	61	76	117	195	211	240	306	362	455	634	767	1357
1E					0	12	27	51	66	107	185	201	230	296	352	445	624	757	1347
1F						0	15	39	54	95	173	189	218	284	340	433	612	745	1335
1G							0	24	38	80	158	173	203	269	325	417	596	730	1320
2A								0	14	56	134	150	179	245	301	394	573	706	1296
2B									0	42	120	135	165	231	287	379	558	692	1281
2C										0	78	94	123	189	245	338	517	650	1240
3A											0	15	45	111	167	259	438	572	1162
3B												0	29	96	151	244	423	556	1146
3C													0	66	122	215	394	527	1117
4A														0	56	148	327	461	1051
4B															0	93	272	405	995
4C																0	179	312	902
5A																	0	133	723
5B																		0	590
5C																			0

Source: Average spreads by index rating of the Bloomberg US Corporate Investment Grade Index and U.S. High Yield - 1% Issuer Cap Index over 5 years (10/1/2018 through 9/19/2023); Aladdin

If a security was sold, going from a 1A (vertical axis) to a 1C (horizontal axis), the credit related component of its yield would increase approximately 8 basis points. In a sale where the risk-free rate also went up 3% or 300 basis points, the interest related component of the gain/loss would be approximately 37.5x (300/8) the credit related component. The proposal still results in imprecision for IMR eligibility, and may be especially troubling in a declining interest rate environment as gains would not go to IMR (the scenario that was most troubling to regulators when IMR was developed)

In summary, in a falling interest rate environment, gains may overstate a company's surplus or could be distributed (showing the same financial strength when the company now has a lower yielding portfolio). In a rising interest rate environment, losses would show decreased financial strength, when in fact a company would have a higher yielding portfolio. It is important to understand that the portion of any gain/loss attributable to interest and/or credit is essentially linked to three variables 1) credit spreads as articulated in the above table, which fluctuate over time 2) the change in risk-free rate, which also fluctuates over time and 3) where the security exists in the credit spectrum (e.g., represented by either the CRP rating, NAIC Designation, or NAIC Designation Category, where the spread change is not linear as one proceeds from higher ratings to lower ratings).

ACLI believes it is very important to carefully consider:

- Should the existing one-notch NAIC Designation rule be retained?
- Should it be several NAIC sub-categories?
- Should it be different for Investment Grade and Below Investment Grade Securities?
- Should gain losses be bifurcated between interest and credit related components?

- If so, is there a simple way to calculate the bifurcated gains and losses to ensure consistency between companies and so that it can be automated?

Lastly, even if the exposed approach was deemed appropriate, there are additional significant operational issues:

- The SVO feeds are the primary source of data for calculating such IMR related gains/losses but the 20 NAIC categories are not included prior to the implementation of the new factors for risk-based capital.

- It would be impractical for insurance companies to retroactively apply this given their automated processes.

- Most companies do not have all CRP feeds to determine the second lowest CRP ratings.

ACLI strongly encourages any action beyond its alternative acute credit event proposal be addressed as part of the long-term project.

Recommendation:
NAIC Staff recommend that the Working Group adopt this agenda item, with modified revisions as suggested by interested parties for an effective date of Jan. 1, 2024. As this agenda item proposes revisions to the Annual Statement Instructions, it is recommended that this adoption be communicated via a blanks memo to the Blanks (E) Working Group so there is appropriate communication of the change in allocating IMR/AVR beginning with Jan. 1, 2024. The proposed adoption would incorporate the mortgage loan revisions as exposed and incorporated guidance for debt securities that directs AVR reporting if there is an acute credit event (known event) that negatively impacts the price of the security that has not yet been reflected in the CRP ratings / SVO feed at the time of the time of the sale where the resulting gain/loss was predominantly credit related.

Although NAIC staff supports the modified revisions suggested by interested parties to allow for timely implementation of the key changes for 2024, NAIC staff supports continued discussion on the allocation between IMR and AVR for debt instruments but believes this should occur as part of the long-term IMR project and with the involvement of the IMR Ad Hoc Group. Particularly, NAIC staff believes there should be further discussion on the use of 'more than one designation change' in determining IMR or AVR allocation for debt securities and how that should be applied with the expansion of NAIC designations from 6 to 20. NAIC staff highlights that all downgrades in NAIC designations reflect declines in credit quality. The current process, which only focuses on the designation number, and not the designation modifier, allows a security to have many levels of credit-quality declines before losses are taken to AVR and not IMR. Although some may indicate that the same approach was in practice prior to the expansion to 20 designations with NAIC modifiers, now it is more clearly apparent when a security has had credit declines.

Proposed Revisions for Adoption that Reflects the Interested Parties' Comments as Shaded:

1) **Mortgage Loans – Adoption as Exposed:**

IMR:
Mortgage loans where the realized gains (losses) more predominantly reflect interest-related changes. By default, mortgage loans that meet any of the following criteria shall not be considered to reflect interest-related losses. Realized gains (losses) from mortgage loans with these characteristics shall be reported in the AVR:

- Any mortgage loan sold/disposed with an established valuation allowance under SSAP No. 37, or

- Interest is ~~NOT~~ more than 90 days past due, or

- The loan is ~~NOT~~ in process of foreclosure, or

- The loan is ~~NOT~~ in course of voluntary conveyance, or
- The terms of the loan have ~~NOT~~ been restructured during the prior two years.

AVR:
In addition, all gains (losses), net of capital gains tax, on mortgage loans where the realized gains (losses) more predominantly reflect non-interest-related changes. By default, mortgage loans that meet any of the following criteria shall be considered to reflect non-interest-related changes and realized gains (losses) from mortgage loans with these characteristics shall be reported in the AVR:

- Any mortgage loan sold/disposed with an established valuation allowance under SSAP No. 37, or
- Interest is more than 90 days past due, or
- The loan is in the process of foreclosure, or
- The loan is in course of voluntary conveyance, or
- The terms of the loan have been restructured during the prior two years

~~Would be classified as non-interest related gains (losses).~~

2) Debt Securities – Modified with IP Comments: (Changes from Exposure are Shaded.)

IMR:
Include realized capital gains (losses) on:

Debt securities (excluding loan-backed and structured securities) and preferred stocks ~~where the realized capital gains (losses) more predominantly reflect interest-related changes. By default, debt instruments~~ whose National Association of Insurance Commissioners (NAIC)/Securities Valuation Office (SVO) designation at the end of the holding period~~, or within a reasonable amount of time after the reporting entity has sold/disposed of the instrument, areis~~ is ~~NOT~~ different from its NAIC designation at the beginning of the holding period by one or less ~~more than one~~ NAIC designations. ~~or NAIC designation category shall not be considered to reflect interest-related changes. Gains (losses) from those debt instruments shall NOT be reported in the IMR and shall be reported in the AVR Exclude any such gains (losses) exempt from the IMR.~~ However, if the security sold also includes the following, it should not be included in IMR:

- Between the purchase and sale date there was an acute credit event (a known event that significantly negatively impacts the price of the security), that was not yet reflected in CRP ratings and/or the SVO feed at the time of the sale, where the resulting gain/loss from the sale was predominantly credit related.

Shown Clean for Ease of Review:

Debt securities (excluding loan-backed and structured securities) and preferred stocks whose National Association of Insurance Commissioners (NAIC)/Securities Valuation Office (SVO) designation at the end of the holding period is different from its NAIC designation at the beginning of the holding period by one or less NAIC designations. However, if the security sold also includes the following, it should not be included in IMR:

- Between the purchase and sale date there was an acute credit event (a known event that significantly negatively impacts the price of the security), that was not yet reflected in CRP ratings and/or the SVO feed at the time of the sale, where the resulting gain/loss from the sale was predominantly credit related.

AVR:
Report all realized capital gains (losses), net of capital gains tax, on each debt security (excluding loan-backed and structured securities) ~~where the realized capital gains (losses) more predominantly reflect non-interest-related changes. By default, debt instruments~~ whose NAIC/SVO designation at the end of the holding period~~, or within a reasonable amount of time after the reporting entity has sold/disposed of the instrument,~~ is different from its NAIC/SVO designation at the beginning of the holding period by more than one NAIC designation ~~or NAIC designation category~~ shall be considered to reflect non-interest-related changes. Gains (losses) from those debt instruments shall be reported in the AVR ~~by more than one NAIC/SVO designation. The holding period is defined as the period from the date of purchase to the date of sale. For end of period classification, the most recent available designation should be used. For bonds acquired before Jan. 1, 1991, the holding period is presumed to have begun on Dec. 31, 1990.~~. However, securities without more than one designation change shall be included in the AVR if it includes the following:

- Between the purchase and sale date there was an acute credit event (a known event that significantly negatively impacts the price of the security), that was not yet reflected in CRP ratings and/or the SVO feed at the time of the sale, where the resulting gain/loss from the sale was predominantly credit related.

Shown Clean for Ease of Review:

AVR:
Report all realized capital gains (losses), net of capital gains tax, on each debt security (excluding loan-backed and structured securities) whose NAIC/SVO designation at the end of the holding period is different from its NAIC/SVO designation at the beginning of the holding period by more than one NAIC designation shall be considered to reflect non-interest-related changes. Gains (losses) from those debt instruments shall be reported in the AVR. However, securities without more than one designation change shall be included in the AVR if it includes the following:

- Between the purchase and sale date there was an acute credit event (a known event that significantly negatively impacts the price of the security), that was not yet reflected in CRP ratings and/or the SVO feed at the time of the sale, where the resulting gain/loss from the sale was predominantly credit related.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2023-16 (Julie)	**Schedule BA Reporting Categories**	**16 – Agenda Item**	**Comments Received**	**IP – 14**

Summary:
The Working Group exposed this agenda item as a SAP clarification to further define for consistency purposes the investments captured as non-registered private funds, joint ventures, partnerships or limited liability companies, or residual interests and reported based on the underlying characteristics of assets.

Interested Parties' Comments:
Interested parties recommend several edits to further clarify and define the investments that should be categorized as non-registered private funds, joint ventures, partnerships or limited liability companies or residual interests, based on the characteristics of the underlying assets.

Please see the related attachment with marked edits.

We do not recommend any changes to the language describing Non-Registered Private Funds, but we would like to comment on what is included in that section in response to the Working Group's request: in addition to private funds which have been filed with the SVO and private funds which have not been filed with the SVO, there are certain fixed income instruments not included on schedule D or schedule B, consistent with the Annual Statement Instructions for that schedule.

Proposed Interested Parties' Edits to the Schedule BA Instructions from Separate Attachment:

Non-Registered Private Funds with Underlying Assets Having Characteristics of a Bond, Mortgage Loan or Other Fixed Income Instrument

Include: Fixed income instruments that are not corporate or governmental unit obligations (Schedule D) or secured by real property (Schedule B).

Any investments deemed by the reporting entity to possess the underlying characteristics of a bond or other fixed income instrument that has been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 0799999 and 0899999.

Any investments deemed by the reporting entity to possess the underlying characteristics of a bond or other fixed income investment that has not been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 0999999, 1099999, 1199999, 1299999, 1399999 and 1499999.

Joint Ventures, Partnership or Limited Liability Company Interests with Underlying Assets Having the Characteristics:

Fixed Income Instruments

Include: Investments with underlying collateral which include contractual principal and/or interest payments, excluding mortgage loans~~Leveraged Buy-out Fund~~.

~~A fund investing in the "Z" strip of Collateralized Mortgage Obligations.~~

Any investments deemed by the reporting entity to possess the underlying characteristics of fixed income instruments that has been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 1599999 and 1699999.

Any investments deemed by the reporting entity to possess the underlying characteristics of fixed income instruments that has not been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 1799999 and 1899999.

Common Stocks

Include: Venture Capital Funds or other underlying equity investments.

Real Estate

Include: Real estate development interest. Reporting should be consistent with the detailed property analysis appropriate for the corresponding risk-based capital factor for this investment category. If the requisite details are not available for reporting, report under "Other" subcategory.

Mortgage Loans

Include: Mortgage obligations. Reporting should be consistent with the detailed property analysis appropriate for the corresponding risk-based capital factor for this investment category. If the requisite details are not available for reporting, report under "Other" subcategory.

Other

Include: Limited partnership interests in oil and gas production.

Forest product partnerships.

Investments within the Joint Venture and Partnership Interests category that do not qualify for inclusion in the "Fixed Income Instruments," "Common Stocks," "Real Estate" or "Mortgage Loans" subcategories.

~~Reporting should be consistent with the corresponding risk-based capital factor for this investment category (i.e., Other Long-Term Assets).~~

Residual Tranches or Interests with Underlying Assets Having Characteristics of:

Investment in Residual Tranches or Interests should be assigned to the subcategory with the highest underlying asset concentration. There shouldn't be any bifurcation of the underlying assets among the subcategories.

Include: Residual tranches or interests from securitization tranches and beneficial interests as well as other structures captured in scope of *SSAP No. 43R – Loan-Backed and Structured Securities* Investments in joint ventures, partnerships and limited liability companies captured in scope of *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* that represent residual interests or that predominantly hold residual interests.

This category shall also include residual interests or residual security tranches within investment structures that are not captured in scope of SSAP No. 43R or SSAP No. 48 but that reflect, in substance, residual interests or residual security tranches.

Fixed Income Instruments

Include: Investments with underlying collateral which include contractual principal and/or interest payments, excluding mortgage loans~~, if held individually, would be reported on *Schedule D – Part 1 – Long-Term Bonds*~~.

Common Stocks

Include: Investments with underlying collateral which are securities that represent a subordinate equity ownership.~~, if held individually, would be reported on *Schedule D – Part 2 – Section 2 – Common Stocks*~~

Preferred Stocks

Include: Investments with underlying collateral which is a security that represents ownership of a corporation and gives the holder a claim prior to the claim of common stockholders on earnings and also generally on assets in the event of liquidation.~~, if held individually, would be reported on *Schedule D – Part 2 – Section 1 – Preferred Stocks*~~

Real Estate

Include: Investments with underlying collateral which is defined as directly-owned real estate properties and single real estate property investments that are directly and wholly-owned through a limited liability company~~,~~ . ~~if held individually, would be reported on *Schedule A – Real Estate Owned*~~

Mortgage Loans

Include: Investments with underlying collateral which is secured by a mortgage on real estate.~~,~~ ~~if held individually, would be reported on *Schedule B – Mortgage Loans*~~

Other

Include: Items that do not qualify for inclusion in the above subcategories.

Recommendation:

NAIC staff recommends that the Working Group expose the agenda item, with the proposed modifications from interested parties, but with the continued proposal to combine the reporting lines for non-registered private funds to be included in the reporting lines for joint ventures, partnerships and limited liability company interests. (This edit was previously included in the Schedule BA reporting changes.) NAIC staff note that there is no SSAP for non-registered private funds and that they would be captured in SSAP No. 48. It is also noted that there is no clear distinction on what would be captured as a non-registered private equity fund and not a joint venture. On the proposed descriptions, NAIC staff notes that some of the descriptions are fairly broad, so looking for additional regulator and industry feedback during the exposure period on whether more specification is needed.

NAIC staff has had a conversation with key industry representatives and the opposition on the proposal to combine non-registered private funds with other SSAP No. 48 items, and it was identified that there is a current industry interpretation for including "warehouse loans" within the non-registered private equity fund line. It was communicated that these loans were previously included on this line on Schedule BA and when that line was revised to reflect 'private equity funds' the inclusion of these warehouse loans in that reporting line continued. This conversation noted that these warehouse loans are not in scope of SSAP No. 48, but the reporting as non-registered private funds allows them to be classified by the underlying interests (mortgage loans) and obtain the RBC charge that is more in line with mortgage loans.

NAIC staff has the initial impression that these warehouse loans are collateral loans and should be accounted for and reported in accordance with *SSAP No. 21R—Other Admitted Assets* with reporting in the collateral loan reporting lines. As there has been a desire for more granular reporting of collateral loans, for ease of identification of the type of collateral that secures the loan, a new agenda item has been proposed to report collateral loans by type of collateral. NAIC staff believes that this approach, especially if there is subsequent mapping to RBC, will address the concern of not having a dedicated line for these investments on Schedule BA.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2023-17 (Julie)	**Short-Term Investments**	**17 – Agenda item**	**No Comments**	**IP – 15**

Summary:

The Working Group exposed revisions as a new SAP concept to further restrict the investments that are permitted for cash equivalent or short-term investment reporting.

To correspond with the bond project, this agenda item proposes an effective date of Jan. 1, 2025. Additionally, subsequent blanks reporting changes will be considered to modify the cash equivalent and short-term reporting lines accordingly. This item contains revisions to further restrict the investments that are permitted to be included in cash or shorter-term investment reporting.

Interested Parties' Comments:
Interested parties have no comments on this item.

Recommendation:
NAIC staff recommend that the Working Group adopt the revisions exposed to *SSAP No. 2R—Cash, Cash Equivalents, Drafts, and Short-Term Investments* to further restrict the investment that are permitted for cash equivalent and short-term reporting with an effective date of Jan. 1, 2025.

With the revisions, the following investments will be excluded from cash equivalent / short-term reporting: (Items shaded are explicitly new with the agenda item.)

a. Asset-backed securities captured in scope of SSAP No. 43R.

b. All investments that are reported on Schedule BA, including but not limited to:

   i. All debt securities that do not qualify as bonds in scope of SSAP No. 21R.

   ii. Collateral / Non-Collateral loans captured in scope of SSAP No. 21R.

   iii. Working capital finance investments in scope of SSAP No. 105R.

   iv. Surplus notes in scope of SSAP No. 41R

c. Mortgage loans captured in scope of SSAP No. 37.

d. Derivative instruments in scope of SSAP No. 86 or SSAP No. 108.

e. Securities with terms that are reset at predefined dates (e.g., an auction-rate security that has a long-term maturity and an interest rate that is regularly reset through a Dutch auction) or have other features an investor may believe results in a different term than the related contractual maturity shall be accounted for based on the contractual maturity at the date of acquisition, except where other specific rules within the statutory accounting framework currently exist.

NAIC staff recommend that the Working Group direct NAIC staff to sponsor a blanks proposal to revise the reporting lines accordingly and to draft an issue paper to detail the revisions for historical reference.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2023-22 (Robin)	**Actuarial Guideline 51 and Appendix A-010 Interaction**	**18 – Agenda item**	**No Comments**	**IP– 16**

Summary:
On August 13, the Working Group exposed revisions to *SSAP No. 54R—Individual and Group Accident and Health Contracts* to clarify that gross premium valuation (under Appendix A-010) and cash flow testing (under AG 51) are both required, if indicated. In addition, the Working Group directed staff to provide formal notice of the exposure to the Long-Term Care Actuarial (B) Working Group and the Valuation Analysis (E) Working Group.

Interested Parties' Comments:
Interested parties have no comments on this item.

Recommendation:
NAIC staff recommends adoption of the exposed revisions. While NAIC staff previously noted that they were considering recommending an expansion of the exposed illustration, subsequent conversations with regulatory actuaries indicated that it was not necessary. The Long-Term Care Actuarial (B) Working Group and the Valuation Analysis (E) Working Group staff support have noted that the Working Groups do not intend to provide formal comments.

The following 2 items will be addressed in a separate hearing packet - Hearing 2 as comments are pending in mid-November.

1. INT 23-04: Life Reinsurance Liquidation Questions [Comments pending - Hearing 2]
2. Ref #2023-23: Residuals in Preferred Stock and Common Stock [Comments pending - Hearing 2]

The comment letters are included in Attachment 19 (31 pages).

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/12-1-23 Fall National Meeting/Hearing/00 - 12-2023 - SAPWG Hearing Agenda.docx

Draft: 8/28/23

Statutory Accounting Principles (E) Working Group
Seattle, Washington
August 13, 2023

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met in Seattle, WA, Aug. 13, 2023. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Sheila Travis (AL); Kim Hudson (CA); William Arfanis (CT); Rylynn Brown (DE); Cindy Andersen (IL); Stewart Guerin and Melissa Gibson (LA); Judy Weaver and Steve Mayhew (MI); Doug Bartlett and Pat Gosselin (NH); Bob Kasinow (NY); Diana Sherman (PA); Jamie Walker and Amy Garcia (TX); David Smith (VA); and Amy Malm (WI).

1. Adopted its July 5, June 28, May 16, April 12, April 10, and Spring National Meeting Minutes

The Working Group conducted an e-vote that concluded July 5 to expose revisions to *Interpretation (INT) 23-01T: Net Negative (Disallowed) Interest Maintenance Reserve*. During its June 28 meeting, the Working Group took the following action: 1) heard comments and received Working Group direction on revisions to INT 23-01T. During its May 16 meeting, the Working Group took the following action: 1) heard comments and considered action on three items exposed during the Spring National Meeting, one of which has corresponding 2023 year-end blanks reporting revisions; and 2) exposed three agenda items. The Working Group conducted an e-vote that concluded April 12 to expose revisions to *INT 22-02: Third Quarter 2022 through Second Quarter 2023 Reporting of the Inflation Reduction Act - Corporate Alternative Minimum Tax*. The Working Group also conducted an e-vote that concluded April 10 to expose tentative INT 23-01.

Additionally, the Working Group met Aug. 8 in regulator-to-regulator session, pursuant to paragraph 3 (specific companies, entities or individuals) and paragraph 6 (consultations with NAIC staff related to NAIC technical guidance) of the NAIC Policy Statement on Open Meetings, to discuss the Summer National Meeting agendas.

Walker made a motion, seconded by Travis, to adopt the Working Group's July 5, (Attachment One-A), June 28 (Attachment One-B), May 16 (Attachment One-C), April 12 (Attachment One-D), April 10 (Attachment One-E) and March 22 (*see NAIC Proceedings – Spring 2023, Accounting Practices and Procedures (E) Task Force*) minutes. The motion passed unanimously.

2. Adopted Non-Contested Positions

The Working Group held a public hearing to review comments received on previously exposed items (Attachment One-F).

Malm made a motion, seconded by Hudson, to adopt the revisions detailed below as non-contested statutory accounting revisions. The motion passed unanimously.

A. Agenda Item 2023-02

Bruggeman directed the Working Group to agenda item 2023-02: Statement of Statutory Accounting Principles (SSAP) No. 43R – CLO Financial Modeling (Attachment One-G). Wil Oden (NAIC) stated that during the Spring National Meeting, the Working Group exposed statutory accounting principle (SAP) clarifications to *SSAP No.*

43R—Loan-backed and Structured Securities to incorporate changes to add collateralized loan obligations (CLOs) to the financial modeling guidance and to clarify that CLOs are not included as legacy securities.

B. Agenda Item 2023-05

Bruggeman directed the Working Group to agenda item 2023-05: ASU 2022-06, Reference Rate Reform (Topic 848), Deferral of the Sunset Date of Topic 848 (Attachment One-H). Jake Stultz (NAIC) stated that the Financial Accounting Standards Board (FASB) issued *Accounting Standards Update* (*ASU) 2022-06, Reference Rate Reform (Topic 848), Deferral of the Sunset Date of Topic 848* to extend the sunset date of the reference rate reform guidance that was included in *ASU 2020-04, Reference Rate Reform (Topic 848) Facilitation of the Effects of Reference Rate Reform on Financial Reporting* and *ASU 2021-01, Reference Rate Reform (Topic 848), Scope*. As background, reference rate reform refers to the transition away from referencing the London Interbank Offered Rate (LIBOR) and other interbank offered rates (IBORs), and moving toward alternative reference rates that are more observable or transaction-based. To address ASU 2020-04, the Working Group issued *INT 20-01: Reference Rate Reform*, and this INT was then revised to incorporate guidance from ASU 2021-01 (Attachment One-I). Stultz recommended adoption of the exposed revisions, which revise INT 20-01 to include the updated sunset date of Dec. 31, 2024, from ASU 2022-06.

C. Agenda Item 2023-07

Bruggeman directed the Working Group to agenda item 2023-07: *ASU 2019-08, Codification Improvements to Topic 718 and Topic 606* (Attachment One-J). Oden stated that in November 2019, the FASB issued *ASU 2019-08 Compensation, Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606): Codification Improvements—Share-Based Consideration Payable to a Customer,* which includes amendments to Topics 718 and 606. The changes to Topic 718 include share-based payment transactions for acquiring goods and services from non-employees and superseded guidance in Subtopic 505-50, Equity—Equity-Based Payments to Non-Employees. The changes to Topic 606 expand the scope to include share-based payment awards granted to a customer in conjunction with selling goods or services. The exposed revisions were as follows: 1) revisions to *SSAP No. 104R—Share-Based Payments* to adopt ASU 2019-08, with modification, for statutory accounting; 2) revisions to *SSAP No. 95—Nonmonetary Transactions* to adopt ASU 2019-08, with modification by updating previously adopted U.S. generally accepted accounting principles (GAAP) guidance; and 3) revisions to *SSAP No. 47—Uninsured Plans*, which reject Topic 606 guidance in ASU 2019-08. For statutory accounting assessments, prior U.S. GAAP guidance related to share-based payments has been predominantly adopted with modification in SSAP No. 104R.

D. Agenda Item 2023-08

Bruggeman directed the Working Group to agenda item 2023-08: ASU 2019-07, Codification Updates to SEC Sections (Attachment One-K). Oden stated that the FASB issued *ASU 2019-07, Codification Updates to SEC Sections: Amendments to SEC Paragraphs Pursuant to SEC Final Rule Releases No. 33-10532, Disclosure Update and Simplification, and Nos. 33-10231 and 33-10442, Investment Company Reporting Modernization, and Miscellaneous Updates*, which primarily affects the codifications of Financial Services—Depository and Lending (Topic 942), Financial Services—Insurance (Topic 944), and Financial Services—Investment Companies (Topic 946). The update amends and supersedes certain U.S. Securities and Exchange Commission (SEC) sections in Topic 942, Topic 944, and Topic 946 to align codification guidance with SEC Releases No. 33-10532, 33-10231, and 33-10442. These SEC releases amend a wide range of disclosure requirements that were determined to be redundant, duplicative, overlapping, outdated, or superseded by other relevant literature. Additionally, the SEC releases include several miscellaneous updates and corrections intended to clarify SEC guidance. Historically, SEC guidance from ASUs has been rejected as not applicable for statutory accounting in *Appendix D—Nonapplicable GAAP Pronouncements*.

E. Agenda Item 2023-09

Bruggeman directed the Working Group to agenda item 2023-09: ASU 2020-09—Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470) (Attachment One-L). Oden stated that the FASB issued *ASU 2020-09, Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)*, which affects the codification in debt (Topic 470). The update amends and supersedes certain SEC sections in Topic 470 to align codification guidance with SEC Release No. 33-10762. No. 33-10762 amends the SEC financial disclosure requirements for guarantors and issuers of guaranteed securities registered or being registered, and issuers' affiliates whose securities collateralize securities registered or being registered in Regulation S-X to improve those requirements for both investors and registrants. The changes are intended to provide investors with material information given the specific facts and circumstances, make the disclosures easier to understand, and reduce the costs and burdens to registrants. Oden recommended adoption of the exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2020-09, Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)* as not applicable to statutory accounting. This action is consistent with previous Working Group actions regarding similar SEC guidance.

F. Agenda Item 2023-10

Bruggeman directed the Working Group to agenda item 2023-10: *ASU 2022-05, Transition for Sold Contracts* (Attachment One-M). Oden stated that this agenda item has been drafted to consider *ASU 2022-05, Transition for Sold Contracts* for statutory accounting. The FASB issued the ASU in December 2022 to amend specific sections of *ASU 2018-12, Targeted Improvements for Long-Durations Contracts* (LDTI). The amendments made by ASU 2022-05 are intended to reduce implementation costs and complexity associated with the adoption of LDTI for contracts that have been derecognized in accordance with the ASU before the LDTI effective date. The amendments in ASU 2022-05 amend the LDTI transition guidance to allow an insurance entity to make an accounting policy election on a transaction-by-transaction basis. An insurance entity may elect to exclude contracts that meet certain criteria from applying the amendments in the LDTI. Oden recommended adoption of the exposed revisions to reject ASU 2022-05 in *SSAP No. 50–Classifications of Insurance or Managed Care Contracts*; *SSAP No. 51R—Life Contracts*; *SSAP No. 52—Deposit-Type Contracts*; *SSAP No. 56—Separate Accounts*; *SSAP No. 71—Policy Acquisition Costs and Commissions*; and *SSAP No. 86—Derivatives*.

G. Agenda Item 2023-13

Bruggeman directed the Working Group to agenda item 2023-13: PIK Interest Disclosure Clarification (Attachment One-N). Oden stated that this agenda item has been developed to further clarify, and incorporate a practical expedient, to the paid-in-kind (PIK) interest aggregate disclosure adopted in *SSAP No. 34—Investment Income Due and Accrued*. In response to questions received on how paydowns or disposals would affect PIK interest included in the cumulative balance, it was noted that clarifying guidance would assist with consistent application. Furthermore, without clarification, it was identified that companies and investment software vendors may interpret the need to detail the retrospective PIK allocations and paydowns or disposals as evidence for the resulting amount. The previously adopted disclosure in SSAP No. 34 is not intended to change, but the proposed clarification and practical expedient guidance would also be included in the annual statement instructions. This agenda item will be used to subsequently provide a memo to blanks for year-end 2023 application and to formally revise the instructions for 2024.

3. Reviewed Comments on Exposed Items

A. Agenda Item 2019-21

Bruggeman directed the Working Group to agenda item 2019-21: Principles-Based Bond Definition. Stultz stated that during the Spring National Meeting, the Working Group exposed revisions that reflect most of the interested parties' comments to the statutory accounting guidance that details the bond definition and the accounting and reporting guidance for bonds, including asset-backed securities (ABS), debt securities that do not qualify as bonds, and other SSAPs that were also affected or that referenced the prior bond guidance. The revisions exposed for comment included documents related to *SSAP No. 26R—Bonds, SSAP No. 43R—Loan-Backed and Structured Securities, SSAP No. 21R—Other Admitted Assets*, and other SSAPs that were affected. Stultz stated that in addition to the documents proposing SAP revisions, during the Spring National Meeting the Working Group exposed a proposal to revise the reporting lines on Schedule BA to include debt securities that do not qualify as bonds, as well as to consolidate existing reporting lines.

Stultz noted that interested parties had no comment on the last exposed revisions to SSAP No. 26R, SSAP No. 43R, and the other SSAPs, and he recommend that those be adopted.

Stultz noted that interested parties provided comments on the exposed revisions to SSAP No. 21R. As a result, NAIC staff had further revised the SSAP No. 21R, and Stultz recommended that it be re-exposed for public comment, along with the bond project issue paper that details the direction and discussions in developing this project.

Finally, Stultz also recommended that the Working Group sponsor a blanks proposal to revise Schedule BA for debt securities that do not qualify as bonds, with formal notice to the Valuation of Securities (E) Task Force and the Capital Adequacy (E) Task Force.

Mike Reis (Northwestern Mutual), representing interested parties, stated that interested parties support adoption of the revisions SSAP No. 26R, SSAP No. 43R, and the other affected SSAPs.

Walker made a motion, seconded by Clark, to adopt the bond definition revisions in SSAP No. 26R (Attachment One-O) and SSAP No. 43R (Attachment One-P) and the other impacted SSAPs document (Attachment One-Q), with an effective date of Jan. 1, 2025. The motion passed unanimously.

Clark made a motion, seconded by Hudson, to expose the revised SSAP No. 21R and the bond project issue paper as recommended by NAIC staff. The motion passed unanimously.

Walker made a motion, seconded by Weaver, for the Working Group to sponsor a blanks proposal to revise Schedule BA in accordance with the bond project for debt securities that do not qualify as bonds and to provide notice of the actions to the Valuation of Securities (E) Task Force and to the Capital Adequacy (E) Task Force. The motion passed unanimously.

B. Agenda Item 2022-01

Bruggeman directed the Working Group to agenda item 2022-01: Conceptual Framework – Updates. Marcotte stated that during the Spring National Meeting, the Working Group exposed additional revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets* and *Issue Paper No. 168—Updates to the Definition of a Liability* related to the definition change of a liability. The revisions incorporate the definition of a liability from FASB *Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 7, Presentation*, and *Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which updates the definition of an asset and of a liability. For U.S. GAAP, the FASB Conceptual statements definitions are not authoritative, but rather are concepts to consider when developing and applying guidance.

Marcotte stated that the Spring National Meeting exposure also included revisions to add an additional footnote to the definition of a liability in SSAP No. 5R, which defers to more topic-specific contradictory guidance in an SSAP, revises the relevant literature section of SSAP No. 5R to note the modification, and the additional exposure action in the issue paper. These clarifications were because of the authoritative treatment that statutory accounting provides to the definition of a liability SSAP No. 5R. The FASB basis for conclusions noted that some existing authoritative FASB literature regarding liabilities is inconsistent with the updates to Concepts Statement No. 8. Therefore, a modification regarding topic-specific liabilities guidance was incorporated to address variations from the definition of a liability.

Hudson made a motion, seconded by Weaver, to adopt the exposed revisions to SSAP No. 5R (Attachment One-R) and *Issue Paper No. 168—Updates to the Definition of a Liability* (Attachment One-S). The motion passed unanimously.

C. Agenda Item 2022-11

Bruggeman directed the Working Group to agenda item 2022-11: Collateral for Loans. Marcotte stated that during the Spring National Meeting, the Working Group re-exposed revisions to SSAP No. 21R to clarify that invested assets pledged as collateral for admitted collateral loans must qualify as admitted invested assets. She stated that interested parties support the proposed changes but that the Working Group also received two comment letters from Security Benefit Life Insurance Company (SBL) that opposed the changes, noting that in some cases the fair value of the collateral of these types of investments was higher than audited book value. Marcotte stated that the second comment letter from SBL was asking for an accounting policy election to use fair value. She stated that normally collateral is measured at fair value. However, when this issue was initially brought to the Working Group, one of the concerns was that using Level 3 fair values for a related party loan could essentially admit a greater amount than if the assets were directly held.

Weaver stated that optionality is not consistent with the general practice of statutory accounting, noting that there had been some recent receiverships and exam reports with significant comments regarding this type of investment.

Smith agreed with Weaver and stated that the proposed fair value election would be left to the discretion of the commissioner, which would lead to inconsistencies between states.

Caleb Brainerd (SBL) stated that SBL supports the clarification that collateral loan secured by *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* and *SSAP No. 97—Investments in Subsidiary, Controlled* *and Affiliated Entities* investments require audits of the underlying collateral to be admissible assets under statutory accounting. He stated that the basis used to test the sufficiency of collateral for these types of collateral loans is a substantive change and recommended that the Working Group reconsider the issue prior to adopting this exposure. Specifically, SBL believes fair value is the most appropriate basis for determining the sufficiency of collateral. Fair value is the measure that reflects the value of assets that would be available to support policyholder liabilities in the event of foreclosure on collateral loans. Brainerd stated that fair value is also the basis upon which insurers have historically, and currently underwritten, collateral loans and aligns with covenants entered into between the insurer and the borrowers within the corresponding loan agreements. Finally, continuing to use fair value will retain consistency across all collateral loans under statutory accounting and with the tests used for other types of collateralized financial instruments. He asked the Working Group to extend the exposure period to Sept. 12 to allow industry and the Working Group to further consider whether fair value should be retained as the basis for testing the sufficiency of collateral for collateral loans.

Bruggeman asked if the audited value of SSAP No. 48 and SSAP No. 97 entities which are pledged as such collateral approximates fair value in instances when the collateral was from investment entities. He noted that in his understanding, the audits of the pledged collateral from non-investment type entities, such as operating entities, may result in audited value that might not be a good proxy for fair value. That is, for such entities, the audited book value does not approximate fair value because many of the underlying assets are not reported as fair value.

Brainerd stated that in most instances, the SSAP No. 48 and SSAP No. 97 underlying collateral investments would likely be from entities that are considered investment companies. He noted that for investment entities, net asset value (NAV) is calculated, which approximates fair value. As such, audited equity and fair value of investment companies would be similar or the same. However, for some of the SSAP No. 48 and SSAP No. 97 investments that are not considered investment companies, their assets are not held at fair value. He noted that the investment company guidance is complex. As a result, the book value is often significantly lower than the fair value for non-investment entities. He stated that using book value could result in non-admitting loans that are in good standing that have been underwritten on the fair value of the collateral basis. In cases where collateral is not an investment company, SBL obtains independent fair value calculations or independent reviews of the fair value calculations, which are also subject to audit.

Bruggeman questioned whether a distinction needs to be made between affiliated and non-affiliated investments. He noted that the Working Group choice today was whether to adopt what was exposed or extend the exposure until after the Sept. 12 deadline. Additionally, he clarified that the question is whether non-investment companies should be allowed to use audits and measure the collateral at fair value instead of book value.

Clark stated that he agreed with the prior comments that there should not be optionality. He questioned what additional information should be provided if the decision-making process was extended. He asked if the rest of industry was willing to provide input.

Andrew Morse (Global Atlantic), representing interested parties, noted support for the current exposed guidance, but he stated that given the comments that fair value might be a better measurement for asset collateral adequacy, interested parties as a group feel that there are good arguments for using either the fair value measurement or the U.S. GAAP equity measurement. He stated that interested parties would support exposure until Sept. 12.

Bruggeman stated that for the non-investment entities, there would need to be more support for obtaining fair value. He noted that this agenda item originated because of a lack of support for the valuation of collateral, especially for level three fair values. Clark stated that he did not see the harm in allowing additional time for industry to build consensus on the issue.

Malm stated that as part of the extended comment period, industry should provide not just a consensus view, but if the consensus view is to use fair value, then also provide language around documentation and expectations of the valuations at fair value. She also requested that interested parties' comments also include details on the regulatory arbitrage related to going from book value to fair value, as well as the risk-based capital (RBC) impact.

Morse stated that the asset in question is a collateral loan, which has a value as a loan. That value does not change based on the underlying collateral unless part of the asset is nonadmitted. He stated that the asset itself is not fluctuating regularly based on the valuation of the collateral; it is typically carried at cost or amortized cost. He stated that the proposed revisions are just a check to see if there is sufficient collateral to support the collateral loan.

The Working Group noted no objections to re-exposing this agenda item until Sept. 12 to allow industry the opportunity to provide support for using fair value measurement.

D. Agenda Item 2022-12

Bruggeman directed the Working Group to agenda item 2022-12: Review of INT 03-02: Modifications to an Existing Intercompany Pooling Arrangement. Marcotte stated that on March 22, the Working Group re-exposed the intent to nullify INT 03-02, effective Dec. 31, 2023. The nullification is proposed because INT 03-02 is inconsistent with *SSAP No. 25—Affiliates and Other Related Parties* guidance regarding economic and non-economic transactions between related parties. Treatment of transfers of assets between affiliates should be consistent for all intercompany transactions, and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions. Marcotte stated that this agenda item was re-exposed to allow more time for comments. She recommended deferral of this agenda item to allow more time to review interested parties' comments and have further discussions with industry.

Hudson expressed support for the deferral recommendation.

Keith Bell (The Travelers Companies), representing interested parties, noted support for deferral and that he has started work on examples of when intercompany plan agreements would be modified. He stated that if INT 03-02 was nullified and the assets were changed to fair value, there would be a significant impact. He noted that changing interest rate environments could affect the amounts transferred. He stated that Travelers will provide a specific example to show the Working Group the mechanics of how it works.

Bruggeman requested that interested parties include examples to break out the differences between amending a pooling arrangement for existing members versus adding a company that was recently acquired and added to the pool. He stated that there are some definite distinctions between those situations.

The Working Group members had no objections to deferring action and re-exposing this item.

E. Agenda Item 2022-14

Bruggeman directed the Working Group to agenda item 2022-14: New Market Tax Credits. Oden stated that on May 16, the Working Group exposed revisions to *SSAP No. 93—Low-Income Housing Tax Credit Property Investments* and *SSAP No. 94R—Transferable and Non-Transferable State Tax Credits*.

Bruggeman stated that this agenda item was drafted in response to the federal Inflation Reduction Act and the subsequent issuance of ASU 2023-02, which amended U.S. GAAP guidance on the application of the proportional amortization method for income tax equity investments. Oden stated that since the project was started, its scope has been expanded in response to comments received. SSAP No. 93 is proposed to include all qualifying tax credit investments irrespective of structure or tax credit program, and SSAP No. 94R is proposed to include all purchased and certain allocated state and federal tax credits. He stated that on June 30, the Working Group received comments from interested parties on the May 16 exposure drafts. Oden stated that the comments were included in the hearing agenda for exposure in the Summer National Meeting, and staff responses were included in the agenda item. Oden provided a summary of the comments received and the proposed recommendations. He recommended the Working Group expose the revisions to SSAP No. 93 and SSAP No. 94R and direct staff to begin working with industry on revisions to the annual statement Schedule BA reporting lines, as well as how those reporting lines flow through to the asset valuation reserve.

Angelica Sanchez (New York Life), representing interested parties, commented that they agree with what has been proposed and reiterated the need for uniformity in accounting and reporting for tax credit investments and other types of tax credit certificates. She stated they also agree that the proportional amortization method is the right accounting to follow for investments where earnings are returned primarily through tax credits. She stated they appreciate the Working Group incorporating some of the interested parties' comments and providing such detailed explanations of issues where they did not necessarily agree with industry. She stated that interested parties agree with most of the changes made. Sanchez stated that there are two main items on which they will focus. First is that they did not intend to confuse things about referring to the retrospective accounting under U.S. GAAP. She stated that they will continue to work to obtain consensus with both industry and the Working Group on what makes the most sense for adoption and what the transition requirements should be. Second, currently all low-income housing tax credit investments are reported in a dedicated section on Schedule BA that allows them to have specific RBC charges that are different from most other investments on Schedule BA. She stated that interested parties recommend that the same should happen for any other type of tax credit investment that is within the scope of SSAP No. 93 since those investments tend to be very high credit quality investments.

Walker made a motion, seconded by Hudson, to direct NAIC staff to expose the additional revisions and to work with the Blanks (E) Working Group on drafting proposed revisions for Schedule BA. The motion passed unanimously.

F. Agenda Item 2022-19

Bruggeman directed the Working Group to agenda item 2022-19: Negative IMR (Attachment One-T). Marcotte stated this agenda item has been developed to discuss the interest maintenance reserve (IMR) within statutory accounting, specifically the current guidance for the nonadmittance of disallowed negative IMR. Although the statutory accounting guidance has been in place for several years, the rising interest rate environment has created an increased likelihood for reporting entities to move to a negative IMR position. Discussion of this topic began after receipt of an American Council of Life Insurers (ACLI) comment letter dated Oct. 31, 2022. Marcotte stated that since the receipt of the ACLI letter, the Working Group has discussed this issue and directed various actions.

Most recently, on June 28, 2023, the Working Group met to hear comments *on INT 23-01: Net Negative (Disallowed) Interest Maintenance Reserve*, which was exposed to permit limited admittance of net negative (disallowed) IMR. As a result of that meeting, the Working Group directed NAIC staff to incorporate several revisions to the proposed INT 23-01. The revised INT was exposed via e-vote on July 5 for a shortened comment period ending July 21. Marcotte noted that interested parties provided three editorial revisions to the most recent exposure that were included in the meeting materials.

Marcotte recommended adoption of the exposed INT 23-01 with the editorial revisions noted. She stated that INT 23-01 would be automatically nullified on Jan. 1, 2026. NAIC staff would also provide the Blanks (E) Working Group with a disclosure memorandum for posting on its website. Marcotte stated that NAIC staff recommend the Working Group continue to work on a long-term solution. She stated that the ACLI suggested forming an ad hoc technical group, which would include members from the Working Group, the Life Actuarial (A) Task Force, industry, and the American Academy of Actuaries (Academy) as part of the long-term solution. She stated that because INT 23-01 creates overrides of existing statutory accounting and annual statement instructions, the policy statement would require a two-thirds super majority vote of the Working Group present and voting to adopt.

Reis thanked state insurance regulators for working on an interim solution to not disincentivize prudent investment or risk management activity until the longer-term solution can be finalized. He said interested parties look forward to working with the Working Group or an ad hoc group. He stated that interested parties are supportive of the Life Actuarial (A) Task Force and the Academy being part of that group.

Bruggman stated that this interpretation does not place any key reliance on asset adequacy testing. The asset adequacy testing will still use the interest maintenance reserve (IMR) as its natural process. He noted that, the larger the admitted asset within the asset adequacy testing, the greater the chance of an asset adequacy additional reserve requirement. He stated that the Working Group is not placing primary reliance on asset adequacy testing (AAT).

Hudson made a motion, seconded by Malm, to adopt *INT 23-01: Net Negative (Disallowed) Interest Maintenance Reserve*, reflecting the editorial revisions to the recent exposure discussed during the meeting (Attachment One-U). With this motion, the Working Group also agreed to form an ad hoc technical group, which would continue to work on this topic. The motion passed unanimously.

G. Agenda Item 2023-01

Bruggeman directed the Working Group to agenda item 2023-01: Review Annual Statement Instructions for Accounting Guidance. Stultz stated that this agenda item was developed to establish a project to review the annual and quarterly statement instructions to ensure that all accounting guidance is primarily reflected within the SSAPs. The focus of this project is to ensure that the annual or quarterly statement instructions are not the primary source of statutory accounting guidance. This agenda item and project was proposed due to limited situations in which the annual statement instructions have been identified as containing more detailed accounting guidance than the SSAPs.

Bruggeman directed NAIC staff to continue with this project.

H. Agenda Item 2023-04

Bruggeman directed the Working Group to agenda item 2023-04: Corporate Alternative Minimum Tax Guidance. Marcotte stated that this agenda item is to provide guidance regarding the corporate alternative minimum tax (CAMT) for year-end 2023 and after. Interested parties of the Working Group have submitted comments and a draft interpretation, which is included with the comment letters.

Marcotte provided a summary of the CAMT that is in effect for tax years beginning after 2022, noting that the CAMT is very different from the prior alternative minimum tax. She noted that the requirement to calculate the CAMT only applies to corporations on a tax-controlled basis with an average adjusted book income in excess of $1 billion on average for the prior three years (with a $100 million threshold for certain foreign-owned entities).

Marcotte stated that because the CAMT will only apply to a limited number of reporting entities*, INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax* had been developed separately from *SSAP No. 101—Income Taxes*. She noted that INT 23-03 was organized to provide guidance for: 1) non-applicable reporting entities, which do not have to do the calculation; 2) applicable reporting entities, which must do the calculation to determine the tax; and 3) applicable reporting entities with tax sharing agreements that exclude the entities from having to pay the CAMT.

Marcotte stated that the proposed INT 23-03 follows many of the principles in SSAP No. 101. For example, the consideration of the statutory valuation allowance assessment for the CAMT is determined on a group basis, and the statutory valuation allowance for other non-CAMT deferred tax assets (DTAs) is computed on a separate entity basis. She stated that INT 23-03 uses the applicable realization threshold limitations tables in SSAP No. 101, paragraph 11b. For example, most reporting entities will be above the 300% ex DTA RBC threshold in the tables and will admit CAMT credits in the admittance calculation that can be used within three years and up to 15% of statutory capital and surplus as adjusted in the SSAP No. 101 admissibility calculation. Marcotte stated that one of the exceptions to SSAP No. 101 that was proposed is to not require such entities (three-year/15%) to have to do the "with and without" calculation. She noted that the proposed guidance relies on tax allocation agreements for treatment of the CAMT and requires disclosures.

Marcotte highlighted that proposed transition guidance, which would allow reporting reliance on unapproved filed tax sharing agreements at year-end with domiciliary department of insurance consent, was not as specific as requested by industry because of *Insurance Holding Company System Regulatory Act* (Model #440) concerns. She noted that the transition guidance is focused on the subsequent events reporting exceptions. She noted that the meeting materials contained an updated attachment that tracked minor edits to the INT 23-03 since the initial materials posting.

Marcotte recommended exposure of INT 23-03 after the Working Group provides direction regarding paragraph 11.c. of SSAP No. 101. She stated that the third step in the SSAP No. 101 admissibility test admits DTAs to the extent of deferred tax liabilities (DTLs) if the DTAs can be offset on a tax return; this requires consideration of tax character. She stated that Working Group direction was requested on which version of paragraph 34 in the INT 23-03 discussion draft to include in the exposure. The first version would follow SSAP No. 101, paragraph 11.c. and admit CAMT credits to the extent of offsetting DTLs. The second version, which is a departure from SSAP No. 101, would not allow the admission of any CAMT credits under SSAP No. 101, paragraph 11.c.

Marcotte noted that Working Group direction was requested because although the CAMT credit does not expire, it has additional contingencies that make the use of the credit more questionable. The CAMT credit can only be used for non CAMT tax liabilities that are greater than the CAMT tax liability. She also noted that that if the tax-controlled group is a CAMT payor, the CAMT credit cannot be used. The CAMT is a credit, like a net operating loss carry forward, which does not have a reversal pattern. Instead, the entity must be eligible to use the CAMT credit. She also noted that while having more DTLs reverse increases the likelihood that the regular taxable income will exceed the CAMT liability, the result is not guaranteed.

Bruggeman stated that much of the INT 23-03 follows a general pattern of what is already in SSAP No. 101 with some subtle differences. He stated that he prefers to continue to follow the general pattern of SSAP No. 101, including allowing DTL offset in SSAP No. 101, paragraph 11.c. He stated that this avoids some misinterpretation by companies and auditors by continuing a pattern that has already been in place.

Hudson expressed support for the use of language consistent with SSAP No. 101, paragraph 11c. He stated that as the Working Group receives comments, it can evaluate them. Clark, Walker and Sherman also stated support following SSAP No. 101, paragraph 11.c.

Aimee Hoke (Nationwide), representing interested parties, stated that CAMT is a unique accounting consideration as the tax is consolidated in nature and applies an applicability test. She stated that industry supports the position that the CAMT credits should be admitted against deferred tax losses under SSAP No. 101, paragraph 11.c. She stated that the CAMT credit operates in the same way as the prior alternative minimum tax (AMT) that was in place before 2018. The AMT DTAs were allowed to be used on the tax return and admitted against DTLs for that prior AMT. She stated that CAMT DTAs are no different from the other DTAs. They represent a future tax benefit. The premise of admitting DTAs against DTLs rests on the fact that DTLs will create future taxable income. In the case of CAMT DTAs, regular tax must exceed CAMT to be used. But for all other DTAs to be admitted, that entity would also need taxable income, so the basic mechanics are the same. A good example of a similar DTA is net operating losses (NOLs). NOL DTAs can only be used if the taxable group has taxable income but cannot be used to offset DTLs in the tax return. CAMT DTAs are evaluated for a valuation allowance, meaning that if the CAMT DTA is not expected to be realized, a valuation allowance would be set up.

Bruggeman asked whether industry supports having an earlier comment deadline for this exposure. He noted that tax sharing agreements for some entities will need to be updated prior to year-end. He summarized the proposed transition guidance, noting that statutory accounting cannot override Model #440 in the states but that the Working Group was trying to provide acceptable subsequent events transition guidance for the recognition of needed pending agreement updates, which may not be final until after the first of the year. Hoke stated support for the earlier comment deadline of Sept. 12.

Hudson made a motion, seconded by Walker, to expose INT 23-03 with the revisions to paragraph 34, which incorporate allowing admittance of the CAMT credits following the concepts in SSAP No. 101, paragraph 11.c. This exposure has a Sept. 12 comment deadline. Marcotte stated that because INT 23-03 creates overrides of existing guidance, the policy statement would require a two-thirds super majority vote of the Working Group present and voting to adopt. The motion passed unanimously.

I. Agenda Item 2023-06

Bruggeman directed the Working Group to agenda item 2023-06: Additional Updates on ASU 2021-10, Government Assistance. Marcotte stated that on Aug. 10, 2022, the Statutory Accounting Principles (E) Working Group adopted revisions to *SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items* in agenda item 2022-04. The revisions incorporated certain disclosures, adopted with modification from ASU 2021-10, to supplement existing disclosures regarding unusual or infrequent items.

Marcotte stated that with the follow-up questions about the adoption of the disclosures, most were regarding whether adoption with modification of the disclosures were intended to allow insurers to use the grant and contribution model. She stated that the intent was not to change accounting but to adopt the disclosures. The most recent exposure is to reject ASU 2021-10 instead of adopting it with modification, but still maintain government assistance disclosures. Marcotte stated that interested parties indicated they agreed with the proposed revisions but noted that some entities were using the grant and contribution model, and the discussion did not indicate whether it should be applied. She stated that there is no specific accounting guidance addressing accounting for government assistance transactions, and some of the health industry noted that in the absence of specific guidance, companies have looked to non-authoritative GAAP guidance, which supports the use of that model. Marcotte recommended adopting the exposed revisions to SSAP No. 24 to reject the ASU 2021-10 and include certain government assistance disclosures. She stated that the alternative is the disclosures could also be wholly rejected.

Hudson made a motion, seconded by Sherman, to adopt revisions to SSAP No. 24 as exposed (Attachment One-V). These revisions include the rejection of ASU 2021-10, while also maintaining government assistance disclosures. The motion passed unanimously.

J. Agenda Item 2023-12

Bruggeman directed the Working Group to agenda item 2023-12: *Residuals in SSAP No. 48 Investments.* Stultz stated that this agenda item proposes revisions to clarify the scope and reporting for investment structures that represent residual interests within statutory accounting principles. Previously, revisions have been incorporated in SSAP No. 43R to address the reporting of residual interests within securitization structures. With these revisions, residual interests, as defined within SSAP No. 43R, were required to be reported on Schedule BA on designated reporting lines beginning year-end 2022. After reviewing the 2022 reporting results, it was identified that the information for residuals may be underrepresented because of the various legal forms that residual investments can take. For example, a reporting entity could hold investments that have the substance of residual interests in the form of limited partnerships, joint ventures, or other equity fund investments. To ensure consistent reporting of all residual interests, this agenda item proposes guidance to clarify the reporting of in-substance residuals regardless of the structure of the investment vehicle in SSAP No. 48. Stultz stated that the application is really the issue, not the definition itself, and NAIC staff believe that these proposed changes address those issues. NAIC staff recommend the Working Group expose the agenda item with the expanded update proposal to reflect revisions to the interim discussions and coordination with interested parties, and they recommend this exposure have a shortened deadline of Sept. 12 with the intent of this agenda item being adopted for 2023 reporting.

Rose Albrizio (Equitable), representing interested parties, agreed with the shortened comment period.

Clark stated that he wanted to make clear that there are two separate agenda items discussing residuals at this meeting. He noted that this agenda item is more focused on reporting. The other agenda item provides more accounting and is also exposed.

Clark made a motion, seconded by Sherman, to expose the clarifying guidance for residuals in SSAP No. 48 until Sept. 12. The motion passed unanimously.

4. Considered Maintenance Agenda – Active Listing

Hudson made a motion, seconded by Kasinow, to expose the following agenda items for a public comment period. The motion passed unanimously. The comment deadline for exposures was Sept. 29 for all exposures except INT 23-02, which had a comment deadline of Sept. 12. The motion passed unanimously.

A. Agenda Item 2023-14

Bruggeman directed the Working Group to agenda item 2023-14: Asset Valuation Reserve and Interest Maintenance Reserve. Marcotte stated that this agenda item is a broad concept agenda item developed with the goal of incorporating accounting guidance for the AVR and the IMR into *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. Historically, this statement has included a brief overview of the AVR and IMR with the calculation and reporting guidance determined as directed by individual SSAPs or in accordance with the *Annual Statement Instructions for Life, Accident and Health/Fraternal Companies*. It has also been noted that there are some disconnects between the SSAPs and the IMR/AVR guidance included in the Annual Statement Instructions and that there are limited financial reporting cross-checks to the reporting within the AVR. Marcotte recommended the Working Group move this item to the maintenance agenda as a new SAP concept and expose this agenda item with an overall concept for a long-term project to capture accounting and reporting for IMR/AVR in SSAP No. 7.

B. Agenda Item 2023-15

Bruggeman directed the Working Group to agenda item 2023-15: IMR/AVR Specific Allocations. Marcotte stated that this agenda item has been developed to update guidance for IMR/AVR in the Annual Statement Instructions that currently establish specific allocation guidance. The principal concept of the IMR and AVR is that interest-related losses go to IMR, and non-interest-related losses go to AVR. This agenda item is to correct instructions that appear to direct an entity to allocate non-interest-related losses to IMR rather than correctly to the AVR.

Although the presence of examples for illustration are beneficial, the current annual statement instructions permit unintended allocations that do not reflect the intent of the principles. These have been specifically noted through inquiries to NAIC staff, particularly within the last year. NAIC staff believe these inquiries have been spurred by the discussions regarding the industry request to admit net negative IMR, therefore creating an incentive to allocate losses to IMR instead of AVR. This agenda item will focus on specific allocations within the annual statement instructions for NAIC designation changes for debt securities (excluding loan-backed and structured securities [LBSS]) and mortgage loans. Marcotte recommended the Working Group move this item to the maintenance agenda as a new SAP concept and expose the annual statement revisions to remove guidance that permits specific allocation and non-interest-related losses to IMR.

C. Agenda Item 2023-16

Bruggeman directed the Working Group to agenda item 2023-16: *Schedule BA Reporting Categories*. Oden stated that this agenda item has been developed to incorporate more detailed definitions for the annual statement reporting categories of SSAP No. 48 and residual interests on Schedule BA: Other Long-Term Invested Assets. Discussions identified that variations exist across industry on the types of investments included within each of the existing categories shown in Schedule BA. Oden stated that it was also noted that the annual statement instructions provide limited guidance, and the examples were not helpful for determining the reporting classifications. The intent of the recommended changes is to reduce reporting difficulty, improve consistency, and allow regulators to better assess the type and volume of investment types. Oden recommended that the Working Group move this item on the maintenance agenda as an SAP clarification and potential blank reporting change and expose the agenda item with a request for industry and regulator feedback. Specifically, comments were requested on what should be included as an investment with the underlying asset characteristics of the following categories: fixed income instruments, common stocks, real estate, mortgage loans, and others.

Bruggeman stated that as part of the discussion on this exposure, NAIC staff should coordinate with NAIC staff for the RBC items.

D. Agenda Item 2023-17

Bruggeman directed the Working Group to agenda item 2023-17: Short-Term Investments. Oden stated that this agenda item has been developed to review the guidance in *SSAP No. 2R—Cash, Cash Equivalents, Drafts, and Short-Term investments* and establishes principal concepts for the types of investments that should be permitted for reporting as either cash equivalents or short-term investments. This agenda item is in response to noted situations in which certain types of investments, particularly collateral loans or other Schedule BA items, have been specifically designed to meet the parameters for short-term reporting. Effectively, this agenda item, and the prior revisions to exclude certain investments from SSAP No. 2R, which were discussed as part of the bond project, will eliminate investments (except money market mutual funds and cash pooling dynamics) from being reported as cash equivalents or short-term investments unless they would qualify under SSAP No. 26R as an issuer credit obligation. Such investments will then only qualify as a cash equivalent or short-term investment if they have a maturity date within three months (cash equivalents) or 12 months (short-term) from the date of acquisition or meet the specific requirements for money market mutual funds or cash pooling arrangements. This agenda item proposes to retain the guidance in SSAP No. 2R that prevents cash equivalent or short-term reporting for related party investments if the reporting entity does not reasonably expect to terminate the investment, the original maturity time has passed, and if the reporting entity reacquired a substantially similar investment. Oden recommended the Working Group move this item to the maintenance agenda as a new SAP concept and expose this agenda item with proposed revisions to further restrict the investments that are permitted to be reported as cash equivalent or short-term investments. With the adoption consideration of the bond definition, including the edits to exclude ABS and debt securities that do not qualify as bonds from SSAP No. 2R, this agenda item proposes edits to reflect the bond project changes, and it is proposed to have an effective date of Jan. 1, 2025. Additionally, subsequent blanks reporting changes will be considered to modify the cash equivalent and short-term reporting lines accordingly.

E. Agenda Item 2023-18

Bruggeman directed the Working Group to agenda item 2023-18: ASU 2016-19, Technical Corrections and Improvements. Oden stated that In December 2016, the FASB issued *ASU 2016-19, Technical Corrections and Improvements,* as part of a standing project on its agenda to address suggestions received from stakeholders on FASB codifications and to make other incremental improvements to U.S. GAAP. The changes made by ASU 2016-19 included minor clarifications, corrections, the addition of codification references, guidance relocations, and removal of redundant, outdated, or superseded guidance. Oden recommended that the Woking Group move this item to the active listing as an SAP clarification and expose revisions to adopt with modification *ASU 2016-19, Technical Corrections and Improvements* for statutory accounting. The agenda item includes the details of the revisions to be exposed and the rationale for which guidance is recommended for inclusion and which was recommended for rejection. Unless noted otherwise, Oden recommended that all other amendments made within ASU 2016-10, as detailed in the agenda item, be rejected for statutory accounting in SSAP No. 5R, *SSAP No.*

92—Postretirement Benefits Other Than Pensions, *SSAP No. 102—Pensions*, and *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

F. Agenda Item 2023-19

Bruggeman directed the Working Group to agenda item 2023-19: ASU 2018-09, Codification Improvements. Oden stated that in July 2018, the FASB issued *ASU 2018-09, Codification Improvements.* This ASU is part of its standing project to facilitate FASB codification updates for technical corrections, clarifications, and other minor improvements. The changes made by ASU 2018-09 included minor clarifications, corrections, the addition of codification references, guidance relocations, and the removal of redundant, outdated, or superseded guidance. NAIC staff recommended that the ASU be rejected in *Appendix D—Nonapplicable GAAP Pronouncements* as not applicable for statutory accounting purposes.

G. Agenda Item 2023-20

Bruggeman directed the Working Group to agenda item 2023-20: *ASU 2020-10, Codification Improvements*. Oden stated that in October 2020, the FASB issued *ASU 2020-10 Codification Improvements.* The changes made by the ASU either move disclosure guidance to the disclosure section of the codification or add codification references to direct readers to the disclosure section, and this ASU does not provide any relevant new guidance. NAIC staff recommended that the ASU be rejected in *Appendix D—Nonapplicable GAAP Pronouncements* as not applicable for statutory accounting purposes.

H. Agenda Item 2023-21

Bruggeman directed the Working Group to agenda item 2023-21: *Removal of Transition Guidance from SSAP No. 92 and SSAP No. 102.* Stultz stated that on Dec. 18, 2012, the Statutory Accounting Principles (E) Working Group adopted SSAP No. 92 and SSAP No. 102. The adopted SSAPs included transition guidance that expired after 10 years, and this agenda item intends to remove that expired transition guidance from SSAP No. 92 and SSAP No. 102.

I. INT 23-02

Bruggeman directed the Working Group to *INT 23-02: Third Quarter 2023 Inflation Reduction Act – Corporate Alternative Minimum Tax*. Marcotte stated that this proposed new interpretation, *INT 23-02: Third Quarter 2023 Corporate Alternative Minimum Tax* is to provide temporary guidance for third quarter 2023 reporting for the corporate alternative minimum tax (CAMT). The Working Group has previously adopted *INT 22-02: Third Quarter 2022 through Second Quarter 2023 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax,* which requires disclosure if the reporting entity is an applicable entity but does not require accrual of CAMT payable amounts, noting that a reasonable estimate is not possible. The Inflation Reduction Act was passed in August 2022, and it provides that the CAMT is effective beginning with the 2023 tax year. The proposed INT recommends that for third-quarter 2023, reporting entities should disclose whatever information is available regarding their applicable reporting entity status. If the reporting entity is able to make a reasonable estimate regarding the CAMT 2023 liabilities, such an estimate should be disclosed for third-quarter 2023. If a reasonable estimate is not possible because of pending material information, the fact that a reasonable estimate is not feasible should be disclosed. This agenda item is proposed to be exposed with a comment deadline of Sept.12. Marcotte stated that because INT 23-02 creates overrides of existing SSAP and annual statement instructions, the policy statement would require a two-thirds super majority vote of the Working Group present and voting to adopt.

J. Agenda Item 2023-22

Bruggeman directed the Working Group to agenda item 2023-22: Actuarial Guideline 51 and Appendix A-010 Interaction. Marcotte stated that this agenda item addresses the Feb. 23 request from the Financial Reporting and Solvency Committee of the Health Practice Council to the Long-Term Care Actuarial (B) Working Group of the American Academy of Actuaries, and to the Statutory Accounting Principles (E) Working Group requesting clarifications regarding some observed diversity in practice across issuers of long-term care insurance (LTCI) with regard to how the guidance in *Actuarial Guideline LI—The Application of Asset Adequacy Testing to Long Term Care Insurance Reserves* (AG 51), specifically Section 4.C, on determining when additional reserves may be necessary interacts with existing guidance on accident and health insurance reserve adequacy in *SSAP No. 54R—Individual and Group Accident and Health Contracts*, and Appendix A-010*, Minimum Reserve Standards for Individual and Group Accident and Health Insurance Contracts.* The Academy referenced a survey that provided examples of the diversity of practices that have been observed. The fundamental question is regarding whether gross premium valuation only, cash-flow testing only, or both cash-flow testing and gross premium valuation are required. Marcotte recommended the Working Group add this agenda item to the maintenance agenda classified as an SAP clarification and expose clarifying revisions and an illustration to SSAP No. 54 to clarify that gross premium valuation under *Appendix A-010* and cash-flow testing under AG 51 are both required if indicated. In addition, Marcotte recommended providing notice of the exposure to the Long-Term Care Actuarial (B) Working Group and the Valuation Analysis (E) Working Group.

5. Discussed Other Matters

A. Review of U.S. GAAP Exposures

Marcotte identified two GAAP exposures with comment deadlines from July to August that are recommended for review by the Working Group in the normal maintenance process (Attachment One-W).

B. Comment Deadline

Marcotte stated that the comment deadline for exposures is Sept. 29 for all exposures except INT 23-02 (CAMT third quarter), INT 23-03 (CAMT year-end 2023); agenda item 2022-11: Collateral for Loans; and agenda item 2023-12: Residuals in SSAP No. 48 Investments, which have a comment deadline of Sept. 12.

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/8-13-23 SummerNational Meeting/Summary and Minutes/SAPWG Minutes 08.13.23.docx

Draft: 10/9/23

Statutory Accounting Principles (E) Working Group
Virtual Meeting
September 21, 2023

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met Sept. 21, 2023. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Sheila Travis (AL); Kim Hudson (CA); Michael Estabrook (CT); Tom Hudson (DE); Cindy Andersen (IL); Melissa Gibson (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Diana Sherman (PA); Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI).

1. Reviewed Comments on Exposed Items

The Working Group met to review comments received (Attachment- A) on items exposed at the Summer National Meeting.

A. Agenda Item 2023-12

Bruggeman directed the Working Group to agenda item *2023-12: Residuals in SSAP No. 48 Investments*. Julie Gann (NAIC) stated that this agenda item proposed revisions to clarify the scope and reporting for investment structures that represent residual interests within statutory accounting principles. Previously, the Working Group incorporated guidance in *Statement of Statutory Accounting Principles (SSAP) No. 43R—Loan-Backed and Structured Securities* to address the reporting of residual interests because they are most common in securitization structures within the scope of SSAP No. 43R and that guidance specified that they should be captured on designated reporting lines on Schedule BA. Gann stated that residual interests could occur in other structures that could be captured in *SSAP No. 48—Joint Ventures, Partnerships, and Limited Liability Companies*. She stated that this agenda item proposed revisions to SSAP No. 48 as well as corresponding revisions to SSAP No. 43R and narrative changes to the *Annual Statement Instructions,* which clarify that all residual interests should be captured on the dedicated Schedule BA reporting lines.

Gann said the Working Group received comments from interested parties, proposing minor edits to the *Annual Statement Instructions* and for clarity of the effective date. Gann stated that the guidance is expected to be applied for year-end 2023 since it is only a reporting change. Gann stated that it is not proposed to capture the explicit effective date in the guidance, but the Dec. 31, 2023, effective date will be noted in the agenda item in the status update. NAIC staff recommended that the Working Group adopt the exposed revisions to SSAP No. 48, SSAP No. 43R, and the *Annual Statement Instructions* with the modifications from interested parties to clarify that all residuals should be on Schedule BA in the dedicated reporting lines. Furthermore, Gann stated there is a little bit of back and forth between the new bond definition and the definition of residuals, and it has been noted once the bond definition is formally in effect on Jan. 1, 2025, a subsequent agenda item can propose updates to reference the bond definition within the residual guidance. She stated that interested parties also provided comments asking what sorts of structures could have residual interest. Gann stated that given the principles-based nature of the residual definition, NAIC staff included comments on page 4 of the agenda stating they are not intending to name specific investments as in or out of the scope of having a residual interest. She said those comments do not revise the guidance proposed to be adopted during this meeting.

Rose Albrizio (Equitable), on behalf of interested parties, stated that they appreciate the clarification of the effective date.

Walker made a motion, seconded by Kim Hudson, to adopt the exposed edits in agenda item 2023-12 with the interested parties' modifications to the annual statement instructions and to state in the Form A that it is effective Dec. 31, 2023 (Attachment-B). The motion passed unanimously.

B. INT 23-02

Bruggeman directed the Working Group to *Interpretation* (*INT) 23-02: Third Quarter 2023 Inflation Reduction Act – Corporate Alternative Minimum Tax*. Robin Marcotte (NAIC) stated that in August, the Working Group exposed the tentative consensuses in INT 23-02 to provide temporary guidance for the third quarter reporting for corporate alternative minimum tax (CAMT). The exposed interpretation recommends that for third quarter of 2023, reporting entities should disclose whatever information is available and whether the entity expects to be an applicable entity that is required to do the tentative CAMT calculation. If the reporting entity can make a reasonable CAMT estimate, this should be disclosed for the third quarter of 2023. Entities should also disclose if a reasonable estimate is not possible. Marcotte stated that INT 23-02 builds on the previously adopted *INT 22-02: Third Quarter 2022 through Second Quarter 2023 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax*. She stated INT 22-02 and INT 23-02 do not require accrual of a CAMT liability for the applicable reporting periods. Marcotte stated that for the third quarter of 2023, some entities may be able to estimate their CAMT. She stated that interested parties' comments noted support for the deferral of statutory accounting until permanent guidance is adopted. Marcotte stated that the Working Group is working on permanent guidance, which is the next agenda item 2023-04. She stated that interested parties noted support for INT 23-02 with minor edits, which are shown in their comment letter. Marcotte stated that NAIC staff recommend adopting the exposed INT 23-02 with the edits recommended by interested parties. She noted that the proposed revisions are minor and do not change the overall principles that were exposed. Marcotte stated that INT 23-02 would be effective immediately to allow for third-quarter 2023 application and would automatically be nullified on Nov. 16, 2023, after third-quarter filings are due. Marcotte reviewed the revisions included in INT 23-02, which included more accurately describing the CAMT, the deletion of a duplicative sentence, minor clarifications about estimates and subsequent events, and editorial items.

Aimee Hoke (Nationwide), on behalf of interested parties, stated appreciation for the extension of not requiring CAMT liability accrual for third-quarter until the final proposed year-end guidance is created.

Kasinow made a motion, seconded by Malm, to adopt INT 23-02 as exposed with the revisions (Attachment-C). The motion passed unanimously, which met the policy statement super majority voting requirements for this item.

C. Agenda Item 2023-04 on INT 23-03

Bruggeman directed the Working Group to agenda item 2023-04: Corporate Alternative Minimum Tax Guidance. Marcotte stated that the Working Group exposed the tentative consensus in *INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax* to provide guidance for year-end 2023 and periods thereafter. She said it is recommended to be in an INT rather than an SSAP. Marcotte stated that the federal Inflation Reduction Act was passed in 2022, and the CAMT goes into effect beginning with the 2023 tax year. The CAMT only applies to corporations determined on a tax-controlled basis with an average adjusted financial statement income in excess of $1 billion for the three prior taxable years. She stated that in some cases, for certain foreign-parented corporations, the threshold goes down to $100 million. The CAMT is assessed at the consolidated return level using book income. Once a corporation is an applicable corporation, it will remain an applicable corporation unless certain very limited exceptions apply. She stated that corporations calculate their CAMT and compare that to the regular tax liability and pay the higher amount. She stated that payment of the tax results in a tax credit that does not expire. However, the tax credit can only be used to pay federal taxes, which are above the CAMT amount.

Marcotte stated that interested parties provided several proposed clarifications and edits that were explained well in their comment letter in the meeting materials (Attachment A). She stated that NAIC staff recommend the Working Group adopt INT 23-03, effective for year-end 2023, with the edits from interested parties with the minor variations noted from NAIC staff, and after the Working Group provides direction regarding edits to the transition guidance in paragraph 37b. She stated that NAIC staff incorporated almost all the interested parties' recommended edits, particularly the edits that provided more specific or more accurate tax terminology. She noted that the INT recommended for adoption had the following differences from interested parties' proposed revisions: 1) did not replace CAMT credit carryforwards with CAMT credit deferred tax assets (DTAs) in all places; 2) did not add additional acronyms; 3) worded one revision in the positive instead of the negative; 4) added a suggested footnote regarding non-RBC filers; and 5) included other minor editorial items. She stated that although INT 23-03 had several proposed clarifications, the overall clarifications were technical in nature and did not change the overall principles exposed.

Hoke stated that interested parties appreciate the Working Group's consideration of the proposed edits and that most of the interested parties' comments were about tax terminology and providing specific language.

Bruggeman directed the Working Group to the interested parties' proposed edits to INT 23-03, paragraph 37b. He stated that this has been referred to as transition guidance, especially for the year-end 2023 filing tax allocation or tax sharing agreements. Bruggeman stated that there are some challenges and that industry wants certainty for scenarios in which they filed their revised or new tax allocation agreement sometime before year-end 2023, and the state insurance regulator's letter of either approval or non-disapproval does not come until after year-end 2023. He noted that the questions are on the application of *SSAP No. 9—Subsequent Events*. Bruggeman stated that if the tax allocation agreement was filed before year-end and the approval happens before year-end, there is no subsequent event. As for what happens if the letter comes after year-end, he stated that it can be broken down further by when that approval or non-disapproval comes. Bruggeman stated that if the approval comes before companies file their year-end statements, they follow the agreement.

Bruggeman stated that if the letter comes after they file the year-end financial statements, it becomes a complicated matter that the Working Group needs to work out. He posed the question of what a company does if a state has not given them an answer by Feb. 28 (the day before the March 1 filing deadline). He stated that, technically, per SSAP No. 9, without approval or non-disapproval, the company would follow whatever existed before that Form D filing. Bruggeman stated that he thinks this is what industry would like to get adjusted, for some certainty, within INT 23-03. He stated that the question to consider is whether a company can assume their domestic state will eventually approve, as they filed the Form D and their annual statement as such. Bruggeman stated that it would be a pseudo SSAP No. 9 Type 1 event. Second, if the approval comes after they filed the statement doing that pseudo Type 1 event, like March 1, but the final approved agreement is slightly different than what was filed and reported on at year-end 2023, can the company treat that change as a Type 2 subsequent event, which would mean pushing that change through the first quarter 2024 statement and not amend the annual statement. Being able to treat the difference between the initially filed contract and the approved contract as a Type 2 event would mean that the company does not have to worry about the audited financial statement being different.

Bruggeman stated that for a major difference from the Form D filing to approval, it would be a discussion or documentation of whether that change is then a Type 1 or Type 2 event to be handled in accordance with SSAP No. 9. He stated that if the Working Group chose to not do anything when the approval letter does not come by the filing due date when the company eventually gets the approval, it would be a Type 1 subsequent event and they would have to amend each company's year-end statement to what was approved, even if the approval were very similar to what was filed. He stated that there could be a lot of impacted companies because the CAMT is a big company and big company group issue. There could be multiple companies involved.

Bruggeman stated that if the company decides to file the Form D after Dec. 31, then the domestic state needs to work with a company to be able to use the main parts of INT 23-03. He stated that the normal process is 30 days for approval under the *Insurance Holding Company System Regulatory Act* (#440). He stated that the Working Group needs to discuss if they want to include guidance in the interpretation for situations in which the approval takes longer than 30 days. Alternatively, the domiciliary regulator can tell the company it will need to decide on an individual basis whether it should file as if the Form D filed is a pseudo Type 1 event, and the state will eventually send the company its letter of approval or non-disapproval, as the state finishes the review. He stated that there may be a few states that are not comfortable putting a timing event that is closer related to a Model #440 situation than it is to statutory accounting.

Walker stated that she is struggling with putting this sort of guidance in INT 23-03 because it is a domestic regulator issue, and nothing would prevent the companies from talking to the domestic regulator to get what they are putting in here cleared through the domestic regulator, as it is originally drafted. She further stated whereas if they get confirmation from the domestic regulator that there is no objection to using the new tax allocation agreement they can do that with or without this language being in INT 23-03, and it appears that it is a one-year problem to resolve. She stated that she would not want to put a requirement on the domestic regulator to firmly tell companies not to use the agreement if the domestic regulator has not had the opportunity to complete its review. Walker stated that the burden should not be on the regulator to notify the company that they cannot use an agreement that has not completed the process yet.

Bruggeman proposed a situation to Walker where there are multiple companies across multiple states, and, for example, Ohio is the lead state, and Texas is the supplemental state. If Texas is not comfortable just yet, but Ohio is, Bruggeman asked what her thoughts were on the timing of where one company can file it as a known Type 1 event and the other company cannot because they have not heard from their state. Walker stated she hoped the company would talk to her, and depending upon what our concerns are and where we are in the process, she would either be able to say she had no objection or that she had concerns about the methodology in the tax allocation. She noted that, hopefully, the filings will be clear, and they will be able to be reviewed within 30 days. She said the key to this is communicating with the domestic regulator to work through the process. She noted that this is also a situation where regulators should coordinate to work together. She noted that she struggled with the idea of putting in language that could impede the state. Bruggeman commented that is the fine line. He wants to provide accounting direction and not interfere with the state or its application of Model #440.

Clark agreed with Walker that with the originally exposed INT 23-03, paragraph 37b language that allows the domestic regulator to, in writing, say they do not object to using the accounting while the agreement is under review. He stated that should be sufficient so that the company can work with their regulator. He noted support for the originally exposed language.

Bruggeman proposed a scenario where the regulator is not able to give approval or non-disapproval before the final due date and does not object to using the tax agreement as filed on Form D in the year-end financial statement. He inquired whether, after a company receives approval and there is a slight change, whether states will accept a Type 2 subsequent event instead of an amended year-end statement. Walker stated she would be fine with that, assuming if, for example, Texas required a change that would need to cascade through all the other states that have also already approved it. Clark stated he would agree, and he is not sure it would have to be an insignificant change if the regulator approved the use of the pending agreement for accounting purposes for the year-end financial statements. He stated he would be fine with any change from there on being a Type 2 subsequent event. Bruggeman stated what he is hearing is that as long as you get the definitive approval from the domestic state, in writing, to file their annual statement using the tax sharing agreement as filed in the Form D, even before the approval or non-disapproval, and that when the approval or non-disapproval does come, and there was a change, that that change would be a Type 2 subsequent event and be made in the first quarter of 2024. Bruggeman stated that is what was exposed.

Marcotte stated that what was exposed was that when the domestic regulator has confirmed that they have no objections to using the tax allocation amendment or new agreement while under review, then the company should be allowed to apply that accounting at year-end. She stated that paragraph 37a notes that companies that do not have the CAMT in their tax allocation agreement now will need to amend it and that it would be under a Form D filing under Model #440. She stated that paragraph 37b says that either the company has the tax allocation agreement updates approved prior to year-end or their domestic regulator has confirmed they have no objections to using it while under review. She stated that paragraph 37c goes into a discussion about whether the final agreement differs from what was originally requested and how to record that difference. She stated that if the Form D approval occurs after the balance sheet date but before the issuance of the statutory financial statements and before the date the audited financial statements are issued or available to be issued, that would be a Type 1 event. If the Form D approval occurs after the period, which is defined as a subsequent event in SSAP No. 9, the difference created by the approval is recognized and disclosed in the period given. The transition of guidance does not apply if the Form D is not filed prior to the end of the year in 2023. She stated that, under SSAP No. 9, there are three periods to be concerned about. Dec. 31 is the reporting date, March 1 is the filing date, and you also must worry about the June 1 audit filing. So, if approved before issuance, then it goes in the financial statements; if not approved until after issuance, then put the changes in the financial statements in the period that the revisions are approved.

Bruggeman stated that the onus is getting some definiteness that the domestic state will approve reporting the tax sharing agreement as in their annual statement as submitted in the Form D filing, even without a formal approval or disapproval on that Form D. He stated that the Working Group has the option to approve everything in INT 23-03 and exclude the transition paragraph 37b. If the Working Group chooses that option, reporting entities need to obtain confirmation from your domestic state that you can file, and you put it in your financial statements what has been filed, and in review, and use that as a pseudo Type 1 event as if it's been approved. Then, paragraph 37c jumps in when it is approved later; then, it is a Type 2 event.

Marcotte stated that the interested parties' wording was that the domiciliary regulator has not provided written objections to using the tax allocation agreement amendment while under review. The exposed wording was that the domiciliary regulator has confirmed that they have no objections to using the tax allocation agreement while under review. It is either whether one is comfortable with the domiciliary regulator having confirmed they have no objections to using it while under review, or the second one is that the domiciliary regulator has not acted and has not provided written objections.

Bruggeman stated that Walker wants to have more of a definitive discussion. Bruggeman said Walker confirmed she has no objections to using the file tax allocation agreement in the financial statement. Walker stated she would be supportive of the language as exposed originally and removing the interested parties' proposed language. Bruggeman asked if other Working Group members support the original language. He stated that this is only in cases when it is in review status, and the company is ready to file its financial statements and wants to know what it needs to do. Kim Hudson, Clark, and Malm stated support for using the original language of paragraph 37b. Andersen stated that the language should include a friendly amendment stating that the confirmation should be in writing. Walker agreed with this recommendation.

Hoke stated that interested parties are concerned that the written confirmation requirement will escalate to a permitted practice and that state insurance regulators might not be willing to provide written confirmation while a tax allocation agreement is under review.

Bruggeman stated the written confirmation is so that what was filed as in the annual statement can be used, not that the agreement is approved or not approved. He stated that the state has confirmed its approval to use the as-filed tax agreement. Bruggeman stated that he would not consider that a permitted practice. Clark agreed, stating that it would not be a permitted practice because it is not a deviation. He stated that if a state insurance regulator was unwilling to provide that confirmation, then that is their authority. It is not the Working Group's place to override that authority.

Marty Carus (Marty Carus Consulting) asked whether an email is acceptable as written communication. Bruggeman confirmed that emails are considered written communication. Kasinow stated it does add another step to the Form D process, but they can certainly see the usefulness in the written communication. He stated that if the Superintendent does not disapprove, they can go forward.

Walker made a motion, seconded by Clark, to adopt as exposed with the editorial changes to everything except paragraph 37b and to leave the as-exposed paragraph 37b, including the friendly amendment that the confirmation must be in writing (Attachment D and Attachment E). The Working Group agreed that the sentence under discussion in paragraph 37b would read: "Accordingly, if a reporting entity files the applicable Form D request(s) for tax allocation agreement amendment or a new tax allocation agreement prior to the end of 2023 to address the CAMT for 2023 and subsequent taxable years, and the domiciliary regulator has confirmed in writing that they have no objections to using the new tax allocation agreement amendment or new tax allocation agreement, while under review." The motion passed unanimously, which met the policy statement super majority voting requirements for this item.

2. <u>Discussed Other Matters</u>

   A. <u>Agenda Item 2023-22</u>

Marcotte stated that agenda item 2023-22, Actuarial Guideline 51 and Appendix A-010 Interaction, was exposed at the Summer National Meeting and referred to the Valuation Analysis (E) Working Group and to the Long-Term Care Actuarial (B) Working Group. She said this item included minor revisions to *SSAP No. 54R—Individual and Group Accident and Health Contracts* and an illustration. Marcotte stated that NAIC staff and actuaries would like to expand the illustration to show more steps. This item will likely have an interim e-vote to re-expose with an expanded illustration.

   B. <u>Agenda Item 2023-15</u>

Marcotte stated that the comment deadline for agenda item 2023-15: IMR Specific Allocations was extended to Oct. 18.

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2023/9-21-23/minutes/sapwg minutes 09.21.23.docx

Draft: 11/2/23

Statutory Accounting Principles (E) Working Group
Virtual Meeting
October 23, 2023

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met Oct. 23, 2023. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Blase Abreo (AL); Kim Hudson (CA); William Arfanis (CT); Tom Hudson (DE); Cindy Andersen (IL); Melissa Gibson and Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Diana Sherman (PA); Amy Garcia and Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI). Also participating was Tish Becker (KS).

1. Adopted Non-Contested Positions

The Working Group met to review comments (Attachment XX) on the following exposed items.

Walker made a motion, seconded by Sherman, to adopt revisions detailed below as non-contested statutory accounting revisions. The motion passed unanimously.

a. Agenda Item 2023-18

Bruggeman directed the Working Group to agenda item 2023-18: *Accounting Standards Update (ASU) 2016-19, Technical Corrections and Improvements.* Wil Oden (NAIC) stated that in Dec. 2016, the Financial Accounting Standards Board (FASB) issued *ASU 2016-19, Technical Corrections and Improvements*, as part of a standing project on its agenda to address suggestions received from stakeholders on FASB codifications and to make other incremental improvements to U.S. generally accepted accounting principles (GAAP). Oden stated that interested parties had no comments on the exposed revisions. Oden recommended adoption of the exposed revisions, which adopt ASU 2016-19 with modification in *Statement of Statutory Accounting Principles (SSAP) No. 5R—Liabilities, Contingencies and Impairments of Assets*, *SSAP No. 92—Postretirement Benefits Other Than Pensions*, *SSAP No. 102—Pensions,* and *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (Attachment XX).

b. Agenda Item 2023-19

Bruggeman directed the Working Group to agenda item 2023-19: *ASU 2018-09, Codification Improvements.* Oden stated that in July 2018, FASB issued *ASU 2018-09, Codification Improvements* as part of a standing project on its agenda to address suggestions received from stakeholders on FASB codifications and to make other incremental improvements to U.S. GAAP. Oden stated that interested parties agreed with the exposed revisions. Oden recommended the adoption of the exposed revisions to reject *ASU 2018-09* in Appendix *D—Nonapplicable GAAP Pronouncements* (Attachment XX).

c. Agenda Item 2023-20

Bruggeman directed the Working Group to agenda item 2023-20: *ASU 2020-10, Codification Improvements*. Oden stated that in Oct. 2020, the FASB issued *ASU 2020-10 Codification Improvements*, which improves the consistency of the codification by ensuring that all guidance that requires or provides an option for an entity to provide information in the notes to financial statements is codified in the disclosure section of the codification. Oden stated that interested parties agreed with the exposed revisions. Oden recommended the adoption of the exposed revisions to reject *ASU 2020-10* in *Appendix D—Nonapplicable GAAP Pronouncements* (Attachment XX).

d. Agenda Item 2023-21

Bruggeman directed the Working Group to agenda item 2023-21: Removal of Transition Guidance from SSAP No. 92 and SSAP No. 102. Jake Stultz (NAIC) stated that on Dec. 18, 2012, the Statutory Accounting Principles (E) Working Group adopted SSAP No. 92 and SSAP No. 102, which superseded *SSAP No. 14—Postretirement Benefits Other Than Pensions* and *SSAP No. 89—Pensions*. The adopted SSAP No. 92 and SSAP No. 102 included transition guidance that expired after 10 years. This agenda item exposed revisions to remove the unneeded transition guidance from SSAP No. 92 and SSAP No. 102. Stultz stated that interested parties had no comments and that NAIC staff recommended the adoption of the exposed revisions in SSAP No. 92 and SSAP No. 102 (Attachment XX).

2. Reviewed Comments on Exposed Items

a. Collateral for Loans

Bruggeman directed the Working Group to agenda item 2022-11: Collateral for Loans. Robin Marcotte (NAIC) stated that during the 2023 Summer National Meeting, the Working Group re-exposed the March 2023 revisions to *SSAP No. 20—Nonadmitted Assets* and *SSAP No. 21R—Other Admitted Assets* to allow interested parties more time to submit additional comments. She stated that this agenda item was drafted in July 2022 to address inconsistencies raised by state insurance regulators regarding the guidance for collateral loans between SSAP No. 20 and SSAP No. 21R.

Marcotte stated that commenters at the Summer National Meeting advocated for the use of fair value to measure the adequacy of pledged collateral from equity entities in the scope of *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* or *SSAP No. 97—Investments to Subsidiary, Controlled and Affiliated Entities.* She stated that fair value is consistent with what is used for the measurement of the adequacy of most collateral.

Marcotte stated that at the 2023 Spring National Meeting, the Working Group exposed a carve-out allowing the use of audited book value instead of using fair value when comparing the adequacy of the collateral pledged, which represents equity ownership in SSAP No. 48 or SSAP No. 97 entities. She stated that the March 2023 exposed carve-out guidance was in response to interested parties' comments that noted concerns with having to obtain both an audit and verification of fair value for collateral from equity method investments.

Marcotte stated that the interested parties' current position agrees that audits are required for this type of collateral to be a qualified invested asset. The most recent interested parties' comments recommend that fair value be used to measure the adequacy of the collateral and recommend additional language stating that reporting entities need to maintain sufficient documentation to support the reasonableness of the fair value measurement of the underlying collateral. She stated that the interested parties have provided proposed revisions to SSAP No. 21R, paragraph 4b noting that documentation of fair value needs to be available to the domiciliary state insurance regulator or the independent audit firm upon request.

Marcotte stated that NAIC staff recommend the Working Group re-expose the exposed revisions with the paragraph 4b updates proposed by interested parties and add additional transition guidance to SSAP No. 21R regarding the timing of obtaining audits. She noted the transition guidance is recommended because prior interested parties' discussions have indicated that not all entities are currently obtaining audits of pledged collateral from SSAP No. 48 or SSAP No. 97 entities.

Andrew Morse (Global Atlantic), on behalf of interested parties, stated that interested parties are in support of the proposed changes.

Becker stated that the Kansas Insurance Department supports the Sept. 12, 2023, interested parties' comment letter and supports the proposed effective date of the transition related to the audit timing.

Hudson made a motion, seconded by Clark, to adopt 1) the minor consistency revisions previously exposed in SSAP No. 20 and 2) the previously exposed and additional proposed revisions to SSAP No. 21R as discussed (Attachment XX). The motion passed unanimously.

3. Discussed Other Matters

   a. INT 23-04T: Life Reinsurance Liquidation Questions

Marcotte stated that a recent liquidation order of a U.S. life reinsurer has raised questions from state insurance regulators and life industry ceding insurers, about the reporting of the unsettled reinsurance recoverable amounts. She stated that NAIC staff drafted *Interpretation (INT) 23-04: Life Reinsurance Liquidation Questions* for Working Group consideration and possible exposure. She provided a summary of the INT as well as details about to the specific situational questions that prompted the INT. She noted that most of the INT is based on existing guidance in *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* including the recapture and commutation guidance. She stated that NAIC staff request Working Group direction on Issue 4 in the INT, specifically paragraph 18, which asks for guidance regarding the admissibility of life reinsurance receivables from a life reinsurer in liquidation.

Bruggeman stated that there is guidance regarding impairment value in Issue 3, but after the amount is evaluated for impairment, there is still the question of the admissible value on Issue 4, which is detailed in the interpretation. He stated there is currently no specific guidance on this topic. He stated that because reporting entities have been impairing the amounts expected to be recovered, interested parties requested that the admitted value remain the same. He said in paragraph 18, because of the liquidation and commutation, the Working Group would have to look at what the admissibility status of the reinsurer was in that state and whether they were authorized and or accredited in the state prior to the liquidation order.

Malm inquired whether the priority in a liquidation makes a difference when funds are being distributed. Marcotte stated that most ceding entities would have a similar priority status in a liquidation. Bruggeman questioned if the ceding company is equivalent to a policyholder in direct policies. He stated that the liquidator will have to determine what priority class each ceding company is part of.

Marcotte stated that with this specific situation, many ceding insurers had already set up a valuation allowance in anticipation of not receiving 100% of what was due. She stated that the INT would most likely be effective for the fourth quarter of 2023. Marcotte also stated that reporting the receivables on the reinsurance schedule (after removing the reinsurance reserve credit) would allow for better tracking of industry exposure. She also noted that ultimately this is still a reinsurance balance, which is why the INT recommended specific reinsurance recoverable lines.

Bruggeman asked for comments concerning paragraph 18 of INT 23-04. Weaver asked whether it was a conservative approach to allow a company to increase surplus on a ceding entity when there is no idea what the court is going to rule regarding future distributions from the liquidation estate. She stated that she has concerns with increasing statutory surplus when there is no idea what is going to be recovered. Weaver stated that it may be more conservative to say it is not an admitted asset, and if the ceding entity receives it, then the increase in surplus would be appropriate because the uncertainty of the recoverable has been removed.

Bruggeman stated that the admittance is after impairment and that the INT includes draft language that would follow the admissibility guidelines on authorized and accredited reinsurance contracts. He stated that the Working Group may have to make an adjustment to use the liquidation date value.

Hudson and Sherman agreed with Weaver that they were more comfortable with a conservative approach of non-admitting the receivables from the reinsurer in liquidation.

Clark stated that a request from interested parties during the exposure period would be to provide what kind of information is available to determine impairment. He stated that Iowa has been requiring ceding companies that have the reinsurer in liquidation to file their impairment analysis. He stated that getting an update on what information is currently available for what might be recovered would be helpful to get a sense of whether a reasonable estimate of the amount that could be recovered is feasible. Clark also stated that the conservative approach would be to non-admit the receivables.

Weaver stated that she would like to expose language to non-admit receivables but is open to letting interested parties provide comments.

Hudson asked whether the Working Group could hold an e-vote and then expose the changes with a public comment period ending Nov. 15.

Marcotte stated that NAIC staff will adjust the language in the INT, and the Working Group could conduct an e-vote for exposure.

Charles Evers (Protective Life) representing the American Council of Life Insurers (ACLI) stated that the Nov. 15 exposure deadline works for interested parties.

Bruggeman stated that the Working Group will conduct an e-vote on the changes to Issue 4 in the INT and would expose the tentative consensuses of INT 23-04 with a public comment period ending Nov. 15.

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/10-23-23/Minutes/SAPWG Minutes 10.23.23.docx

Draft: 10/26/23

Statutory Accounting Principles (E) Working Group
E-Vote
October 24, 2023

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded Oct. 24, 2023. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Kim Hudson (CA); William Arfanis (CT); Cindy Andersen (IL); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Diana Sherman (PA); David Smith (VA); and Amy Malm (WI).

1. Exposed INT 23-04T

The Working Group considered an e-vote exposure of a tentative *Interpretation (INT) 23-04T: Life Reinsurance Liquidation Questions.* INT 23-04T provides accounting and reporting guidance for ceding entities regarding reinsurance receivable and payable amounts related to a life reinsurance counterparty in liquidation.

Malm made a motion, seconded by Guerin, to expose the revised INT 23-04T for a public comment period ending Nov. 15. The motion passed with 11 Working Group members responding with affirmative votes.

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/10-24-23 evote INT 23-04/10-24-23 evote INT 23-04.docx

Draft: 11/6/23

Statutory Accounting Principles (E) Working Group
E-Vote
October 31, 2023

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded Oct. 31, 2023. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Kim Hudson (CA); Bill Arfanis (CT); Rylynn Brown (DE); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Diana Sherman (PA); David Smith (VA); and Amy Malm (WI).

1. Exposed Agenda Item 23-04

The Working Group considered an e-vote exposure of agenda item 2023-23: Residuals in Preferred Stock and Common Stock Structures. This agenda item provides limited revisions to *Statement of Statutory Accounting Principles (SSAP) No. 30R—Unaffiliated Common Stock* and *SSAP No. 32R—Preferred Stock* to identify that investments that are in substance residual interests shall be reported on Schedule BA on the dedicated reporting line for residuals.

Walker made a motion, seconded by Clark, to expose agenda item 2023-23 for a public comment period ending Nov. 17. The motion passed with 12 Working Group members responding with affirmative votes.

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/10-31-23 evote/10-31-23 evote 2023-23.docx

Proposed Revisions to SSAP No. 21R – 2023 Fall National Meeting

Summary of Revisions:

1. All changes exposed in Summer 2023 have been accepted with new edits shown as tracked. (This has been done for readability and to highlight changes from the prior exposure.)

2. Paragraph 30: Revisions specify that temporary reductions in fair value shall be reported as unrealized losses. This guidance was revised to mirror the updated OTTI guidance proposed in paragraph 35.

3. Paragraphs 31-32: Revisions incorporate the measurement method of residuals to be the "effective yield method with a cap." With the revised guidance, the BACV of a residual will be limited to the initial cost, and recognition of interest income / reduction of the cost basis will depend on the cash flows received. Cash flows received that are within the allowable earned yield will be reported as interest income and cash flows received in excess of the allowable earned yield will reduce the carrying value. This revised method intends to allow a systematic approach to recognizing interest income over the life of the security, while not permitting an increase in the cost basis based on an expectation of future cash flows.

4. Paragraph 33: Revisions incorporate a practical expedient to the measurement method detailed in paragraphs 31-32 that permits companies to utilize a "return of cost basis" approach. Under this approach, all cash flows received from residual tranches will be taken as a reduction of BACV. Once the BACV reaches zero, then all cash flows received will be recognized as interest income. (This was the approach exposed at the Summer NM for all residuals.) Although the industry comment letter has noted support for the 'effective yield with a cap' method detailed in paragraphs 31-32, they have noted that some companies would prefer the simplicity of the return of cash basis approach. For companies that do not have significant residual holdings, they would prefer the return of cost basis approach to avoid any operational complexity. NAIC staff supports the inclusion of this practical expedient as it is a more conservative approach in the measurement method of residuals.

5. Paragraph 34: Revisions provide guidance for accounting and reporting if the investment no longer meets the definition of a residual.

6. Paragraph 35: Guidance for OTTI has been revised to be consistent with SSAP No. 43R and the assessment of the present value of expected cash flows to the BACV.

SSAP No. 21R—Other Admitted Assets

Debt Securities That Do Not Qualify as Bonds

20. The guidance within paragraphs 20-28 of this statement shall apply for any security, as defined in *SSAP No. 26R—Bonds*, whereby there is a fixed schedule for one or more future payments (referred to herein as debt securities), but for which the security does not qualify for bond reporting under SSAP No. 26R as an issuer credit obligation or an asset backed security. Investments in scope of this guidance are limited to:

a. Debt securities for which the investment does not reflect a creditor relationship in substance.

b. Debt securities that do not qualify for bond reporting due to a lack of substantive credit enhancement.

c. Debt securities that do not qualify for bond reporting due solely to a lack of meaningful cash flows.

21. Debt securities as described in this statement meet the definition of assets as defined in SSAP 4 and are admitted assets to the extent they conform to the requirements of this statement. The guidance in these paragraphs shall not be inferred to other securities or investment structures that are not otherwise addressed in statutory accounting, nor shall it be applied to any investments that are captured within other statutory accounting guidance.

22. Debt securities in scope of this standard that do not qualify as bonds under SSAP No. 26R and for which the primary source of repayment is derived through rights to underlying collateral, qualify as admitted assets if the underlying collateral primarily qualify as admitted invested assets. As detailed in paragraph 29, in the section pertaining to residual tranches, any residual tranches or first loss positions held from the same securitization that did not quality as a bond under SSAP No. 26R also only qualify to the extent the underlying collateral primarily qualifies as admitted invested assets.

23. Debt securities in scope of this statement shall be initially reported at acquisition at cost, including brokerage and other related fees on *Schedule BA: Other Long-Term Invested Assets*.

24. Debt securities captured in scope shall be reported at the lower of amortized cost or fair value. Changes in measurement to reflect a lower value or to reflect changes in fair value shall be recorded as unrealized gains or losses.

25. Debt securities that do not qualify as bonds in the scope of this statement shall follow the guidance in *SSAP No. 43R—Asset-Backed Securities* for calculating amortized cost, for determining and recognizing other-than-temporary impairments and for allocating unrealized and realized gains and losses between the asset valuation reserve (AVR) and interest maintenance reserve (IMR).

26. Investment income shall be recorded, with assessments for collectability and nonadmittance completed and recognized, pursuant to *SSAP No. 34—Investment Income Due and Accrued*.

27. Securities captured within this section shall be included in all invested asset disclosures, along with the following disclosures:

a. Fair values in accordance with *SSAP No. 100R—Fair Value*.

b. Concentrations of credit risk in accordance with SSAP No. 27;

c. Basis at which the securities are stated;

d. The adjustment methodology used for each type of security (prospective or retrospective);

e. Descriptions of sources used to determine prepayment assumptions.

f. All securities within the scope of this statement with a recognized other-than-temporary impairment, disclosed in the aggregate, classified on the basis for the other-than-temporary impairment: (1) intent to sell, (2) inability or lack of intent to retain the investment in the security for a period of time sufficient to recover the amortized cost basis, or (3) present value of cash flows expected to be collected is less than the amortized cost basis of the security.

g. For each security with an other-than-temporary impairment, recognized in the current reporting period by the reporting entity, as the present value of cash flows expected to be collected is less than the amortized cost basis of the securities:

  i. The amortized cost basis, prior to any current-period other-than-temporary impairment.

  ii. The other-than-temporary impairment recognized in earnings as a realized loss.

  iii. The fair value of the security.

  iv. The amortized cost basis after the current-period other-than-temporary impairment.

h. All impaired securities (fair value is less than cost or amortized cost) for which an other-than-temporary impairment has not been recognized in earnings as a realized loss (including securities with a recognized other-than-temporary impairment for non-interest related declines when a non-recognized interest related impairment remains):

  v. The aggregate amount of unrealized losses (that is, the amount by which cost or amortized cost exceeds fair value) and

  vi. The aggregate related fair value of securities with unrealized losses.

i. The disclosures in (i) and (ii) above should be segregated by those securities that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer using fair values determined in accordance with SSAP No. 100R.

j. Additional information should be included describing the general categories of information that the investor considered in reaching the conclusion that the impairments are not other-than-temporary.

k. When it is not practicable to estimate fair value, the investor should disclose the following additional information, if applicable:

  i. The aggregate carrying value of the investments not evaluated for impairment, and

  ii. The circumstances that may have a significant adverse effect on the fair value.

l. For securities sold, redeemed or otherwise disposed as a result of a callable feature (including make whole call provisions), disclose the number of CUSIPs sold, disposed or otherwise redeemed and the aggregate amount of investment income generated as a result of a prepayment penalty and/or acceleration fee.

Residual Tranches or Interests / Loss Positions

28. Residual tranches or interests from securitization tranches, beneficial interests and loss positions as defined in SSAP No. 43R and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* (which are collectively referred to as residuals), do not qualify for bond reporting and are required to be reported on *Schedule BA: Other Long-Term Invested Assets.*

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

30. Residuals shall be initially reported at cost, or allocated cost (using proportional fair values if acquired along with debt tranches from the securitization). Subsequent to initial acquisition, residuals shall be reported at the lower of ~~"adjusted cost"~~book adjusted carrying value (BACV) as ~~defined~~ detailed in paragraphs 31-32 or fair value, with temporary reductions in fair value reported as an unrealized ~~gain or~~ loss. ~~below adjusted cost reported as an other-than-temporary impairment. as detailed in paragraph 32~~.

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

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

33. Reporting entities may elect a practical expedient in lieu of the Allowable Earned Yield detailed in paragraphs 31-32 and calculate BACV such that all distributions received are treated as a reduction in BACV. With this approach, the reporting entity will not recognize any interest or investment income until the residual tranche has a BACV of zero. Once the residual has a zero BACV, distributions received shall be recognized as interest income.

a. Reporting entities applying the practical expedient shall continue to report residuals on Schedule BA, including those with a zero BACV. Any subsequent distributions shall be reported as interest income until the structure matures/terminates, is unwound, or no longer meets the definition of a residual.

b. Reporting entities are required to apply the practical expedient to all residuals held.

c. Reporting entities that wish to discontinue use of the practical expedient approach and move towards the allowable earned yield method are required to specify and disclose an explicit transition date, and only apply the allowable earned yield method to residuals acquired after that date. Residuals held prior to the transition date shall continue to follow the practical expedient until those residuals mature/terminate, are unwound or no longer meet the definition of a residual.

34. In situations where the residual structure ceases to meet the meet the definition of a residual tranche (i.e., when all senior debt has been repaid), and the investment structure is expected to continue for more than a year (12 months), the investment shall be reclassified and accounted for prospectively in the scope of whichever SSAP applies.

a. Although it will be determined based on the structure of the resulting investments, presumably, at the time a structure ceases to reflect a residual, it will likely be considered a debt security that does not qualify as a bond or an equity investment in scope *of SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*.

b. Reporting entities are not required to reclassify an investment if the resulting structure is unwound within 12 months of the senior debt being repaid.

~~Residuals shall be assessed for other-than-temporary impairment (OTTI) on an ongoing basis. An OTTI shall be considered to have occurred if the fair value is below adjusted cost. Upon identification of an OTTI, the reporting entity shall recognize a realized loss equal to the difference between adjusted cost and fair value. After the recognized OTTI, cash flowsdistributions received from the residual tranche willshall continue to be recorded in accordance with paragraphs 31-33. Subsequent recoveries in fair value shall not result in increases to the BACV. .~~

35. Residuals (under both methods described above) shall be assessed for (OTTI on an ongoing basis. An OTTI shall be considered to have occurred if the present value of expected cash flows discounted by the Allowable Earned Yield, is less than the BACV. Upon identification of an OTTI, the reporting entity shall recognize a realized loss equal to the difference between the BACV and the present value of expected cash flows, with the present value of expected cash flows becoming the new BACV. After the OTTI is recognized, distributions received from the residual shall continue to be recorded in accordance with paragraphs 31-33. Subsequent recoveries in cash flows shall not result in increases to the BACV.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/12-1-23 Fall National Meeting/Hearing/06 - SSAP No. 21R - 11-16-23.docx

Statutory Issue Paper No. 1XX

Principles-Based Bond Definition

STATUS
Exposure Draft – ~~December 12, 2022~~August 13, 2023

Original SSAP: SSAP No. 26 and SSAP No. 43
Current Authoritative Guidance: SSAP No. 26R and SSAP No. 43R

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. The guidance within this issue paper introduces new statutory accounting concept revisions to *SSAP No. 26R—Bonds* (SSAP No. 26R) and *SSAP No. 43R—Loan-backed and Structured Securities* (SSAP No. 43R) pursuant to the Statutory Accounting Principles (E) Working Group's (Working Group) Investment Classification Project as well as in response to expanding investment structures that have been reported on Schedule D-1: Long-Term Bonds. The Investment Classification Project reflects a comprehensive review to address a variety of issues pertaining to definitions, measurement and overall scope of the investment SSAPs. Although SSAP No. 26R was previously revised pursuant to the Investment Classification Project in 2017, it was identified that some entities were classifying securities issued from special purpose vehicles (SPVs) in scope of SSAP No. 26R instead of SSAP No. 43R. As the focus of this current project is on the substance of investments, regardless of whether they include an SPV for issuance, this project includes both SSAP No. 26R and SSAP No. 43R.

SUMMARY CONCLUSION

2. Investments eligible for reporting as bonds on Schedule D-1 shall comply with the principles-based definition of a bond or be specifically noted in scope of SSAP No. 26R or SSAP No. 43R. Revisions to reflect the principles-based bond definition will be incorporated to SSAP No. 26R, with SSAP No. 43R revised for accounting and reporting guidance investments that qualify as asset-backed securities under the bond definition. *SSAP No. 21R—Other Admitted Assets* has been revised to detail accounting and reporting guidance for debt securities that do not qualify as bonds under SSAP No. 26R. Lastly, various revisions to other SSAPs have been incorporated to update guidance and/or references to the bond guidance. ~~and SSAP No. 43R. Tracked changes~~The final adopted SSAPs and other revisions ~~to reflect this guidance~~ are shown in the Exhibits to this Issue Paper. ~~Exhibit A & B.~~

DISCUSSION

3. The discussion of this issue originally began in August 2019 with agenda item 2019-21: SSAP No. 43R – Equity Investments. This agenda item was drafted to consider clarification to SSAP No. 43R particularly with regards to collateralized fund obligations and similar structures that reflect underlying equity interests. In response to the discussion of comment letters in January 2020, this project was expanded to include a comprehensive review of SSAP No. 43R under the Working Group's Investment Classification Project, with NAIC staff directed to prepare a discussion document for subsequent review.

4. A preliminary discussion document was exposed for comment on March 18, 2020. Although there were no proposed recommendations in that exposed document, it captured the following:

   a. History of the definition / scope development of SSAP No. 43R. (This history has been retained in Exhibit ___ of this Issue Paper.)

b. Definitions of asset backed securities (ABS) from the Code of Federal Regulations (CFR), the Securities Exchange Act of 1934 and NAIC Model 280, Investments of Insurers Model Act (Defined Limits Version).

c. Potential options for the accounting and reporting of ABS based on whether they were considered traditional securitizations in accordance with the Code of Federal Regulations (CFR) (17 CFR 229.1101(c)) definition of an ABS or non-traditional securitizations that did not comply with the CFR definition.

5. In response to this initial exposure, a detailed comment letter dated July 31, 2020, was received from interested parties. Although a variety of elements were noted, two key issues were the primary focus:

a. Separation between SSAP No. 26R and SSAP No. 43R: Pursuant to the comments received, it was identified that many insurers had different interpretations of the adopted 2010 revisions that separated investments between SSAP No. 26R and SSAP No. 43R due to the presence of a "trust" or an "SPV" structure. As such, investment designs that had been identified as concerning due to the underlying investments in the SPV (e.g., equity-driven investments) believed by some to be limited to SSAP No. 43R were, under some interpretations, eligible to be captured in scope of SSAP No. 26R.

b. Defining an asset backed security: The comments received focused heavily on whether the 17 CFR definition captured securities within the 1933 or 1934 Securities Act. The proposed use of the 17 CFR definition, which is the ABS definition used by the SEC as a nationally recognized statistical ratings organization (NRSRO) registered for asset-backed securities, was intended to allow consistency in ABS items permitted for NRSRO designations. Furthermore, it was only the first "broad brush" in determining whether an investment would be initially captured in scope of SSAP No. 43R. Regardless, based on the comments received, which noted variations between the 1933 and 1934 Securities Act, differences of assessments based on whether an entity is the issuer or acquirer, the legal scrutiny that may be required in determining whether an investment complies with the definition, as well as a recommendation for independent principles for determining an investment as an asset backed security, it was identified that further discussion should occur before utilizing the CFR definition of an asset-backed security.

6. After considering the interested parties' July 31, 2020, comments, the Working Group directed that a small group of industry work with Iowa representatives and NAIC staff to first define what should be considered a bond for reporting on Schedule D-1. It was identified that some investment designs, which have been previously captured on Schedule D-1 or are proposed for inclusion on that schedule, may be well-performing assets, but are not bonds and should not be captured on Schedule D-1. It was also noted that regulators are not anticipating these sorts of investment structures when reviewing D-1 and assessing investment risk. These small group discussions began December 1, 2020 and continued until the bond proposal was exposed for public comment on May 20, 2021.

7. After considering the comment letters from the May 2021 exposure, on August 26, 2021, the Working Group affirmed the direction of the principle-based bond concepts and directed NAIC staff to utilize those concepts in proposing statutory accounting revisions. With this explicit direction, it was noted that all elements of the principles-based bond proposal, and the reflection of those concepts in statutory accounting guidance, is subject to continued discussion and deliberation. Revised guidance for Schedule D-1 investment classification will not be considered authoritative statutory guidance until the specific effective date detailed in the adopted authoritative SSAP. With the direction to proceed with the development of statutory guidance to reflect the principle-based concepts, the Working Group directed that NAIC staff continue to work with the small group of regulators and industry to discuss concepts, review proposed language and consider innovating investment designs. (During this meeting, the small group was repurposed and referred to as the "study" group with additional regulators participating.)

8. From September 2021 through January 2022, the study group of regulators and industry met to continue discussions on the bond proposal definition. Key elements discussed during this timeframe included 1) the requirement for a credit enhancement that puts the holder of an ABS in a different economic position from holding the underlying collateral directly, 2) the contractual stapling restriction, and 3) guidance for when a debt instrument is issued from an SPV that owns a portfolio of equity interests. Revisions from these discussions, as well as other aspects to clarify the definition and an initial issue paper were presented to the Statutory Accounting Principles (E) Working Group on March 2, 2022, with a request for exposure.

9. This issue paper intends to provide information on discussions that occurred when considering the principles-based bond definition and the needed statutory accounting revisions to specify the types of investments that shall be reported on Schedule D-1: Long-Term Bonds.

a. This issue paper, along with the principles-based bond definition, was exposed March 2, 2022, with comments due May 6, 2022. The Working Group heard comments on July 18, 2022, and directed limited edits to be reflected as followed:

i. Revise the guidance related to U.S. Treasury Inflation Protected Securities (TIPs) and to clarify the guidance regarding variable contractual principal and interest payments. These revisions clarified that securities with plain-vanilla inflation adjustment mechanisms are not intended to be captured within the provisions that restrict bond classification due to varying principal or interest payments, as well as clarified that other variances in contractual amounts due to reference variables (and not just equity interests) are intended to be precluded from bond treatment.

ii. Revise guidance describing substantive credit enhancements, particularly to revise reference to the first loss "tranche" as the first loss "position" and clarify that securitization tranches that do not have contractual principal and interest payments along with substantive credit enhancement do not qualify as a Schedule D Bond and shall be reported on Schedule BA. (Tranches without contractual principal and interest payments are considered residual tranches shall be on Schedule BA.)

iii. Document the outcome of small group discussions around the application of the bond principles (particularly the equity-backed example in Appendix I) to feeder fund structures. Feeder fund structures shall not automatically be assumed to qualify for bond classification (even if the ultimate collateral is fixed income), nor be automatically precluded bond classification. The substance of the investment should be the determining factor in these and other similar situations. In particular, the assessment of feeder fund structures should evaluate whether the structure ensures the pass through of the underlying cash flows, or whether uncertainty as to the timing or amount of cash flows is introduced by the structure.

iv. Requested interested parties to work with NAIC staff in proposing revisions to capture examples currently in Appendix I of the bond definition into the main components of the bond definition.

b. In addition to the revisions incorporated from the July 18, 2022, call, the Working Group also heard comments and elected not to incorporate revisions for the following items:

i. The Working Group identified that non-bond items that are specifically scoped in to SSAP No. 26R will not be identified in the bond definition. The Working Group was explicit that the inclusion of an investment in-scope of SSAP No. 26R did not make the investment a "bond" and such a distinction is necessary to prevent scopecreep or inference of other investments into the bond definition. For example, although SVO-Identified Bond ETFs, SVO-Identified CTLs and certificates of deposit that exceed one year are explicit inclusions to SSAP No. 26R and reported on Schedule D-1, these investments are not bonds.

ii. The Working Group did not incorporate industry proposed edits to limit guidance that requires the consideration of all returns to equity-backed ABS. Rather, the Working Group clarified that all investments that have contractual principal and interest that can fluctuate due to a referenced variable shall consider all returns in excess of principal repayment as interest when determining whether the investment qualifies for bond reporting under the principles-based definition.

iii. The Working Group did not agree with comments supporting ABS to be reported as cash equivalents or short-term investments if acquired within those timeframes. To ensure proper assessment under the bond definition, and reporting based on the underlying components of the investments, the Working Group retained the provisions that all ABS shall be captured within SSAP No. 43R and reported on Schedule D-1.

iv. The Working Group did not direct changes to the exposed bond definition or issue paper after considering the industry “Lease Backed Securities Working Group” May 5, 2022, comment letter. That letter, which is consistent with their prior comments, proposes to capture securities as issuer credit obligations if they pass-through cash flows unaltered (such as with certain lease-backed structures) and are supported primarily by a single rated credit payor, though principal repayment is not fully supported by the obligation of that payor. The discussion noted that these securities shall follow the guidance for asset backed securities if they are not fully supported by an underlying contractual obligation of a single operating entity, including the criteria for substantive credit enhancement and meaningful cash flows. The Working Group identified that these structures are not based on the credit worthiness of a single operating entity and rely on the underlying collateral for repayment, which is why they should be considered asset backed securities rather than issuer credit obligations. The comment letter also raised concerns around guidance included for evaluating project finance debt as it is perceived that inconsistent classification may occur for investments with similar characteristics. As a result of the discussion, there were no changes to the exposed bond definition. Working Group members and other interested parties noted during the discussion that the guidance pertaining to project finance is intended to provide guidance for evaluating issuers that share characteristics of both operating entities and ABS Issuers (i.e., the middle of the spectrum). Nevertheless, the guidance is clear that issuers of project finance debt must themselves have the characteristics of operating entities in order to qualify as issuer obligations. As such, project finance bonds issued by operating entities and other municipal revenue bonds will be retained as issuer credit obligations as the design of these structures are supported by the credit worthiness of a single operating entity and are therefore different than the investment structures presented by the industry Lease Backed Securities Working Group.

c. This issue paper, along with the principles-based bond definition, and proposed revisions to *SSAP No. 26R—Bonds* and *SSAP No. 43R—Asset-Backed Securities* was exposed August 10, 2022, with comments due October 7, 2022. Comments were received from Fermat Capital, the industry Lease-Backed Securities Working Group and Interested Parties. After considering the comments, the following key revisions were incorporated:

i. Revisions to incorporate the entire bond definition within SSAP No. 26R, with a deletion of guidance from SSAP No. 43R. Securities that qualify as ABS after application of the bond definition will follow the measurement and reporting guidance within SSAP No. 43R. This edit prevents unintended inconsistencies in the guidance that could occur if aspects of the bond definition are in both SSAPs.

ii. Revisions to incorporate the guidance for determining a creditor relationship, which was in an exhibit, into the body of guidance within SSAP No. 26R.

iii. Revisions to the examples for ABS analysis, which were moved to SSAP No. 26R, to reflect a scenario in which payments under the instrument are secured by a note, a legal assignment from the borrower of a lease for real property and the assignment of the lease payments from an operating entity tenant. This revision was in response to comments from the industry Lease-Backed Security Working Group and detail that the SPV does not need to have ownership interest in the underlying collateral for the security to qualify as an ABS.

iv. Revisions to SSAP No. 26R to clarify that investments with specific guidance and reporting lines (such as surplus notes, working capital finance investments (WCFI) and structured settlements) shall follow the guidance in their specific SSAP and be reported on designated reporting lines. This edit was made in response to the comments from Fermat Capital, who identified that WCFI meet the definition of issuer credit obligations. These investments shall follow the guidance *in SSAP No. 105R—Working Capital Finance Investments* and be reported of their specific reporting lines on Schedule BA.

v. Revisions to SSAP No. 26R, and the addition of a new footnote, to clarify that the general creditworthiness of an entity can be direct or indirect recourse and is the primary source of repayment for issuer credit obligations.

vi. Revisions to SSAP No. 26R to clarify application when interest and principal vary based on the performance of an underlying value or variable. The revised guidance adds language to clarify that the exclusion is not intended to restrict variables that are commonly linked to debt instruments, such as plain-vanilla inflation or benchmark interest rates.

vii. Revisions to SSAP No. 26R to delete the glossary, with the inclusion of the bank loan definition into a footnote. Other definitions were identified as not being necessary for retained inclusion in the statement.

viii. Revisions to SSAP No. 43R to identify Freddie-Mac When Issued Trust Certificates, pursuant to INT 22-01, as an explicit scope inclusion.

ix. Revisions to SSAP No. 43R to clarify the guidance for prospective adjustment method for high-credit quality investments, and on the assessment of cash flows. This guidance clarifies that if a security is in an unrealized loss position, and there is an adverse change in cash flow, the entity shall recognize an other-than-temporary impairment.

x. Revisions to both SSAP No. 26R and SSAP No. 43R to provide specialized transition and disclosure guidance for the reclassification of securities previously reported that will no longer qualify for reporting as bonds.

xi. Revision to the issue paper to clarify the application of the feeder fund guidance.

d. After considering the comments and proposed revisions, on November 16, 2022, the Working Group exposed revisions to SSAP No. 26R and SSAP No. 43R for comment. The Working Group also exposed proposed revisions to other SSAPs that will be impacted with the revisions under the bond project. This includes revisions to detail the short-term and cash equivalent restriction for ABS in SSAP No. 2R as well as guidance for debt securities that do not qualify as bonds in SSAP No. 21R. This guidance was exposed until February 10, 2023. The Working Group considered comments during the 2023 Spring National Meeting and exposed updated guidance, with a comment period ending June 9, 2023, to reflect most of the interested party comments. Most of the edits were minor, but the following elements are specifically noted:

i. Revisions to SSAP No. 26R incorporated an exception for nominal interest rate adjustments. The guidance defines the exception as being too small to be taken into consideration when assessing an investment's substance as a bond. This revision was added based on industry's comments on inadvertent impact to sustainability-linked bonds, but the exception guidance is not limited to those specific bonds.

ii. Revisions clarify that replication (synthetic asset) transactions are addressed in *SSAP No. 86—Derivatives* and are not impacted by the principles-based bond definition.

iii. Revisions to SSAP No. 26R to explicit identity residuals, including first loss positions that lack contractual payments or substantive credit enhancement, do not qualify as bonds and shall be captured in *SSAP No. 21R—Other Admitted Assets*.

iv. Revisions specific to transition that clarify that investment assessments are required as of origination and to permit current or acquisition information in determining whether investments qualify as bonds at the time of transition. Furthermore, the guidance was clarified that the transition guidance shall be applied prospectively beginning with the first year of adoption. For disclosures that provide comparable information, reporting entities shall not restate the prior year's information in the 2025 disclosure.

v. An updated SSAP No. 21R was also exposed to update guidance for the measurement of debt securities at the lower of amortized cost or fair value and to incorporate proposed accounting and reporting guidance for residuals.

e. The Statutory Accounting Principles (E) Working Group received comments on June 9, 2023 from the 2023 Spring National Meeting exposure. No comments were received on SSAP No. 26R, SSAP No. 43R or the document that detailed revisions to other SSAPs. The Working Group adopted the SSAP revisions reflected in these documents on August 13, 2023, during the 2023 Summer National Meeting, effective January 1, 2025.

f. During the 2023 Summer National Meeting, the Working Group considered comments received on SSAP No. 21R on the guidance for debt securities that do not qualify as bonds and for residual interests and exposed a revised SSAP No. 21R. The revisions for debt securities that do not qualify as bonds reflect a majority of interested parties' comments. For debt securities that do not qualify as bonds, the revisions clarify that if the primary source of repayment is derived through underlying collateral, the investment shall only be admitted if the underlying collateral qualifies as admitted invested assets. For residuals, the revisions clarify that if the reporting entity holds a debt tranche from the same securitization, and the debt tranche does not qualify as a bond (either an issuer credit obligation or asset-backed security), and the debt security does not qualify as an admitted asset under SSAP No. 21R, then the residual does not qualify as an admitted asset. In addition, the revisions to SSAP No. 21R included a proposed new measurement method for residuals. This guidance is different from what was proposed by interested parties but intends to reflect the highly uncertain amount and timing of residual cashflows. This proposed guidance will require all cash flows received to be treated as a return of principal / investment until the residual book adjusted carrying value (BACV) is zero. At that point, all cashflows received would be treated as interest income. This proposed guidance intends to best suit how residuals work conceptually. The reporting BACV will reflect the potential risk of loss prior to recovering the initial investment, rather than requiring an assessment of potential loss over the entire life of the securitization. Comments on the proposed measurement method for residual tranches in general, and also for individual types of residuals, were specifically requested.

Discussion of Principles-Based Bond Concepts

10. Pursuant to the "small group" discussions comprised of industry, Iowa representatives and NAIC staff, the broad principle-based bond concepts discussed on August 26, 2021 reflected the following key concepts:

a. Definition of a bond requires a security structure, representing a creditor relationship, that is considered an Issuer Credit Obligation or an Asset Backed Security (ABS).

b. The assessment of whether a security represents a creditor relationship requires consideration of the substance, rather than the legal form of the document, as well as consideration of other investments owned in the investee and other contractual arrangements. A security that possesses equity-like characteristics or that represents an ownership interest in the issuer in substance does not represent a creditor relationship.

c. An ABS is a bond issued by an entity created for the primary purpose of raising debt capital backed by financial assets or cash generating non-financial assets owned by the ABS Issuer, whereby repayment is primarily derived from the cash flows associated with the underlying defined collateral rather than the cash flows of an operating entity.

d. There are two defining characteristics that must be present for a security to meet the definition of an asset backed security: 1) The holder of a debt instrument issued by an ABS issuer is in a different economic position than if the holder owned the ABS Issuer's assets directly, and 2) When the assets owned by the ABS are non-financial assets, the assets are expected to generate a meaningful level of cash flows towards repayment of the bond other than through the sale or refinancing of the non-financial assets.

11. Various discussions and components were addressed in the establishment of these broad concepts. Specific elements and discussion points are detailed within.

Security Structure Representing a Creditor Relationship

12. Similar to long-standing guidance in defining a bond, the principles-based bond concepts only permit security structures to be considered eligible for Schedule D-1 reporting. Although the concepts continue reference to the adopted security definition from U.S. GAAP, the guidance is expanded to require that the evaluation of the structure under the security definition considers the substance of the instrument rather than solely its legal form.

13. The consideration of whether a structure reflects a "security" is a key factor in determining the appropriate SSAP for accounting and reporting. A structure with one or more future payments that qualifies as a security has historically been captured as a bond, with measurement and risk-based capital (RBC)

charges based on the NAIC designation. Under the prior SSAP guidance, bond securities did not require additional provisions for admittance and would likely only be subject to nonadmittance based on state investment limits. This treatment is distinctly different than a "non-security' structure considered to be a loan under SSAP No. *20—Nonadmitted Assets* or *SSAP No. 21—Other Admitted Assets*. For these structures, the ability to admit the loan under the SSAP provisions is contingent on the nature of the loan and qualifying collateral or related party assessments. (State investment limits may have additional loan to value requirements that impact admittance.) Loans (other than mortgage loans) are captured on Schedule BA: Other Long-Term Invested Assets and are likely limited by state investment limits along with other invested assets reported on Schedule BA. Although the RBC charge for admitted collateral loans is lower than other Schedule BA investments, the RBC charge is still higher than Schedule D-1 investments with most NAIC designations.

14. Over time, since the codification of statutory accounting principles, various industry comments have been received questioning the difference between loans and securities (e.g., bonds), particularly with the different reporting outcomes. This discussion was also revisited as part of the principles-based bond proposal, and it was concluded that structures must meet the security definition to be captured on Schedule D-1. Although industry requested "loans with recourse" to be added to the bond scope paragraph as well as an explicit reference to "loans" as a type of investment captured in the bond definition, these proposals were not supported for inclusion. This discussion highlighted that the security definition is not a high threshold to meet, and direct loans should not be reflected as bonds if they do not qualify as securities. With this discussion it was noted that an investment could meet the definition of a bond regardless of the legal form (paper) it was written on and/or how it was described (such as a bond, note, obligation, etc.) Although an instrument could be described as a "loan," if it meets the security definition requirements and other principle concepts, it shall be captured as a bond. The same concept would be true for instruments named as a "bond" but that do not meet the security or other principle requirements, as they would not be permitted for Schedule D-1 reporting.

15. The statutory accounting guidance in SSAP No. 26R and *SSAP No. 37—Mortgage Loans* adopts the U.S. GAAP definition of a security as it is used in FASB Codification Topic 320 and 860:

a. Security: A share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

   i. It is either represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.

   ii. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

   iii. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests or obligations.

16. The "security/non-security" discussion highlighted that the naming convention of an investment (as a "note," "bond," "obligation," "loan," or other such term) does not determine the correct underlying SSAP or reporting location. Non-security structures (other than mortgage loans) shall be captured as collateral or non-collateral loans pursuant to *SSAP No. 20—Nonadmitted Assets* or *SSAP No. 21—Other Admitted Assets* as applicable. To prevent incorrect assumptions that all loans could be captured as issuer credit obligations, the group agreed not to include explicit reference to loan structures within the principles-based bond concepts and instead refer to the substance of the investment structure. Additionally, the following existing guidance was noted as support for this conclusion and to further highlight that the naming convention does not override the structural design of an investment when it comes to reporting or the application of statutory accounting principles.

a. Existing guidance in SSAP No. 21 states that if an instrument meets the definition of a bond, but has supporting collateral, then the investment is not classified as a collateral loan. This concept was affirmed as part of the principles-based bond discussion, noting that such arrangements that qualify for Schedule D-1 shall not be classified as collateral loans regardless of whether there is collateral backing the investment.

b. Guidance in *SSAP No. 25—Affiliates and Other Related Parties* applies to all transactions, regardless of the SSAP that governs the underlying accounting and reporting. As such, the provisions in SSAP No. 25 that require assessment of "loans or advances (including debt, public or private)" is intended to apply to all forms of lending from a reporting entity to a related party. As such, this guidance applies regardless of the naming convention of the agreement (e.g., loan, bond, note, obligation, etc.,). Structures reported on Schedule D-1 that reflect related party transactions shall only be admitted if the requirements in SSAP No. 25 are met. In addition to having a specific due date and written agreements, these requirements include specific assessments based on whether the arrangement is with a parent or principal owner or to other related parties.

17. After determining whether a structure represents a security, the next component for the principle-based bond definition is assessing whether the security represents a creditor relationship. Although the reference to a "creditor relationship" may seem very similar to prior guidance in SSAP No. 26R, that prior guidance did not explicitly detail the intended meaning of a "creditor relationship" but simply identified that such structures have a fixed schedule for one or more future payments. This prior guidance resulted with interpretations that structures qualified as "bonds" strictly on legal form. With the focus of the principles-based definition, it is explicit that the assessment of a whether a security represents a creditor relationship requires consideration of the substance, rather just the legal form, along with consideration of other investments owned in the investee and other contractual arrangements.

18. Original regulator concerns with the current guidance and reporting were in part due to the identification of investments with underlying equity interests that were structured to resemble bond instruments. This discussion identified that there is a significant incentive for insurers to characterize equity exposures, which would traditionally be captured on Schedule BA, as bonds due to the favorable capital treatment. Transferring or acquiring them as debt issued by an SPV (such as through a collateralized fund obligation (CFO) type structure) is a mechanism to reclassify these equity instruments and characterize them as bonds. The lack of current safeguards in existing SSAPs also provides significant opportunity for these reclassifications.

19. Equity investments differ from other types of financial assets in that they generally do not have contractual payments. Distributions are typically at the discretion of whichever decision maker has control of the entity. However, certain types of entities have greater likelihood and predictability of cash flows than others. For example, private equity and debt funds are often designed to have finite lives that begin with a capital raising and investment phase, and once the portfolio is built and seasoned, investments are monetized, returns realized, and distributed to investors. Therefore, while there can be variability in timing and amounts of cash flows, distributions can be expected with some level of predictability compared to other types of equity investments (e.g., publicly traded companies). Private debt funds are more predictable still given that the underlying investments of the fund have contractual cash flows. If a large, diversified pool of such types of seasoned funds are securitized, referred to as a CFO, there can be a level of predictable cash flows that is suited to support a bond, when coupled with the overcollateralization, liquidity facilities, and other protections that are built into the structure.

20. A regulator concern arises when features that facilitate the production of predictable cash flows are not present. In such a case, when there are not predictable cash flows equipped to service the debt, repayment may rely on sale or refinancing of the underlying equity investments at maturity in order to satisfy the debt. In that case, equity valuation risk may be the primary risk for the non-payment of the SPV-

issued debt. If repayment predominantly relies on a point-in-time equity valuation (such as at maturity), then the substance of the risk is not consistent with what is expected of a bond on Schedule D-1.

21. Although the full disallowance of equity-backed debt would prevent these concerns, there is a position that there are CFO securitizations (or other investments) of well-diversified, seasoned funds for which there is compelling evidence that there will be sufficient cash distributions to amortize the debt and structure protections that minimize the residual equity exposure. The approach to allow such CFO securitizations/investments only works when there are appropriate safeguarding principles established, which require a relatively high standard of proof.

22. An investment for which the primary risk for non-payment is equity devaluation is not consistent with the substance-intent for what is expected to be on Schedule D-1 under the principles-based definition. Allowing these items to be reported on Schedule D-1 could result with the regulatory arbitrage that regulators are concerned about without any real mitigants. This could ultimately result in a situation where industry has taken on significantly more equity risk that they have historically, all while characterizing the investment as a bond exposure. As such, it was noted as critical that appropriate safeguards be incorporated to address this concern, which is why the small group supported a rebuttable presumption that equity-backed ABS do not qualify to be reported on Schedule D-1 unless a documented analysis supporting the predictability of cash flows is completed to overcome that presumption.

23. The principles-based definition is clear that a security that possesses equity-like characteristics or that represents an ownership interest in the issuer in substance does not represent a creditor relationship. Examples of equity investments, equity holdings and equity-like interests include any security ultimately reflecting an ownership or membership interest in an entity (such as common stock, preferred stock, private equity holdings, investments in joint ventures, partnerships, and LLCs) as well as any structure that reflects the performance of an entity (such as dividends or capital gains). Furthermore, examples of equity instruments also include any debt instrument where the risk/reward profile is substantially similar to an equity interest.

24. With the prohibition of equity-like structures or items that represent ownership interests, there is a rebuttable presumption that debt instruments collateralized by equity interests do not qualify as bonds because they do not reflect a creditor relationship in substance. Notwithstanding this rebuttable presumption, it is possible for such a debt instrument to represent a creditor relationship if the characteristics of the underlying equity interests lend themselves to the production of predictable cash flows and the underlying equity risks have been sufficiently redistributed through the capital structure of the issuer.

25. With the establishment of the principles-based bond definition, this rebuttable presumption was specifically discussed, and it was concluded that the determination of whether debt instruments collateralized by equity interests qualify as bonds inherently requires significant judgment and analysis. Unlike debt instruments collateralized with contractual cash flows, or debt instruments collateralized by cash-generating non-financial assets, debt instruments collateralized by equity interests may be dependent on cash flow distributions that are not contractually required to be made and/or may not be controlled by the issuer of the debt. In some instances, sale or refinancing of the underlying equity interests may be the only means of generating cash flows to service the debt instruments. If this is the situation, then it is expected that compensating factors from other characteristics will be present to qualify. For example, if the source of cash flows is driven from the sale or refinancing, then an appropriate, compensating level of overcollateralization would be required to overcome the presumption that the structure does not qualify as a bond.

26. For debt instruments that are collateralized by equity interests, various factors should be considered in determining whether debt collateralized by equity interests qualify as bonds. Additionally, to overcome the presumption that the structure does not qualify as a bond, it is presumed that reporting entities will have sufficient documentation supporting this conclusion. Factors to consider include, but are not limited to, the following:

a. Number and diversification of the underlying equity interests

b. Characteristics of the equity interests

c. Liquidity facilities

d. Overcollateralization

e. Waiting period for the distributions / paydowns to begin

f. Capitalization of interest

g. Covenants (e.g., loan-to-value trigger provisions)

h. Reliance on ongoing sponsor commitments

i. Source(s) of expected cash flows to service the debt (i.e., dividend distributions from the underlying collateral vs. sale of the underlying collateral)

27. The assessment of equity backed securities should be looked at, not only in form, but in substance. For example, a common arrangement exists where debt is issued from a feeder fund, and the feeder fund has an equity interest in another fund which predominantly holds debt instruments. The fund passes those fixed income cash flows through the structure to the ultimate feeder fund debt holder(s), in a way that produces substantially the same risk profile to the debt holders as a collateralized loan obligation (CLO). Accordingly, such an arrangement may have its substance aligned with a debt investment rather than a single equity investment, despite the direct holding being a fund investment. This conclusion would be supported if the terms of the structure ensure that underlying fixed income cash flows are passed through. Factors that add additional uncertainty as to the timing and/or amount of the pass through of the cash flows from the underlying debt instruments may call into question a conclusion that a feeder fund structure is a debt-backed structure in substance. For example, discretion of an underlying fund manager to withhold distribution of the underlying cash flows passed through from underlying debt instruments may create uncertainties as to the timing and/or amount of cash flows in such a manner that is more characteristic of an equity investment. Likewise, a feeder fund structure that is not expected to provide for regular cash interest payments would also call into question the substance as a debt-backed investment. Note, features that are customary to CLOs and other asset backed securities would not ordinarily call the investment's substance into question on its own. For example, a waterfall structure dictating the pass-through and order of payments or retaining sufficient funds for covering contractual underlying fund level payments (e.g., investment management fees, legal costs, and other customary fund level expenses) are common to CLOs and other ABS, as are customary payment in kind (PIK) features designed to address temporary liquidity issues where the PIK then gets prioritized in the waterfall structure. These customary features do not constitute manager discretion that would call into question a conclusion that a feeder fund structure is a debt-backed structure in substance.

28. Conversely, if the feeder fund debt ultimately relies on equity interests for repayment (the final fund holds equity interests that generate the pass-through cash flows), the held debt instrument from the feeder fund would have to meet the requirements of paragraph 26 while looking at the substance of equity interests supporting the debt. Regardless of the underlying collateral, feeder fund arrangements would have to meet the other relevant parts of the standard (e.g., have a substantive credit enhancement, etc.) to qualify for bond reporting. Investments that resemble feeder fund structures will require entity review to determine the underlying source of cash flows and identify the uncertainties or vulnerabilities that could impact the cash flows that will be passed through to the reporting entity holder. Ultimately, the conclusion that a structure represents a feeder fund shall not automatically qualify the structure for bond classification but shall not

automatically preclude bond classification. Substance over form should be the determining factor in these and similar situations.

Determination of Issuer Credit Obligation or Asset Backed Security (ABS)

29. Security structures that qualify as creditor relationship are divided between issuer credit obligations and ABS. The initial distinction between an issuer credit obligation and an ABS is a key factor with the principle-based bond concepts. Given their differing characteristics, investments that qualify as issuer credit obligations are not required to complete assessments for qualifying credit enhancements or meaningful cash flow generation. As such, it is critical to ensure that structures which should be considered ABS or that reflect non-qualifying Schedule D-1 structures, are not classified as issuer obligations to avoid those detailed assessments.

30. Determining whether an investment reflects an issuer credit obligation or an ABS focuses on the issuer and the primary source of repayment of the instrument. An issuer credit obligation represents a bond structure where the repayment is supported primarily[1] by the general creditworthiness of an operating entity or entities. The support for this structure consists of direct or indirect recourse to an operating entity or entities. An "operating entity" can be any sort of business entity, not-for-profit organization, or other provider of goods or services, but cannot be a natural person or an Asset Backed Security (ABS) issuer. An ABS is a bond issued by an entity (an ABS Issuer) created for the primary purpose of raising debt capital backed by financial assets or cash generating non-financial assets owed by the ABS Issuer, whereby repayment is primarily derived from the cash flows associated with the underlying defined collateral rather than the cash flows of an operating entity.

31. The prior assessments to divide structures between SSAP No. 26R and SSAP No. 43R seemed to focus primarily on legal form (issued by trust/SPV that held pledged assets) or on the basis of prepayment risk within the structure (meaning, that the expected timing of cash flows may vary, impacting the effective interest rate). Under the principle-based bond definition, neither of these components shall be used as a determinant in concluding whether a structure represents an issuer credit obligation or an ABS.

a. The prior guidance which focused on the use of an SPV relied more on legal form than the substance of the transaction. Although it is common that many ABS Issuers are in the form of a trust or SPV, the presence or lack of a trust or SPV is not a definitive criterion in determining that a security meets the definition of a Schedule D-1 investment, or that it is limited to a classification as an ABS. A key component of the principles-based bond definition is that it will not be possible to recognize a non-qualifying investment as a bond simply by moving it to a debt-issuing SPV to resemble a creditor relationship with a future payment obligation. Furthermore, the guidance does not preclude the use of SPVs in issuer credit obligations. Such structures are commonly utilized in project finance arrangements to separate business operations that support specific debt instruments, or to facilitate efficient marketing of an issuer credit obligation (e.g. funding agreement backed notes). Although packaging investments together in an SPV, with an SPV-issued note may currently result with better RBC charges, such structures that simply reflect a pass-through of cash flows or performance from the underlying collateral and provide no economic

[1] To clarify the phrase "supported primarily by the general creditworthiness of an operating entity," this means that the full repayment is expected to come from cash flows generated by the operating entity, not from collateral, although secondary recourse to collateral may be present. If it is expected that a majority of repayment will come from operating entity cash flows, but it is expected that some cash flows will come from collateral, this investment does not qualify as an issuer credit obligation and shall be assessed as an asset-backed security. The expectation must be that full repayment will be generated from operating entity cash flows. For asset-backed securities, the expectation is that the source of cash flows will come from collateral, even though there may be secondary recourse to an operating entity.

difference than if holding the underlying collateral items directly should not be characterized as bonds.

b. With regards to the prior interpretation that SSAP classification was based on the presence of prepayment risk, which was not an interpretation based on any explicit guidance to that effect, the presence or absence of prepayment risk will continue to play no role in SSAP classification. Classification is based on whether the investment has the substance of an issuer obligation or asset backed security. This distinction aligns the accounting and measurement with the characteristics of the bond. As asset backed securities rely on the cash flows of underlying collateral, the measurement method described in SSAP No. 43R, which requires a quarterly review of underlying cash flow assumptions, is appropriate regardless of whether variations in timing of cash flows impact the effective yield. This methodology captures variations in **both** timing and **amount** of the underlying cash flows.

32. Whether an issuer of debt represents an operating entity or ABS Issuer is expected to be clear in most instances, but certain instances may be less clear. Ultimately, for an issuer credit obligation, it comes down to whether support for repayment consists of direct or indirect recourse to an operating entity or entities. In addition to "traditional bond" structures previously included in SSAP No. 26R, examples of issuer credit obligations include:

a. Investments in the form of securities for which repayment is fully supported by an underlying contractual obligation of a single operating entity. (e.g., CTLs, ETCs, other lease backed securities, Funding Agreement Backed Notes (FABNs), etc.). For purposes of applying this principle concept, repayment is fully-supported by the underlying operating entity obligation if it provides cash flows for the repayment of all interest and at least 95% of the principal of the security.

b. Bonds issued by real estate investment trusts (REITS) or similar property trusts.

c. Bonds issued by business development corporations, closed-end funds or similar operating entities, in each case registered under the 1940 Act. With this inclusion, it is important to highlight that the intent is specific to bonds issued from SEC-registered entities. The reference to "similar entities" is not intended to capture items issued from collateralized fund obligations (CFOs) or other such structures. Although some may consider CFOs to be similar to closed-end funds, that assessment is not supported for classification as an issuer credit obligation. Instruments considered to reflect CFOs (and other like structures) are required to be assessed as asset-backed securities for inclusion on Schedule D-1.

d. Project finance debt issued by operating entities. These investments reflect financing of a single asset or "operation" (such as a toll road or power generation facility) that collateralizes a debt issuance and the cash flows produced by the asset/operation service the debt, where the issuer may also represent an operating entity. These designs have characteristics of both issuer credit operations, as the operation constitutes a stand-alone business, as well as characteristics of ABS, as they are formed for the purpose of raising debt capital backed by the cash flows from collateral held by a bankruptcy-remote entity. When viewed holistically, these issuing entities are typically used to facilitate the financing of an operating component of a project sponsor or municipality. Although the use of a bankruptcy-remote entity (e.g., SPV) facilitates the efficient raising of debt as a source of financing, the primary purpose is to finance an operating project. Therefore, when the issuing entity represents a stand-alone business producing its own operating revenues and expenses, where the primary purpose is to finance an operating project, the issuing entity shall be considered an operating entity despite certain characteristics that resemble ABS issuances.

i. It is important to highlight that the guidance for project finance is strictly for instruments issued by operating entities, similar to other instruments that qualify as issuer credit obligations under the principles-based bond definition. Consistent with other concepts, the naming convention (e.g., referring to an instrument as project finance) or the presence or absence of an SPV/trust structure are not definitive components in determining whether an investment qualifies for reporting on Schedule D-1, or is classified as an issuer credit obligation or ABS. Instruments (even if identified as "project finance") that do not qualify as issuer credit obligations as they not issued by operating entities, shall be assessed for qualification for reporting on Schedule D-1 as ABS. If the instruments do not qualify for reporting as ABS, they shall not be reported on Schedule D-1.

e. U.S. Treasury Inflation-Protected Securities (TIPs): The inclusion of U.S. TIPs specifically as an issuer credit obligation intends to highlight a specific exception to the determination as a creditor relationship as the variation is due to plain-vanilla inflation adjustment mechanisms. Although U.S. TIPs are specific as issuer credit obligations, Under the bond definition encompassing both issuer credit obligations and asset-backed securities, in order for a debt instrument to represent a creditor relationship, it must have pre-determined principal and interest payments (whether fixed interest or variable interest) with contractual amounts that do not vary based on the appreciation or depreciation (e.g., performance) of any underlying collateral value or other non-debt variable[2]. For example, an issued security that has varying principal and interest payments based on the appreciation of referenced equity, real estate or other non-debt variables are precluded from bond treatment as they do not reflect creditor relationships. Although US TIPS are indexed to the consumer price index and grows with inflation, these securities shall be captured as issuer credit obligations on Schedule D-1.

33. This Schedule D-1 project is not expected to reconsider certain investments previously considered by the Working Group and explicitly permitted for Schedule D-1 reporting. As such, unless subsequently addressed within this project, the following investment types are expected to continue to qualify as Schedule D-1 investments and be classified as issuer credit obligations. (By including these investments as issuer credit obligations, these investments are not subject to the assessments of sufficiency or meaningful cash flow generation required for ABS securities.)

a. Certificates of deposit that have a fixed schedule of payments and a maturity date in excess of one year from the date of acquisition.

b. Bank loans that are obligations of operating entities, issued directly by a reporting entity or acquired through a participation, syndication or assignment.

[2] The principles-based bond definition requiring pre-determined principal and interest payments with contractual payments that do not vary based on the performance of an underlying collateral value or other non-debt variable does not intend to encompass nominal interest rate adjustments. Nominal interest rate adjustments are those that are too small to be taken into consideration when assessing the investment's substance as a bond. Nominal adjustments are not typically influential factors in an investors' evaluation of investment return and are often included to incentivize certain behavior of the issuer. An example would include sustainability-linked bonds where failure to achieve performance metrics could cause interest rate adjustments. In general, interest rate adjustments that adjust the total return from interest by more than 10% (e.g., >0.4% for a 4% yielding bond), would not be considered nominal. Further, any such adjustments that cause an investment to meet the definition of a structured note would not be considered nominal.

c. Debt instruments in a certified capital company (CAPCO).

d. SVO-Identified Bond ETFs.

34. The investment structures explicitly permitted for Schedule D-1 reporting no longer includes a generic reference to "hybrid securities". Under prior guidance in SSAP No. 26R, hybrid securities, defined in the Annual Statement Instructions as securities with characteristics of both debt and equity securities, were included and captured on a specific Schedule D-1 reporting line. Examples in the Annual Statement Instructions included Trust Preferred Securities and Yankee Tier 1 bonds, however, both types of securities are no longer overly prevalent, although some insurers may continue to have them in their portfolios. Pursuant to the intent of the principle-based bond proposal, a broad exception for securities that have characteristics of both debt and equity is not viable. Rather, to ensure that securities are classified and reported based on the substance of the investments, securities with characteristics of both debt and equity shall be assessed for inclusion on Schedule D-1 in accordance with the principal-based bond definition. If the securities qualify as issuer credit obligations or ABS, then they can be reported on Schedule D-1.

a. Trust Preferred Securities – With these securities, there is a trust funded by debt where shares of the trust are then sold to investors in the form of preferred stock. The shares held are referred to as "trust preferred" securities. These securities have characteristics of both stock and debt. While the trust is funded with debt, the shares are considered to be preferred stocks and pay dividends like preferred stock. However, since the trust holds the bank's debt as the funding vehicle, the payments received by investors are considered interest payments. These securities are considered equities under U.S. GAAP, but are taxed as debt obligations by the IRS. With the Dodd-Frank reforms, the incentives for banks to issue trust-preferred securities decreased, resulting with a significant reduction in the issuance of these securities. If these securities continue to be held by insurers, they should be assessed for reporting on Schedule D-1 under the principal-based bond proposal. If these securities do not qualify for Schedule D-1, presumably, these securities would be reported as preferred stock on Schedule D-2-1.

b. Yankee Bond – A Yankee bond is one issued by a foreign bank or company but that is traded in the U.S and priced in U.S. dollars. Yankee bonds are normally issued in tranches, with a large debt structure financing arrangement, with each tranche having different levels of risk, interest rates and maturities. The non-U.S. issuers have to register Yankee bonds with the SEC before offering the bond for sale. If these securities are held by insurers, they should be assessed for reporting on Schedule D-1 under the principal-based bond proposal.

c. Other Hybrid Securities – From information received, it was noted that some reporting entities have previously reported securities on Schedule D-1 as hybrids due to a code in Bloomberg that identified the security as having characteristics of both debt and equity. Such securities shall be reviewed in accordance with the principles-based bond definition and reported on Schedule D-1 only if they qualify.

35. For securities that represent principal-protected securities and structured notes that have been previously captured within SSAP No. 26R or SSAP No. 43R, the principles-based bond definition will no longer permit these security structures to be reported on Schedule D-1. Fundamentally, these structures have the potential for variable principal or interest / returns, or both, due to appreciation or depreciation (i.e., performance) of an underlying collateral value or other non-debt variable. This structural characteristic precludes these investments from being captured as issuer credit obligations or ABS as the investment does

not represent a creditor relationship in substance. It should be clear that the principles-based bond definition is intended to require a structural assessment inclusive of all investment components, therefore it is not permissible to segregate components within a structure, such as bond collateral supporting principal and interest payments to determine Schedule D-1 reporting when the structure also includes other collateral with the potential to generate additional interest or returns. Such structures must be viewed wholistically within the principles-based bond definition, with all potential returns considered in determining whether the structure qualifies as a creditor relationship.

a. A principal-protected security is defined in *the Purposes and Procedures Manual of the NAIC Investment Analysis Office*, but generally includes a high-quality traditional bond (such as a U.S. Treasury) that is used to safeguard principal repayment at the structure's maturity, has along with performance components where payments originate from, or are determined by, non-fixed income securities. These returns, often based on underlying equity factors, prevents these structures from qualifying as a creditor relationship. In addition to the traditional design of principal-protected notes, other designs have been identified that may provide "interest" payments in the form of tax-credits based on underlying equity exposures. (So, a high-quality bond still safeguards principal returns, but the structure acquires equity elements that provide tax credits to the note holder as a form of interest.) Although the classification of a creditor-relationship may not be as clear in this example, such designs would further be disqualified from Schedule D-1 reporting as they would not qualify as issuer credit obligations due to the different forms of collateral within the structure (considering both the bond and equity items) and such structures would not qualify as ABS as there is generally no credit enhancement. These investments shall follow the guidance for non-bond securities in *SSAP No. 21—Other Admitted Assets*.

b. A structured note is a security that otherwise meets the definition of a bond, but for which the contractual amount of the instrument to be paid at maturity (or the original investment) is at risk for other than failure of the borrower to pay the principal amount due. These instruments, although in the form of a debt instrument, incorporate the risk of an underlying variable in the terms of the agreement, and the issuer obligation to return the full principal is contingent on the performance of the underlying variable. These investments are addressed in *SSAP No. 86—Derivatives.* Mortgage-referenced securities issued by a government sponsored enterprise are explicit inclusions in scope of SSAP No. 43R. Foreign-denominated bonds subject to variation as a result of foreign current fluctuations are not structured notes.

36. The guidance in the principles-based bond proposal requires "assessment at origination" in determining whether a security complies for Schedule D-1 reporting. This provision intends to reflect the reporting entity's understanding of the intent and ultimate structure of the security at origination, not simply what a structure holds on the day of origination. It is not permissible to conclude that a principal-protected security is an issuer credit obligation at origination (when the structure includes only a US Treasury and cash) and disregard the intended use of the cash in the structure to subsequently acquire other investments to generate additional returns. The determination of whether an investment qualifies as a creditor-relationship, and then as an issuer creditor obligation or ABS (as applicable) requires an assessment of the full structure as it is ultimately intended by the reporting entity at the time of acquisition.

37. Consistent with prior guidance in SSAP No. 26R, mortgage loans and other real estate lending activities, which are not securities, made in the ordinary course of business are excluded from Schedule D-

1. Those investments shall follow the application statutory accounting guidance in *SSAP No. 37—Mortgage Loans* and *SSAP No. 39—Reverse Mortgages*.

Asset Backed Securities and Required Components

38. An Asset Backed Security (ABS) is a bond issued by an entity (an ABS Issuer) created for the primary purpose of raising debt capital backed by financial assets or cash generating non-financial assets owed by the ABS issuer, whereby repayment is primarily derived from the cash flows associated with the underlying defined collateral rather than the cash flows of an operating entity. In most instances, the ABS issuer is not expected to continue functioning beyond the final maturity of the debt initially raised by the ABS Issuer. As previously noted, ABS Issuers are often in the form of a trust or special purpose vehicle, though the presence or lack of a trust or special purpose vehicle is not a definitive criterion for determining that a security meets the definition of an asset backed security.

39. To qualify on Schedule D-1 as an ABS, there are two defining characteristics that must be present. If the structure is a not an issuer credit obligation or identified for specific inclusion on Schedule D-1, and does not meet these ABS requirements, the instrument is not permitted to be reported as a bond. Assessment on these aspects is investment specific, with determination at origination by the reporting entity based on the overall intent and ultimate expected holdings of the structure:

a. Substantive Credit Enhancement: The holder of the debt obligation issued by the ABS Issuer is in a different economic position than if the holder owned the ABS Issuer's assets directly.

b. Collateral Assets: The assets owed by the ABS issuer are either financial assets or cash-generating non-financial assets. Cash-generating non-financial assets are defined as assets that are expected to generate a meaningful source of cash flows for repayment of the bond through use, licensing leasing, servicing or management fees, or other similar cash flow generation. other than through the sale or refinancing of the assets.

40. Substantive Credit Enhancement: The component for substantive credit enhancement is required for all ABS structures. There are no practical expedients or thresholds that can be applied in determining whether a structure reflects substantive credit enhancement. Although certain structures may only require a limited analysis (such as agency-backed MBS), and insurers may benefit from prior analysis when acquiring similar subsequent structures, an automatic assessment is not permitted for this requirement.

41. To qualify as an ABS, the holder of the debt obligation is required to be in a different economic position than if the holder owned the ABS issuer's assets directly. For purposes of this assessment, the holder of the instrument is considered to be in a different economic position if the instrument benefits from substantive credit enhancement through guarantees (or other similar forms of recourse), subordination and/or overcollateralization. This element is required for all ABS designs, regardless of the collateral that is backing the ABS.

42. The requirement for substantive credit enhancement is intended to address investment designs crafted to appear as a debt / bond structure for reporting and RBC purposes, but for which the holder does not have a "more than nominal" change to the risk or reward profile than if they held the underlying investment directly. This guidance prevents using a specifically designed legal form (such as transferring assets to an SPV and acquiring an SPV-issued note), but which lacks any economic substance, to obtain favorable measurement and RBC impact or to avoid nonadmittance that would occur if the assets were directly held by the reporting entity.

43. The intent of the "substantive" threshold requiring the holder to be in a different economic position is to distinguish qualifying bonds from instruments with equity-like characteristics or where the substance of the transaction is more closely aligned with that of the underlying collateral. To qualify as a bond under this standard, there is a requirement that there are substantive credit enhancements within the structure that absorb losses before the debt instrument being evaluated would be expected to absorb losses. This is inherent in the context of an Issuer Credit Obligation as the owners of the equity in the operating entity are the first to absorb any variability in performance of the operating entity. The same concept applies to asset-backed securities. If substantive credit enhancement did not exist, the substance of the investment would be more closely aligned with that of the underlying collateral than that of a bond. Credit enhancement that is merely nominal or lacks economic substance does not put a holder in a different economic position.

44. The original exposure (May 2021) detailed this ABS requirement as a "sufficient" credit enhancement and detailed the provision as the level of credit enhancement a market participant (i.e., reasonable investor) would conclude is expected to absorb losses (or decreases in cash flows) to the same degree as other debt instruments of similar quality, under a range of stress scenarios (i.e., scenarios are similar to stress scenarios performed for other debt instruments of the same quality). This original proposal noted that losses are those a market participant would estimate with consideration of historical losses (including loss recoveries) on similar collateral, current market conditions, reasonable and supportable forecasts, and prepayment assumptions associated with the collateral. Excluded from the estimate of expected losses are historical gains on similar collateral and expected market appreciation on the collateral. After further discussion of this concept, it was identified that the term sufficient and its proposed definition implies a quantitative assessment of credit quality is required. As a result, the proposed concept could be interpreted to mean that a reperformance of the credit underwriting process would be needed to support accounting classification, which is not the intent and could be seen to violate the policy that credit ratings not determine accounting classification, as well as introduce an administrative reporting burden that is both duplicative and lacking any added value. Further, a misinterpretation could occur that would permit satisfaction of this component if a credit rating or NAIC designation was obtained. The intent of the concept is not to address credit quality. Rather, the intent is to require that there must be economic substance to support the transformation of the underlying collateral risk, to bond risk. As a result of these discussions, revisions were incorporated to revise the terminology and related definition to reflect a "substantive credit enhancement." In addition to eliminating a perception that reporting entities could use credit ratings to support this distinction, this guidance incorporates principle concepts to ensure that the provision cannot be satisfied with structural elements that are merely nominal or lack economic substance.

45. Substantive credit enhancement can come in various forms, including but not limited to, subordination/overcollateralization, guarantees, or other forms of recourse. In whatever form the credit enhancement comes in, it must be of a level of significance that the holder of the debt instrument is in a substantively different position than owning the underlying collateral directly. Evaluation of whether a credit enhancement has substance may involve an evaluation of the level of overcollateralization (LTV) or the capacity of whatever form of subordination, guarantee or recourse to absorb collateral losses. As noted, the guidance intends to be specific that an NAIC designation, obtained from either the NAIC Securities Valuation Office (SVO) or from a Credit Rating Provider (CRP) does not provide standalone evidence to support a conclusion that the structure includes a substantive credit enhancement. Although the presence of independent market validation may provide evidence supporting the substance of a credit enhancement, that provision shall not be interpreted to indicate that the presence of an NRSRO rating is automatic validation that the substantive threshold has been met.

46. The following elements were specifically discussed with regards to the requirement for a substantive credit enhancement:

a. Agency-Backed Pass-Through Structures (e.g., RMBS/CMBS): These structures, when they have an agency guarantee, are expected to meet the substantive credit enhancement requirement with little analysis. Although the reporting entity participates on a proportional basis in the cash flows from the underlying mortgage loans held by the SPV, the reporting entity is in a different economic position than if it owned the underlying mortgages directly because the credit risk has been redistributed and assumed by the agencies.

b. Non-Agency Backed Pass-Through Structures: Unlike the above agency-backed example, a pass-through MBS without a credit enhancement, if one were to exist, would not put the holder in a different economic position as owning the mortgage loans directly as they would participate proportionally in the first dollar of losses on the underlying loans. Pursuant to the intent of the overall Schedule D-1 project and required substantive credit enhancement, the guidance does not permit use of an SPV to recharacterize an asset to qualify for Schedule D-1 reporting if the holder is in the same economic position as holding the underlying investments directly. This would apply to any type of underlying asset. In contrast, if the holder of the debt instrument held a senior interest in the pool of loans, through existence of a subordinated tranche for example, the holder may conclude that it is in a different economic position, provided the subordination is determined to be substantive.

c. Loan-To-Value (LTV) Assessments: An assessment of LTV at origination may provide evidence of substantive credit enhancement through overcollateralization. The review should be a holistic assessment, evaluating the expected LTV over the life of the transaction, in conjunction with the liquidity and market value volatility of the underlying collateral, particularly in points in time when the underlying equipment is expected to be off-lease or at the time of maturity if refinancing or sale is required. It is appropriate to consider any expected economic depreciation, but it is not appropriate to factor in any expected economic appreciation. Although an expected decline in the LTV ratio may support the presence of a credit enhancement, a declining LTV is not required, and an increasing LTV is not prohibited, as long as the structure continues to provide a substantive credit enhancement. An expected high LTV at maturity, relative to the market value volatility of the underlying collateral, is considered to lack substantive overcollateralization and would require other forms of credit enhancement in order to meet the substantive credit enhancement criteria.

d. The first loss position may be issued as part of the securitization in the form of debt or equity interest, or it may be retained by the sponsor and not be issued as part of the securitization. The holder of the loss position, or whether it is issued as a tranche or retained by the issuer, does not impact the determination of whether the loss position provides substantive credit enhancement. Rather, the assessment focuses on whether the holder of the debt instrument is in a substantively different position than owning the underlying collateral directly. This assessment include consideration on the first loss position (or more senior positions, if the first loss position is not sufficient) regardless of the holder of the loss positions. If the first loss position (or a more senior position(s), if the first loss position(s) lacks contractual payments along with a substantive credit enhancement) is issued as part of the securitization and does not have contractual principal and interest payments along with substantive credit enhancement and is held by a reporting entity, the investment(s) does not qualify for reporting as a bond and shall be reported on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value consistent with the treatment for residuals. (These items are further addressed in ~~should be reported as a non-bond security pursuant to~~ *SSAP No. 21R—Other Admitted Assets*.)

47. Meaningful Level of Cash Flows to Service Debt: The element for meaningful cash flow generation is only a requirement for ABS that are backed by non-financial assets. ABS designs backed by financial assets, when there is no future performance obligation outside of default risk that could impact the ability to generate cash flows to service the debt, are not required to be assessed under the meaningful cash flow requirement.

48. To qualify as an ABS, there must be a meaningful level of cash flows generated from non-financial assets backing an ABS to service the debt, other than through the sale or refinancing of the assets. The evaluation is specific to each transaction and should consider the market volatility and remarketing potential of the underlying collateral, the variability of the cash flows produced, as well as the diversification of the source of cash flows within the structure. The main intent of this guidance is to ensure that non-financial assets supporting structures reported as bonds on Schedule D-1 encompass a level of "cash generation" that is conducive to servicing traditional bond-like cash flows.

49. Consistent with the substance theme of the principles-based bond proposal, this guidance intends to prohibit situations in which the legal form of an investment is utilized to receive favorable accounting and reporting treatment, while the primary non-payment risk is the point-in-time valuation of an underlying asset. The prior guidance in SSAP No. 43R that focused on placing collateral assets in trust, with the SPV issuing a debt instrument, enabled situations in which non-cash generating structures could be reported as bonds on Schedule D-1. As a simple example, this guidance prevents artwork from being captured as the collateral backing a debt instrument issued by an SPV, with the reporting entity then reporting the SPV-issued note as a bond investment that reflects the expected future value that will be received upon the ultimate sale of the artwork.

50. The guidance requires meaningful cash generation to satisfy the debt instrument throughout the duration of the debt term. The timing of the cash generation, at points prior to maturity of the investment, is a key element as it intends to specifically exclude transactions in which the underlying assets must be sold or refinanced at maturity to produce cash to meet the meaningful requirement. However, this restriction is not intended to automatically exclude all structures that may incorporate collateral asset sales or refinancing throughout the debt duration as part of the expected cash generation. An example could be the securitization of short-term rental car receivables. Such a design could encompass both the rental car lease payments as well as periodic sales of the rental cars as the means to generate meaningful cash flows to service the debt. This design, with planned periodic sales of the non-financial collateral assets over the debt term, is distinctly different than a structure in which cash flows are not meaningfully generated over the course of the debt term and would rely predominantly on the sale or refinancing of the underlying collateral at maturity to satisfy the debt obligation. This restriction also does not exclude all structures that have any amount of sales or refinancing at the end of the debt term. Such investments can qualify for Schedule D-1 reporting if they meet the meaningful cash generation criteria throughout the term of the instrument other than through the sale/refinancing at maturity.

51. The assessment of meaningful cash flows may require detailed evaluations as it is not permissible to conclude that the presence of any cash flows generated within the structure will result with the investment reaching the "meaningful" threshold. It is also not expected to commonly see asset-backed securities that include both financial and non-financial collateral. Such designs shall be reviewed to determine that the structure is in line with the principle intent of the bond definition and has not been developed to circumvent separate assessment or reporting of non-financial asset components. As a simplistic example, including mortgage-backed securities and artwork in a single structure, and identifying that the cash flows of the MBS satisfies the meaningful threshold, with the artwork representing a minimal residual element, so that the full structure qualifies for Schedule D-1 reporting is not reflective of the intent of the principles-based standard. If there are instances in which financial asset and non-financial asset collateral are combined in a single asset-backed structure, consideration should occur on the intent of commingling these collateral elements pursuant to the intent of the principles-based bond definition and in assessing the meaningful cash flow requirements. Structures identified that have been developed to circumvent the provisions of the principle-based bond definition are not permitted to be reported on Schedule D-1 and shall be reported on Schedule BA at the lower of amortized cost or fair value.

52. The assessment of meaningful cash flows is specific to each transaction, determined at origination, and should consider various factors collectively in determining if the meaningful threshold is met. For this assessment, it is noted that an increase in price volatility or variability of cash flows requires a greater percentage of cash flows generated to service the debt from sources other than the sale or refinancing of the

underlying collateral. On the flip side, as liquidity, diversification or overcollateralization increase, the required percentage of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral is permitted to decrease. The following factors should be considered with the assessment of meaningful cash flows:

a. Price volatility in the principal market in the underlying collateral.

b. Liquidity in the principal market for the underlying collateral.

c. Diversification characteristics of the underlying collateral (i.e., types of collateral, geographic locations, sources of cash flows within the structure, etc.,)

d. Overcollateralization of the underlying collateral relative to the debt obligation.

e. Variability of cash flows, from sources other than sale or refinancing, expected to be generated from the underlying collateral.

53. The assessment of meaningful cash flows does permit a practical expedient under the principles-based bond definition. A reporting entity may consider an asset for which less than 50% of the original principal relies on sale or refinancing to meet the meaningful criteria. In applying this practical expedient, only contractual cash flows of the non-financial asset may be considered. This practical expedient should not be construed to mean that assets cannot meet the meaningful criteria if they rely on the sale or refinancing to service greater than 50% of the original principal or if they rely on cash flows that are not contracted at origination. Rather, such instances do not qualify under the practical expedient and would require a complete analysis of the noted factors.

Additional Elements for Asset Backed Securities

54. When establishing the ABS definition and required components, various aspects were discussed to improve clarity on the application of the guidance.

55. Determination of "Assets" Backing Securities: Although the definition of an asset detailed in SSAP No. 4 is applied throughout the statutory accounting principles, the question was raised as to where the asset definition would be applied in determining a qualifying ABS. For example, an entity that expects to have subsequent receivables from future operations does not have recognized "assets" from those expectations as the requirements of the asset definition have not been met. However, if that entity were to sell the rights to future cash flows from expected operations, the selling entity would receive cash (a qualifying asset), and the acquiring entity would also have a recognized asset from the acquired right to future cash flows.

56. For purposes of qualifying as an "asset" permitted in an ABS structure, the definition of an asset must be met by the ABS issuer. In some situations, particularly when the asset represents a right to future cash flows, the asset may not be in a form that could be liquidated to provide payment towards the debt obligations. (For example, if the asset represents acquired rights to future royalties, those royalty rights would have to materialize to have liquid assets available toward the debt obligations.) The ability to liquidate the backing collateral asset at a single point in time does not impact the structural determination of whether the issued security meets the definition of an ABS provided that the assets are expected to produce meaningful cash flows to service the debt terms. Additionally, the inability to liquidate the assets backing the instrument may impact the assessment of what constitutes substantive credit enhancement. Failure of cash flows to materialize may impact recoverability and require impairment of an ABS.

57. There is no requirement for a collateral asset backing an ABS structure to qualify as an admitted asset under statutory accounting. Assessing whether the underlying asset qualifies for admittance is not necessary as non-financial assets backing ABS must meet the meaningful cash-generating criteria. If the structure fails to meet the meaningful cash-generating requirement, the instrument does not qualify for

reporting on Schedule D-1. Note that statutory accounting has not historically restricted bonds backed by inadmissible assets from being admissible either, nor has it included any kind of evaluation of the cash flow producing ability of underlying assets. The proposed bond definition adds a requirement to evaluate the cash flow producing ability of the underlying collateral, but continues to recognize that assets that may not be admissible if held individually on an insurer's balance sheet, may be well suited to support bond-like cash flows when securitized in large numbers with appropriate structuring (e.g. prioritization of cash flows).

58. Determining Whether the Structure Reflects "Financial" or "Non-Financial" Assets: – The definition of a "financial asset" has previously been adopted from U.S. GAAP and is reflected in *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* as cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right 1) to receive cash or another financial instrument from a second entity or 2) to exchange other financial instruments on potentially favorable terms with the second entity.

59. For purposes of excluding financial assets from the ABS meaningful cash generation criteria, the financial asset definition was clarified, for the avoidance of doubt, to not include assets for which the realization of benefits conveyed by the rights to receive or exchange financial assets depends on the completion of a performance obligation such as with a lease, mortgage servicing right, royalty rights, etc. For purposes of applying the ABS guidance, when there is a performance obligation required before the cash flows are generated, the assets represent non-financial assets, or a means through which non-financial assets produce cash flows, until the performance obligation has been satisfied. As another way to assess this clarification, if the assets backing the ABS are only subject to default risk (meaning the risk of nonpayment is solely based on failure of the underlying payer to satisfy its unconditional promise to pay), then the asset is a financial asset. If the asset is subject to any other risk in addition to default risk, then the assets represent non-financial assets. As simple illustrative examples:

a. A mortgage-backed security (MBS), where the underlying mortgages have been securitized into a structure, the mortgage receivables represent unconditional promises to pay, with no further performance obligation of the lender or any other party. This structure is considered to be backed by financial assets. Although this structure is excluded from the meaningful cash flow assessment, it must still comply with the substantive credit enhancement requirement

b. A structure that represents the securitization of rental car leases is contingent on the lessor performing its side of the transaction (providing the car for use) before the lessee is obligated to pay. Therefore, a lease is a non-financial asset due to the performance obligation that must be satisfied in order for payment to become unconditional. Additionally, as is the case with short-term car rentals, the lease (rental agreement) may not themselves be in place and the structure may represent a securitization of the rights to future rental payments, which adds an additional performance condition. This structure combines performance risk with default risk, resulting with the structure not qualifying for classification as being backed by financial assets. For this structure, the reporting entity would have to complete assessments that 1) the structure results with substantive credit enhancement and 2) the structure produces meaningful cash flows over the term of the instrument to satisfy the debt obligation other than through the sale or refinancing at maturity. If at origination, the cash flows from the underlying collateral (rental cars) are expected to generate at least 50% of the original principal, then the meaningful criteria would be met through the practical expedient.

60. Whole-Business Securitizations: In most ABS structures, the assets backing the cash flows are specified and limited to a distinct collateral pool. For example, dedicated cash flows from specific lease arrangements, or specific receivables from credit cards or mortgages. However, ABS structures can exist that represent an entire range of operating revenues or cash flows generated by the business. These structures are often referred to as "whole business" or "operating asset" securitizations." These structures

(which could only include cash flows from certain operating segments, and not necessarily the entire business of a company's operations) transfer the cash flows from the dedicated operations first to the investment holders, with the operating entity receiving their "operation proceeds" after the investment holders have been paid. This is different from a traditional bond structure where the operating entity first receives the proceeds from their operations, and has discretion for how it uses those proceeds to continue operations and pay expenses and then ultimately pay the bond holders according to the debt terms. Further, debt holders in a whole-business securitization generally only have recourse to the cash flow streams pledged to support the debt, unlike a general credit obligation of the operating entity.

61. For the principles-based bond definition, structures that refer to whole-business securitizations, or that refer to operation proceeds as the collateral for the source of debt repayment still meet the definition as an ABS and do not reflect issuer credit obligations. For these structures, the dedicated operational cash flows represent the defined collateral pool and should not be classified as issuer credit obligations based on an interpretation that the proceeds represent the cash flows of an operating entity as they are not supported by the general creditworthiness of an operating entity, but rather only on referenced cash flow streams from operations.

62. Residual Tranches / "Equity" Components of Schedule D-1 Qualifying Structures: The assessment of qualifying Schedule D-1 investments has to consider the overall investment structure but focuses primarily on the specific instrument held by the reporting entity. Structures, particularly ABS, may include residual tranches that do not have contractual principal or interest payments, but rather provide payment after contractual principal and interest payments have been made to other tranches or interests based on remaining available funds. Although payments to residual note holders could occur throughout an investment's duration, and not just at maturity, such instances still reflect the residual amount permitted to be distributed after other holders have received contractual interest and principal payments. In all instances, despite whether other tranches of the investment structure qualify for Schedule D-1 reporting, residual tranches do not qualify for reporting on Schedule D-1.

63. Under prior guidance in SSAP No. 43R, there was no exclusion that restricted residual tranches of qualifying securitizations from being captured in scope and being reported as bonds. From the outreach performed in developing the principles-based bond definition, it was identified that several insurers have previously reported these residual tranches on Schedule BA: Other Long-Term Invested Assets. However, it was noted that some reporting entities have reported these tranches on Schedule D-1 as a component of the securitization or as a beneficial interest in scope of SSAP No. 43R. Although residual tranches (first loss tranches) are not rated, when reported on Schedule D-1, an NAIC designation would be required. From information obtained, entities reporting residual tranches on Schedule D-1 have either been reporting as self-assigned 6* or applied the NAIC 5GI concept to self-designate these securities. Under the 5GI concept, the P&P Manual permits self-designation as an NAIC 5 if the documentation necessary for a full SVO credit analysis does not exist, the issuer is current on all principal and interest payments, and the reporting entity has an expectation that they will receive all contracted interest and principal. The use of the NAIC 5GI concept to self-designate residual tranches on Schedule D-1 is a misapplication of this guidance. It is faulty to conclude that an investment is current and will provide all contractual interest and principal payments when the investment has no contractual interest or principal payments. Furthermore, the 5GI provision was intended to prevent an NAIC 6 designation simply because the documentation for a full credit analysis could not be provided or reviewed, such as situations involving foreign securities when the supporting documents may be in a foreign language. The NAIC 5GI provision was not intended to permit self-assignment of an NAIC 5 designation to securities that would not qualify as a fixed-income instrument eligible for an NAIC designation under the P&P Manual.

64. With the identification that residual tranches are inconsistently reported, with some entities reporting on D-1 and others reporting on Schedule BA, the Working Group drafted and exposed agenda item 2021-15: SSAP No. 43R – Residual Tranches in September 2021 as an interim action prior to the conclusion of the bond proposal project. The guidance within this agenda item clarifies that residual

tranches shall be reported on Schedule BA at lower of amortized cost or fair value. The guidance also clarifies that the reference to residual tranches intends to capture securitization tranches and beneficial interests, as well as other structures captured in scope of SSAP No. 43R that reflect loss layers without contractual interest or principal payments. Payments to holders of these items occur after contractual interest and principal payments have been made to holders of other tranches or interests and are based on the remaining available funds. Although payments can occur throughout an investment's duration, such instances still reflect the residual amount permitted to be distributed after other holders have received contracted interest and principal payments.

65. On November 10, 2021, the Statutory Accounting Principles (E) Working Group adopted the agenda item, clarifying that residual tranches are required to be reporting on Schedule BA: Other Long-Term Assets beginning December 31, 2022, with early adoption permitted. The effective date of this action allows time for reporting entities to implement this change and corresponds with a Blanks (E) Working Group proposal to incorporate separate reporting lines for residuals, based on underlying characteristics, on Schedule BA. With the adoption of this guidance, the Working Group noted that reporting entities may elect to reclassify residual tranches or interests to Schedule BA in advance of the effective date. As of the effective date, residual tranches or interests previously reported on Schedule BA shall be reclassified to the appropriate residual tranche Schedule BA reporting line based on the underlying characteristics of the investment structure.

66. Along with the action to specify the Schedule BA reporting for residuals, the Working Group and the Valuation of Securities (E) Task Force provided a joint memorandum to the Blanks (E) Working Group to specifically identify that application of the NAIC 5GI process is an inaccurate application. Residual tranches or interests reported on Schedule D-1 for year-end 2021 shall be reported with an NAIC 6. The Working Group also provided the Task Force a referral requesting clarification of the NAIC 5GI process so future misapplications could be mitigated. The Task Force considered specific changes to address residuals and adopted those revisions during the 2021 Fall National Meeting.

67. With the specific removal of residuals from being classified as a bond, guidance has been incorporated to SSAP No. 21R to specific and accounting and reporting guidance for residuals. This guidance has the following key aspects:

a. Residuals are permitted to be admitted assets if debt securities from the same securitization qualify (or would qualify) as bonds under SSAP No. 26R as an issuer credit obligation or asset-backed security. If a debt security held from the same securitization is (or would be) nonadmitted, then any residual interests or first loss positions held do not qualify as admitted assets.

b. Residuals shall be initially reported at cost, or allocated cost (using proportional fair values) if acquired along with debt tranches from the securitization. Subsequent to initial acquisition, residuals shall be reported at the lower of adjusted cost (as defined in paragraph 67c) or fair value, with changes in fair value (or from adjusted cost to fair value) reported as other-than-temporary impairments.

c. The adjusted cost basis shall be calculated such that all cash flows received attributed to the residual tranche shall be treated as a return of principal and a reduction to the adjusted cost. In other words, cash flows received as a holder of the residual tranche shall not be recognized as interest or investment income until the residual tranche has a BACV (adjusted cost basis) of zero. Once the residual has a zero BACV, cash flows received shall be recognized as interest income. The residual shall continue to be reporting on Schedule BA, with the zero BACV, with reporting of the received cash as interest income until the structure matures/terminates, is unwound or no longer meets the definition of a residual tranche. With this guidance, the BACV (adjusted cost basis) shall not be increased prospectively or retrospectively based on a reporting entity's estimates of future cash flows, and there shall be no amortization or accretion. Furthermore, adverse changes in estimated cash flows, resulting in an expectation that cash flows will not be received to cover the adjusted cost basis shall be recognized as an other-than-temporary impairment.

~~a.~~d. At the point the residual ceases to meet the definition of a residual tranche (i.e., when all senior debt has been repaid), and the investment structure is expected to continue for more than a year, the investment shall be reclassified and accounting for prospectively in the scope of whichever SSAP applies. Although dependent on the resulting structure, presumably structures that cease to reflect a residual will likely be considered a debt security that does not qualify as a bod or an equity tranche in scope of SSAP No. 48. Reporting entities are not required to reclassify an investment if the resulting structure is unwound within 12 months of the senior debt being repaid.

~~66.~~68. Stapling of investments: The original exposure of the principles-based bond definition (May 2021) included an initial example (originally referred to as Appendix I – Example I) detailing a situation where "equity interests" from a tranche (such as residuals) were required to be held by a reporting entity when holding debt tranches. (That language identified situations where the reporting entity would be restricted from selling, assigning, or transferring the unsecured debt investment without also selling, assigning or transferring the equity interest to the same party. This restriction is often referred to as the "stapling" of investments.) Pursuant to the guidance in the original example, although the debt instrument would separately qualify as a creditor relationship for bond reporting, when considering the entirety of the holdings (both the equity interests and debt tranches combined), the investment would be considered an equity instrument in substance. Although the debt instrument would appear to have a higher priority of payment, that priority would be supported by the equity interest the reporting entity has to hold. (Ultimately, the reporting entity would be subordinate to themselves as they would recognize a loss on the equity tranche to safeguard payment under the debt tranche.) Under that initial proposed guidance, all holdings under such situations, including the debt tranches, would not qualify as creditor relationships and would not qualify for bond reporting.

~~67.~~69. After considering comments from the first exposure period, as well as discussing within the small group of industry and regulators, this example was eliminated from the principles-based bond definition. These discussions ultimately concluded that tranches that separately qualify as bonds should be reported as bonds even if other tranches from a structure that do not qualify as bonds are also held by the reporting entity. Elements noted as part of the decision to remove the stapling restriction include:

a. A key element in the initial proposal to require the entire holdings as equity was to ensure that the risk of the holdings was properly captured. It was noted that recent developments to tranche investments that were previously reported as investments in LLCs or joint ventures could result in RBC arbitrage. This is because the risk of the investment would be concentrated in a specific tranche intended to absorb losses, and only that limited tranche would be reported on BA with higher RBC charges. This would allow the debt tranches (as they are subordinated by the equity tranche) to likely qualify as bonds with Schedule D-1 reporting and lower RBC charges. However, because risk has been concentrated into the smaller equity tranche as a result of leverage, and because Schedule BA RBC charges are fixed and insensitive to leverage, there is a lowering of risk-based capital in total despite no change in risk. The subsequent discussions highlighted that this is an RBC issue for the equity tranche and is not an accounting classification issue. As consideration on appropriate risk charges for residual tranches has been requested to the Financial Condition (E) Committee and is a discussion item for the RBC Investment Risk and Evaluation (E) Working Group, this issue is not within the focus of the Statutory Accounting Principles (E) Working Group. It was also noted that consideration of statutory accounting provisions (such as nonadmittance) to achieve a desired risk assessment would be an inappropriate use of the accounting guidance. It was also noted that the investments within scope of these discussions are likely permitted for admittance under state law, and differing SAP guidance would only result with identification of prescribed practices as domiciliary state laws and statutes are the ultimate authority for the application of SAP.

b. It was also identified that the initial exposed example was specific to investments that were "stapled" under contractual terms. This guidance would have only been applicable to dynamics in which there was an explicit restriction in the sale, assignment, or transfer of the equity tranche separately from a debt tranche. It was identified that without an active market for equity tranches (which is common) the explicit restrictions would not be necessary to achieve a similar result. Structures would only need to be designed to require initial acquisition of equity tranches when acquiring debt tranches (with removal of the explicit disposal restrictions) to avoid the proposed stapling guidance. Since the proposed guidance could be easily avoided, the guidance would not address the underlying concern.

c. This discussion noted that it is quite common for acquisitions to require purchases of a vertical slice of a structure and for investments to be stapled for a short duration of time. These provisions are generally done for easier marketing and for easier compliance with conflict-of interest provisions. The short-term aspect of some stapled investments raised concerns as to how bond-qualifying debt tranches would be reported if stapling provisions to an equity tranche were subsequently eliminated. This was identified as likely requiring a schedule move (from BA to D-1) with potential other accounting and reporting impacts (such as with NAIC designations and measurement method). This discussion noted that an issuer's stapling of investments may reflect a legitimate business purpose, and not intend for RBC arbitrage, and the elimination of such components after the stated timeframe could cause confusion or unnecessary noise in the financial statements from the reclassification of investments. This discussion further supported that the acquisition of different tranches, even if explicitly stapled, should not prevent separate debt (bond) and equity recognition based on the characteristics of the specific tranche.

~~68.~~70. ABS as Short-Term or Cash Equivalents: With the required focus and requirements to be met for asset-backed securities, as well as dedicated reporting based on the underlying collateral assets, ABS will no longer be permitted to be reported as short-term or cash equivalents. All qualifying ABS will be required to be reported on Schedule D-1, even if acquired within one year or less from the maturity date, to allow for full assessment of the extent of ABS by the regulators. Investments captured in scope of *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* are intended to reflect situations in which limited risk remains, either from changes in credit-quality or interest rates, due to the short-duration until maturity. As ultimate cash flows from asset-backed securities may have other risks beyond default risk or interest rate risk (such as performance factors, balloon payments, collateral quality), reporting as a cash equivalent or short-term investment is not permitted to prevent inappropriate assumptions of the investment's remaining potential risk.

Key Discussions / Aspects in Developing the Definition:

~~69.~~71. Refinancing Risk / Residual Risk Exposure: Discussion of refinancing risk (where there is outstanding debt owed at maturity that will need to be refinanced for the remaining principal to be received by the note holder) was a key element discussed in accordance with the meaningful cash flows requirement for non-financial asset backed securities. This discussion highlighted that traditional refinancing risk is accepted in the context of corporate debt but is viewed differently when assessing the cash flows of non-financial assets in an ABS structure. This differentiation was confirmed, with identification that there are concerns unique to non-financial asset-backed securities.

~~70.~~72. The requirement for a non-financial asset backed security to produce meaningful cash flows to service the debt other than through the sale or refinancing of the collateral assets ensures that structures captured on Schedule D-1 actually reflect bond-like cash flows. Structures that rely on the sale or refinancing at maturity to generate cash flows to repay debt obligations ultimately reflect a point-in-time reliance on the underlying collateral asset values that does not reflect the intent of Schedule D-1 reporting of bond-like cash flows. These structures are more reflective of the underlying collateral risk, ultimately contingent on the market at a future point in time and whether the underlying assets can be sold or refinanced in accordance with original expectations at the time of the structure origination.

~~71.~~73. A key comment raised by industry with regards to the meaningful cash flow requirement, and the restriction against relying on the sale/refinancing at maturity to produce meaningful cash flows, is that consideration should be given to the level of overcollateralization that exists in a structure if the meaningful requirement will not be met without sale or refinancing. These industry comments take the position that as the level of overcollateralization to the debt obligation increases, then there is a greater likelihood that the debt issuer will be successful in refinancing or selling the assets and generate the means to repay the debt obligation. Although overcollateralization is a factor in securities for bond classification, allowing overcollateralization to override the requirement for meaningful cash flows other than the refinancing / sale at maturity is not permitted for the following reasons:

a. The intent of the principles-based bond proposal is to clarify what shall be reported as long-term bonds on Schedule D-1. Non-financial asset backed securities that do not generate meaningful cash flows and rely on the refinancing or sale of the underlying assets do not reflect bond-like cash flows and are not characteristic of bond investments. These structures ultimately reflect equity (point-in-time) valuation risks of the assets held as collateral.

b. The industry position that overcollateralization safeguards the asset performance is an argument that supports the quality of the structure, but not the substance of the investment design. The principles-based bond proposal does not factor in investment or credit quality within the determination of whether a structure qualifies for reporting on Schedule D-1. Permitting an assessment based on overcollateralization would introduce a concept that credit quality determines Schedule D-1 reporting, and that is not an accurate conclusion in line with the principle concepts of bond classification.

~~72.~~74. Consistent with prior conclusions, reporting on Schedule D-1 is not indicative of the quality of the investment, but rather reflects securities expected to generate bond-like cash flows. Securities reporting on Schedule D-1 may be of high-quality or low-quality, but the reporting is based on the substance of the structure, which ultimately requires bond-like cash flows for all investments. This includes a requirement that non-financial asset backed securities must produce meaningful cash flows through the use of the underlying collateral assets other than through the sale or refinancing of the assets.

~~73.~~75. Additionally, through the small group discussions around the refinancing restriction noted above, it was noted that even if a debt instrument meets all of the criteria to be reported as a bond on Schedule D-1, there will still be a potential for unintentional RBC arbitrage related to securitizations, because the residual tranches absorb all of the redistributed risk of the underlying collateral, but receives a fixed RBC charge that is not in any way risk-rated. While this could be the case in any type of securitization, it is particularly pronounced if the underlying collateral is equity investments. Equity investments generally receive a 30% RBC charge for life companies. If equity investments are securitized, the bond tranches will get low bond charges (<2%), while the residual tranche will continue to receive a flat 30% charge. This will have the effect of bringing the overall weighted-average capital charge on the underlying investments from 30% to approximately 10-15%, as an example. This will occur even if the bond tranches have all of the substance associated with a bond. Following these discussions, it was identified that this regulatory concern may not be able or appropriate to address through the accounting standards but may warrant discussion for the Capital Adequacy (E) Task Force. Subsequent discussions from the Financial Condition (E) Committee directed the new RBC working group (the RBC Investment Risk and Evaluation (E) Working Group) to evaluate this and any other investment-related RBC items.

~~74.~~76. Use of NAIC Designation / SVO Review in Determining Schedule D-1 Reporting: The accuracy of the financial statements, and compliance with statutory accounting provisions, is the responsibility of the reporting entity. Assessment and compliance with key concepts, such as the "meaningful" and "substantive credit enhancement" concepts for ABS are also the responsibility of the reporting entity, along with appropriate documentation of these assessments for regulator review when requested. As such, consistent with the existing *NAIC Policy Statement on Coordination of the Accounting Practices and Procedures Manual and the Purposes and Procedures Manual of the NAIC Investment Analysis Office*, a reporting entity cannot obtain an NAIC designation to conclude on the substance of an investment or the resulting reporting schedule. Pursuant to the policy statement, obtaining an NAIC designation does not change an investment's applicable SSAP, annual or quarterly statement reporting schedule, or override other SSAP guidance required for an investment to be an admitted asset.

~~75.~~77. Questions have been received whether an NAIC designation in the AVS+ product or an assessment of an investment from an RTAS submission can be utilized as support that an investment qualifies for Schedule D-1 reporting. These are inaccurate interpretations on the use of NAIC designations within those products. The assignment of an NAIC designation (either from the SVO or CRP) reflects the credit quality of an investment. An assessment of credit quality does not provide assurances that the investment qualifies for reporting on Schedule D-1 as an issuer credit obligation or an ABS. As part of this project, consideration is planned to expand the ability to report and use NAIC designations on Schedule BA (or other schedules) so that investments that do not qualify as bonds can have appropriate risk assessments that factor in the credit quality of the investment. This capability would ultimately depend on action by the Capital Adequacy (E) Task Force.

~~76.~~78. Although the NAIC designation and RTAS processes cannot be used in determining Schedule D-1 compliance, it is envisioned that a small group of regulators and NAIC staff could be formed to review specific investment structures under the principle-based concepts to assist in assessments of complex new investment designs. It is anticipated that NAIC staff on the statutory accounting side and within the SVO would assist this small group.

~~77.~~79. Interest Only / Principal Only Strips: Discussion occurred on whether specific guidance should direct the reporting of interest only (IO) and principal only (PO) strips. The resulting conclusion from this discussion was that the principle concepts from the bond definition should continue to be applied for these investments. If the strips qualify within the definition as issuer credit obligations, they would be captured in scope of that guidance. If the strips qualified as asset-backed securities, they would be captured in scope of that guidance. It was noted that interest only strips shall also be assessed in accordance with the residual guidance. If the interest only strip reflects excess interest (e.g., remaining differential spread from interest collected from interest paid), these investments would be akin to a residual investment without contractual interest or principal payments and shall be captured in scope of that guidance. (Residuals are required to be reported on Schedule BA and not permitted to be reported on Schedule D-1.)

~~78.~~80. The discussion of IO/PO strips with industry representatives identified that they are not overly prevalent investments with insurance reporting entities. It was also noted that IO/PO based on RMBS are relatively rare due to the prepayment risk, however those based on CMBS generally have contractual provisions that prohibit prepayments, thus ensuring that they act more akin to typical bonds. This discussion further highlighted that changes to the principal-based bond definition are not justified for IO/PO investments, and insurers should document their accounting policies for these investments to demonstrate compliance with the bond definition.

~~79.~~81. The discussion of IO/PO strips focused on U.S. Treasury strips and mortgage-backed securities as likely investments, but it was noted that the application of the overall bond definition concepts should be applied to any future design of these investments. Specific elements noted for the two general designs:

a. U.S. Treasury Strips: Treasury Strips are created when a bond's coupons are separated from the bond. The coupons separated from the bond are also sold individually (IO), becoming separate securities from the principal payments due at maturity (PO). U.S. Treasury Strips are backed by the U.S. government. U.S. Treasury strips (IO/PO) were noted to be considered U.S. government issues and would be captured with other securities backed by the U.S. government as issuer obligations. Specific identification of U.S. Treasury strips as specific elements as issuer credit obligations, captured within the U.S. government category, was noted to be repetitive and not necessary.

b. Mortgage-Backed Securities and Other Non-Treasury Strips: Other IO and PO strips are required to be assessed in accordance with the principle concepts of the bond definition. It is anticipated that non-U.S. strips (including mortgage-backed security strips) would not qualify as issuer credit obligations and shall be reviewed in accordance with the asset-backed security concepts to determine whether the strip qualifies for reporting on Schedule D-1. The separation of the principal and interest components into separate securities does not change the application of the principle concepts for determining whether a security qualifies as a bond. It was noted that IO strips could be high in the capital structure (supported by subordination) or could represent residual interests (reflecting the spread between proceeds collected and contractual interest). The specific details of the individual IO/PO security shall determine the appropriate accounting and reporting.

~~80.~~82. The discussion of IO/PO strips identified that there is likely no current need to have separate reporting lines to identify these items within the investment schedules. However, it was identified that the ability to identify these investments with a code (or other feature) would allow for future aggregation and assessment. This was requested to be considered as part of the reporting revisions.

~~81.~~83. Embedded Derivatives / Underlying Variables: Discussion occurred on the language that precludes bond reporting based on the appreciation or depreciation of an underly collateral value or other variable. Although industry comments noted that the intent of the language was understood, it was identified that the language could be interpreted to mean that amounts in both the magnitude and timing of principal and interest payments must be known in advance, and it could also be interpreted to mean the amounts need to be contractual in nature but can still vary as long as the variability is not dependent on the appreciation or depreciation of an asset or variable. It was also noted that the reference to "other variable" could be interpreted to mean interest is not allowed to vary based on any variable or just the appreciation or depreciation of the variable. After discussing these comments, revisions were drafted to clarify that the exclusion is not intended to restrict variables that are commonly related to debt instruments such as but not limited to plain vanilla inflation or benchmark interest rate adjustments (such as with U.S. TIPs or SOFR-Linked coupons), scheduled interest rate step-ups, or credit~~-rating~~quality ~~-~~related interest rate adjustments. (As detailed in footnote 2, this exclusion is not intended to encompass nominal interest rate adjustments.) This guidance has also been incorporated within the provisions for determining whether a debt instrument represents a creditor relationship and is applicable for debt instruments structured as issuer credit obligations and asset-backed securities.

Accounting for Debt Securities That Do Not Qualify as Bonds:

~~82.~~84. Securities that have a fixed schedule for one or more future payments, but for which the security does not qualify for bond reporting as an issuer credit obligation or an asset backed security shall follow specific guidance captured in SSAP No. 21R and be reported on Schedule BA. Investments in scope of this guidance are limited to:

a. Debt securities for which the investment does not reflect a creditor relationship in substance.

b. Debt securities that do not qualify for bond reporting due to a lack of substantive credit enhancement.

c. Debt securities that do not qualify for bond reporting due solely to a lack of meaningful cash flows.

85. The debt securities captured in the guidance within SSAP No. 21R meet the definition of assets as defined in SSAP 4 and are admitted assets to the extent they conform to the requirements within ~~the~~ SSAP No. 21R.~~statement~~. ~~The provisions include specific guidance that debt securities for which the source of repayment is derived through rights to underlying collateral, qualify as admitted assets only to the extent they are secured by admitted invested assets.~~

~~83.~~86. Debt securities in scope of this standard that do not qualify as bonds under SSAP No. 26R and for which the primary source of repayment is derived through rights to underlying collateral, qualify as admitted assets if the underlying collateral primarily qualify as admitted invested assets. As detailed in the section pertaining to residual tranches, any residual tranches or first loss positions held from the same securitization that did not quality as a bond under SSAP No. 26R also only qualify to the extent the underlying collateral primarily qualifies as admitted invested assets.

~~84. Debt securities that do not qualify for bond reporting due solely to a lack of meaningful cash flows shall be reported on Schedule BA: Other Long-Term Invested Assets using the same accounting and measurement basis described in *SSAP 43R—Asset-Backed Securities*, including using a carrying value method determined by NAIC designation. Reporting entities that are reporting an amortized cost measurement shall obtain an NAIC designation in accordance with the parameters of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and report the designation on Schedule BA.~~

~~85.~~87. ~~All other d~~Debt securities in scope of the SSAP No. 21R guidance shall be reported at acquisition at cost, including brokerage and other related fees on Schedule BA: Other Long-Term Invested Assets. ~~These securities are permitted as admitted assets, with s~~Subsequent measurement shall reflect ~~at~~ the lower of amortized cost or fair value. Changes in measurement to reflect the lower value or to reflect changes in fair value shall be recorded as unrealized gains or losses.

~~86. Debt securities that do not qualify as bonds shall follow the guidance in *SSAP No. 43R—Asset-Backed Securities* for calculating amortized cost, for determining and recognizing other-than-temporary impairments and for allocating unrealized and realized gains and losses between the asset valuation reserve (AVR) and interest maintenance reserve (IMR). Investment income shall be recorded, with assessments for collectability and nonadmittance completed and recognized, pursuant to *SSAP No. 34—Investment Income Due and Accrued*. Disclosures are also included consistent with other invested assets.~~

Transition Guidance:

~~87.~~88. At the time of transition, reporting entities shall make their best efforts to assess investments to determine whether they qualify within the bond definition for reporting on Schedule D-1. The bond definition requires assessments at the time of acquisition (as of the origination date), and it is recognized that reporting entities may not have the means to complete historical assessments for securities held at the time of transition. For these instances, if information is not readily available for reporting entities to assess a security as of the date at origination~~acquisition~~, reporting entities may utilize current or acquisition information in concluding that a security qualifies for reporting as a bond as either an issuer obligation or asset-backed security.

~~88.~~89. Investments that were reported as a bond on Schedule D-1: Long-Term Bonds as of December 31, 2024, that do not qualify under the principle-based bond concepts shall be reported as a disposal from that schedule, with a reacquisition on the appropriate reporting schedule as of January 1, 2025. These investments shall be accounted for in accordance with the resulting SSAP that addresses the specific investment structure. For securities that are reported at the lower of amortized cost or fair value under the new applicable guidance, this could result with an unrealized loss in the measurement of the investment at the time of the reclassification. Although the adoption of this guidance is considered a change in accounting principle under SSAP No. 3, the following transition guidance shall be applied on January 1, 2025, to ensure consistency in reporting and to allow investment schedules to roll appropriately:

a. Securities reclassified from Schedule D-1 as they no longer qualify under the bond definition shall be reported as a disposal from Schedule D-1 at amortized cost. Although no proceeds are received, amortized cost at the time of disposal shall be reported as consideration on Schedule D-4.

   i. For securities held at amortized cost at the time of disposal, book adjusted carrying value and amortized cost shall agree, preventing gain or loss recognition at the time of reclassification.

   ii. For securities held at fair value under the lower of amortized cost or fair value measurement method, previously reported unrealized losses shall be reversed on Jan. 1, 2025, prior to disposal, resulting with a reported value that mirrors amortized cost at the time of disposal. This action prevents realized loss recognition at time of reclassification.

b. Securities reclassified from Schedule D-1 shall be recognized on the subsequent schedule (e.g., Schedule BA) with an actual cost that agrees to the disposal value (amortized cost). Immediately subsequent to recognition on the resulting schedule, the securities shall be reported in accordance with the measurement method prescribed by the applicable SSAP:

   i. For securities previously reported at fair value on Schedule D-1 (under a lower of amortized cost or fair value measurement method), the reporting entity will recognize an unrealized loss to match the previously reported book adjusted carrying value. Subsequently, the security will continue to reflect a lower of amortized cost or fair value measurement method.

   ii. For securities previously reported at amortized cost on Schedule D-1, if the subsequent statement requires a lower of amortized cost or fair value measurement method, then the reporting entity shall recognize an unrealized loss to the extent fair value is less than amortized cost.

   iii. After application of the transition guidance all securities shall reflect either the same reported value as of December 31, 2024 (amortized cost or fair value) or a lower reported value (if the security is subject to the lower of amortized cost or fair value measurement method). There should be no instances that result with a security having a greater reported value than what was presented on December 31, 2024. Subsequent to transition, securities reported at fair value may incur unrealized gains or losses due to fair value fluctuations, but should never have unrealized gains that result with a book adjusted carrying value that exceeds amortized cost.

~~89.~~90. With this transition guidance, changes in measurement for securities reclassified under the bond definition will be reported as a change in unrealized capital gains (losses) in the first quarter 2025 financial statements (unless sold in the interim with a realized gain or loss) and not as a change in accounting principle. To enable regulators the ability to identify the impact of securities reclassified under the bond definition, the following disclosure for the 2025 first quarter financial statement is required:

c. Aggregate book adjusted carrying value for all securities reclassified off Schedule D-1.

d. Aggregate book adjusted carrying value after transition for all securities reclassified off Schedule D-1 that resulted with a change in measurement basis. (This shall be a subset of the aggregate BACV reclassified off Schedule D-1 and captures the securities that moved from an amortized cost to a fair value measurement method under the lower of amortized cost or fair value approach.)

e. Aggregate surplus impact for securities reclassified off Schedule D-1. This shall include the difference between book adjusted carrying value as of December 31, 2024 and book adjusted carrying value after transition for those securities that moved from an amortized cost to a fair value measurement method under the lower of amortized cost or fair value approach.

91. Asset-backed securities that were previously reported as short-term (Schedule DA) or as a cash equivalent (Schedule E2) shall be reclassified to be reported on Schedule D-1-2 on Jan. 1, 2025. Similar to the process detailed above, the securities shall be removed from DA and E2 at amortized cost, with reversal of any unrealized loss prior to the reclassification. The amortized cost shall be reported as "consideration received on disposals' on Schedule DA – Verification Between Years or Schedule E-2 – Verification Between Years, as applicable based on the prior reporting location. The security shall be recognized as an ABS acquired on Schedule D-3 at amortized cost. Immediate after initial recognition, if the security was required to be held at fair value, under the lower of amortized cost or fair value measurement method, the reporting entity shall recognize an unrealized loss.

~~90.~~92. The transition guidance shall be applied prospectively beginning with the first year of adoption (Jan. 1, 2025). For disclosures that provide comparative information, reporting entities shall not restate the prior year's information in the 2025 disclosure.

Investment Examples – Securities That Do Not Represent Creditor Relationship Despite Legal Form

~~91.~~93. As detailed in the principles-based bond definition, an initial determinant in the principles-based bond definition is whether the investment is a security that represents a creditor relationship in substance. Examples included intend to identify scenarios that do not reflect an in-substance creditor relationship.

~~92.~~94. Example 1: Debt Instrument from SPV with Large Number of Diversified Equity Interests: A reporting entity invests in a debt instrument issued by a SPV that holds a large number of diversified equity interests with characteristics that support the production of predictable cash flows. The structure contains sufficient overcollateralization and liquidity provisions to ensure the production of adequate cash flows to service both principal and interest payments without significant reliance on refinancing or sale of the underlying equity investments. The debt instrument's periodic principal or interest payments, or both, contractually vary based on the appreciation or depreciation of the equity interests held in the SPV.

~~93.~~95. Example 1 Rationale: Because the instrument's principal or interest payments, or both, contractually vary with the appreciation or depreciation of the underlying equity interests, it contains an equity-like characteristic that is not representative of a creditor relationship. It would be inappropriate to conclude that a security with any variation in principal or interest payments, or both, due to underlying equity appreciation or depreciation, or an equity-based derivative, is a bond under this standard as such security would contain equity-like characteristics.

~~94.~~96. Example 2: Debt Instrument from SPV with Few Equity Interests, Not an Issuer Credit Obligation: A reporting entity invests in a debt instrument issued from a SPV that owns a portfolio of equity interests, and the debt instrument does not meet the definition of an issuer credit obligation.

~~95.~~97. Example 2 Rationale: Determining whether debt instruments collateralized by equity interests qualify as bonds under this statement inherently requires significant judgment and analysis. Unlike debt instruments collateralized by assets with contractual cash flows, or debt instruments collateralized by cash-generating non-financial assets, debt instruments collateralized by equity interests may be dependent on cash flow distributions that are not contractually required to be made and/or may not be controlled by the issuer of the debt. In some instances, sale or refinancing of the underlying equity interests may be the only means of generating cash flows to service the debt instruments. As a result, there is a rebuttable presumption that a debt instrument collateralized by equity interests does not qualify as a bond. Notwithstanding this rebuttable presumption, it is possible for such debt instruments to qualify as bonds, if the characteristics of the underlying equity interests lend themselves to the production of predictable cash flows and the underlying equity risks have been sufficiently redistributed through the capital structure of the issuer. Factors to consider in making this determination include but are not limited to:

a. Number and diversification of the underlying equity interests

b. Characteristics of the underlying equity interests (vintage, asset-types, etc.)

c. Liquidity facilities

d. Overcollateralization

e. Waiting period for distributions/paydowns to begin

f. Capitalization of interest

g. Covenants (e.g., loan-to-value trigger provisions)

h. Reliance on ongoing sponsor commitments

i. Source(s) of expected cash flows to service the debt (i.e., dividend distributions from the underlying collateral vs. sale or refinancing of the underlying collateral)

~~96.~~98. While reliance of the debt instrument on sale of underlying equity interests or refinancing at maturity does not preclude the rebuttable presumption from being overcome, it does require that the other characteristics mitigate the inherent reliance on equity valuation risk to support the transformation of underlying equity risk to bond risk. As reliance on sale or refinancing increases, the more compelling the other factors needed to overcome the rebuttable presumption become.

~~97.~~99. Furthermore, this analysis should be conducted and documented by a reporting entity at the time such an investment is acquired. The level of documentation and analysis required will vary based on the characteristics of the individual debt instrument, as well as the level of third-party and/or non-insurance company market validation to which the issuance has been subjected. For example, a debt instrument collateralized by fewer, less diversified equity interests would require more extensive and persuasive documented analysis than one collateralized by a large and diversified portfolio of equity interests. Likewise, a debt instrument that has been successfully marketed to unrelated and/or non-insurance company investors, may provide enhanced market validation of the structure compared to one held only by related party and/or insurance company investors where capital relief may be the primary motivation for the securitization.

Investment Examples – Analysis of ABS Under the Meaningful and Credit-Enhancement Concepts

~~98.~~100. All asset-backed security structures are required to provide substantive credit enhancement to qualify for Schedule D-1 reporting. Furthermore, asset-backed security structures that are backed by non-financial assets must generate meaningful cash flows to service the debt without reliance on the sale or refinancing at the maturity of the investment. Examples 4-7 provide examples of analysis under these criteria:

~~99.~~101. Example 4 – Agency Mortgage-Backed Securities: A reporting entity invests in debt instruments issued from a SPV sponsored by the Government National Mortgage Association (GNMA), the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, "Agency or Agencies"). These debt instruments pass through principal and interest payments received from underlying mortgage loans held by the SPV to the debtholders proportionally, with principal and interest guaranteed by the Agencies. While there is prepayment and extension risk associated with the repayment of the underlying mortgage loans, the credit risk associated with the mortgage loans is assumed by the Agencies.

~~100.~~102. Example 4 Rationale: Although the reporting entity participates on a proportional basis in the cash flows from the underlying mortgage loans held by the SPV, the reporting entity is in a different economic position than if it owned the underlying mortgage loans directly because the credit risk has been redistributed and assumed by the Agencies. This is a substantive credit enhancement because a market participant (i.e., knowledgeable investor transacting at arm's length) would conclude the Agency guarantee is expected to absorb all losses before the debt instrument being evaluated. Therefore, the holder of the debt instrument is in a substantively different economic position than if the holder owned the ABS Issuer's unguaranteed assets directly. When guarantees do not cover 100% of principal and interest as the Agency guarantees do in this example, it is still appropriate to determine if the guarantee is substantive in accordance with the requirements of the principles-based bond definition to determine if the holder is in a substantively different economic position than if the holder held the ABS Issuer's assets directly.

~~101.~~103. Example 5 ~~–~~ – Debt Instrument Issued by an SPV: A reporting entity invested in a debt instrument issued by a SPV. Payments under the instrument are secured by a note, a legal assignment from the borrower of a lease for real property and an assignment of the lease payments from an operating entity tenant. Additional security is provided by a mortgage on the leased property (the "underlying collateral"). The leased property is owned by the borrower under the note ~~–~~ – the SPV does not have any ownership interest in the underlying collateral, though it has legal recourse to it through the mortgage. The tenant makes contractually-fixed payments over the life of the lease to the borrower, who has assigned both the lease and the lease payments to the SPV as security for the debt. While the debt is outstanding, the lease, the lease payment, and the mortgage all serve as security for the debtholders. Should a default occur, the debtholders can foreclose on and liquidate the real property as well as submit an unsecured lease claim in the lessee's bankruptcy for any defaulted lease payments. The loan-to-value (as a percentage of property value) at origination is 100%.

~~102.~~104. The existing lease payments are sufficient to cover all interest payments and all scheduled debt amortization payments over the life of the debt instrument. However, at debt maturity, there is a balloon payment due, totaling 50% of the original outstanding debt principal amount. The corresponding lease has no balloon payment due at lease maturity, so the SPV will either need to refinance the debt or sell the underlying collateral to service the final debt balloon payment. The property has a high probability of appreciating in value over the term, however ignoring any potential for appreciation, the 50% loan-to-value at maturity is the expected figure at the end of the debt term based solely on scheduled amortization payments. The real property is expected to be subject to some market value volatility and periods of lower liquidity at certain points in time but has a predictable value range and ready market over a longer period of time, such that the property could be liquidated over a reasonable period of time, if necessary.

~~103.~~105. Example 5 Rationale: The reporting entity determined that a debtholder was in a fundamentally different position than if the real estate was owned directly. The lease is a cash generating non-financial asset which is expected to generate a meaningful level of cash flows for the repayment of the bonds which covers all interest payments and 50% of the principal payments. The level of reliance on the collateral value for sale or refinancing is just over the cutoff for using the practical expedient (<50%), so a full analysis is required. In reaching its determination, the reporting entity considered the predictable nature of the cash flows, which are contractually fixed for the life of the debt instrument, as well as the ability of the underlying collateral value to provide for the balloon payment through sale or refinancing in light of its characteristics. While the real property may have some market value volatility and periods of lower liquidity at points in time, the cash flows produced by the lease were concluded to reduce the loan balance to a level (50% loan-to-value) that would be able to be recovered by sale or refinancing at the maturity of the loan.

~~104.~~106. The reporting entity also determined that the structure provides substantive credit enhancement in the form of overcollateralization to conclude that investors are in a different economic position than holding the real property directly, in accordance with the requirements of the principles-based bond definition. In reaching this conclusion, the reporting entity noted that although the debt instrument starts with a 100% loan-to-value (not including the value of the contractually required lease payments), contractual fixed payments from the lease provide additional security such that the reporting entity is in a different economic position than owning the property directly. Lease cash flows are sufficient to cover the payment of all interest and 50% of the outstanding principal over the term of the lease. In the context of the predictable nature of the cash flows and collateral value range over time, the reporting entity concluded that a market participant (i.e., a knowledgeable investor transacting at arm's length) would consider this level of overcollateralization to put the investor in a substantially different economic position than owning the underlying property directly.

~~105.~~107. For the purposes of determining whether there is substantive overcollateralization, it is appropriate to consider any expected economic depreciation, if it is reasonably expected, but it is not appropriate to consider any expected economic appreciation. Note that a debt instrument with a loan-to-value that is expected to decrease over time is not necessarily deemed to have substantive overcollateralization.

~~106.~~108. Example 6 – Debt Instrument Issued by an SPV With Lease Term Less than Debt Instrument: A reporting entity invested in a debt instrument with the same characteristics as described in Example 5, except that the existing lease at the time of origination has a contractual term that is shorter than that of the debt instrument. It is expected with a high degree of probability that the lease will be renewed, and a substantial leasing market exists to replace the lessee should they not renew. However, in the unlikely circumstance that the property cannot be re-leased, there would not be enough cash flows to service the scheduled principal and interest payments, and the property would have to be liquidated to pay off the debt upon default.

~~107.~~109. Example 6 – Rationale: All details of this example, including the expected collateral cash flows, are consistent with those in Example 5, except that the cash flows in Example 5 are contractually fixed for the duration of the debt while the cash flows in this example are subject to re-leasing risk. Notwithstanding the involvement of re-leasing risk, the reporting entity concluded that the ability to re-lease the property was highly predictable and supported the conclusion that the underlying collateral was expected to produce meaningful cash flows to service the debt.

~~108.~~110. This distinction is to highlight that the expected cash flows of a cash-generating non-financial asset may or may not be contractually fixed for the term of the bond. Certain securitized cash flow streams may not by their nature lend themselves to long-term contracts (e.g., single-family home rentals), but may nevertheless lend themselves to the production of predictable cash flows. While the non-contractual nature of the cash flows is an important consideration in determining whether a non-financial asset is expected to produce meaningful cash flows to service the debt, it does not, in and of itself, preclude a reporting entity from concluding that the assets are expected to produce meaningful cash flows.

~~109.~~111. Example 7 ~~–~~ Lease in SPV with 80% Balloon Payment: A reporting entity invested in a debt instrument issued by a SPV that owns equipment which is leased to an equipment operator. The equipment operator makes lease payments to the SPV, which are passed through to service the SPV's debt obligation. While the debt is outstanding, the equipment and lease are held in trust and pledged as collateral for the debtholders. Should a default occur, the debtholders can foreclose on and liquidate the equipment as well as submit an unsecured lease claim in the lessee's bankruptcy for any defaulted lease payments. The loan-to-value at origination is 70%.

~~110.~~112. The existing lease payments are sufficient to cover all interest payments and all scheduled debt amortization payments over the life of the debt instrument. However, at maturity, there is a balloon payment due, totaling 80% of the original outstanding principal amount. The corresponding lease has no balloon payment due at lease maturity, so the SPV will either need to refinance the debt or sell the underlying equipment to service the final debt balloon payment. The loan-to-value at maturity is expected to increase to 95% considering the scheduled principal amortization payments net of the expected economic depreciation in the equipment value over the term of the debt. The equipment is expected to be subject to some market value volatility and periods of lower liquidity at certain points in time, but has a predictable value range and ready market over a longer period of time, such that the equipment could be liquidated over a reasonable period of time, if necessary.

~~111.~~113. Example 7 Rationale: The equipment is a cash generating non-financial asset which is not expected to generate a meaningful level of cash flows for the repayment of the bonds via the existing lease that covers all interest payments and 20% of principal payments. In reaching this determination, the reporting entity considered that, while the cash flows being produced are predictable, the ability to recover the principal of the debt investment is almost entirely reliant on the equipment retaining sufficient value to sell or refinance to satisfy the debt

~~112.~~114. The reporting entity also determined that the structure lacks a substantive credit enhancement to conclude that investors are in a different economic position than holding the equipment directly, in accordance with the requirements of the principles-based bond definition. In reaching this conclusion, the reporting entity noted that the debt starts with a 70% loan-to-value, but the overcollateralization is expected to deteriorate over the term of the debt as the equipment economically depreciates more quickly than the debt amortizes. This results in a high loan-to-value (i.e., 95%) at maturity, relative to the market value volatility of the underlying collateral. Despite the predictable nature of the cash flows, the reporting entity concluded that the debt instrument lacked a substantive level of overcollateralization to conclude that the investor is in a different economic position than owning the underlying equipment directly. It was determined that the level of overcollateralization, as determined by a market participant (i.e., a knowledgeable investor transacting at arm's length), is nominal. Therefore, the reporting entity concluded that it was in a substantively similar position as if it owned the equipment directly.

~~113.~~115. For the purposes of determining whether there is substantive overcollateralization, it is appropriate to consider any expected economic depreciation, if it is reasonably expected, but it is not appropriate to factor in any expected economic appreciation. Note that a debt instrument with a loan-to-value that is expected to increase over time is not necessarily deemed to have nominal overcollateralization.

Reflecting the Principles-Based Bond Proposal in SSAP

~~114.~~116. This issue paper proposes that statutory accounting principles reflect the principles-based bond concepts and the specific accounting guidance for bonds, including both ~~(~~issuer obligations~~)~~ and asset backed securities and debt securities that do not qualify as bond be captured as substantive revisions to ~~two~~ existing SSAPs:

a. *SSAP No. 26R—Bonds*

b. *SSAP No. 43R—Asset-Backed Securities* (renamed from Loan-Backed and Structured Securities)

~~b.~~c. *SSAP No. 21R—Other Admitted Assets*

~~115.~~117. For SSAP No. 26R, the revisions capture the full bond definition, determining whether a security qualifies as either an issuer credit obligation or an asset backed security. The accounting guidance for issuer credit obligations is retained within SSAP No. 26R and is not changed with the inclusion of the bond definition. Other revisions include transition guidance, to reclassify debt securities that do not qualify as bonds from Schedule D-1 to the subsequent schedule and to delete the glossary as no longer necessary.

118. For SSAP No. 43R, revisions ~~have been proposed to~~ reorder and streamline the existing guidance. Although the broad measurement concepts and requirements to assess cash flows have not changed, the guidance specific to whether collection of cash flows is probable, not probable, or pertains to a beneficial interest has been eliminated. Instead, the guidance has been rewritten to provide consistent guidance for the assessment of cash flows and considering the impact of prepayments. These revisions are not expected to result in significant deviations from past practice, as the resulting guidance is believed to be reflective of prominent past industry interpretations. Clarifications have been included to ensure recognition of an other-than-temporary impairment whenever a security is in an impaired state (fair value is less than amortized cost, regardless if an unrealized loss has been recognized) and there is an adverse change in cash flows expected to be collected. Other revisions include transition guidance to reclassify debt securities that do not qualify as bonds from Schedule D-1 to the subsequent schedule as well as to incorporate guidance that prohibits reporting ABS as cash equivalents / short-term investments and transition to reclassify any securities reported as such as of the effective date.

~~116.~~119. For SSAP No. 21R, revisions incorporate new guidance for the accounting and reporting for debt securities that do not qualify as bonds as well as residual interests. These investments are reported on Schedule BA in designated reporting lines.

~~117.~~120. In addition to SSAP No. 26R and SSAP No. 43R, Exhibit ___, details "revisions to other SSAPs." This section identifies all SSAPs that have modified guidance, including revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to restrict ABS from being in scope ~~and *SSAP No. 21R—Other Admitted Assets*, which details the guidance for debt securities that do not qualify as bonds~~.

History of Definition / Scope Development of SSAP No. 43R – Before the Principles-Based Definition

The following section details the historical development of SSAP No. 43R along with the prior benefits for reporting investments in scope of SSAP No. 43R and key issues from the prior guidance. Due to various revisions that have been reflected since its original adoption, this information is retained for historical reference on the SSAP No. 43R guidance prior to the reflection of the principles-based bond proposal.

~~118.~~121. *SSAP No. 43—Loan-backed and Structured Securities* was originally effective with the SAP codification and resulted with separate guidance for "bonds" (in SSAP No. 26) and "loan-backed and structured securities" (in SSAP No. 43). (The initial guidance indicated that investments in scope of SSAP No. 43 met the definition of a bond in *SSAP No. 26—Bonds, excluding Loan-backed and Structured Securities*.) Although most of the guidance between the original SSAP No. 26 and SSAP No. 43 was the same, the guidance in SSAP No. 43 recognized the need to review (at least quarterly) the assumptions and resulting cash flows of the underlying loans, as changes in assumptions could necessitate a recalculation of the effective yield or other-than-temporary impairment.

~~119.~~122. The original issue paper to SSAP No. 43 (Issue Paper No. 43) cited guidance originally contained in Chapter 1, *Bonds and Loaned Backed and Structured Securities*, from the *Accounting Practices and Procedures Manual of the Life and Accident and Health Insurance Companies*. The issue paper identified that the *Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies* contained similar guidance. In this Issue Paper No. 43, and the original SSAP No. 43, loan-backed securities were defined as "pass-through certificates, collateralized mortgage obligations (CMOs) and other securitized loans…" The reference to "securitized loans" was a key aspect of this original definition.

~~120.~~123. Original definition / scope guidance for SSAP No. 43:

> 2. Loan-backed securities are defined as pass-through certificates, collateralized mortgage obligations (CMOs), and other securitized loans not included in structured securities, as defined below, for which the payment of interest and/or principal is directly proportional to the interest and/or principal received by the issuer from the mortgage pool or other underlying securities.
>
> 3. Structured securities are defined as loan-backed securities which have been divided into two or more classes for which the payment of interest and/or principal of any class of securities has been allocated in a manner which is not proportional to interest and/or principal received by the issuer from the mortgage pool or other underlying securities.
>
> 4. Loan-backed securities are issued by special-purpose trusts (issuer) established by a sponsoring parent organization. Mortgage loans or other securities securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee under the issuer's obligation has been fully satisfied. The investor can only look to the issuer's assets (primarily the trusteed assets or third parties such as insurers or guarantors) for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying mortgage loans. Some sponsors do guarantee the performance of the underlying loans.
>
> 5. Loan-backed securities meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted asset to the extent they conform to the requirements of this statement.

~~121.~~124. In agenda item 2007-26, *FAS 156: Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140,* the Working Group adopted with modification FAS 156 in *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, revising the terminology for "retained interests" to "interests that continue to be held by the transferor." This action also clarified that beneficial interests from the sale of loan-backed and structured securities shall be accounted for in accordance with SSAP No. 43. This initial adoption identified that the holder of a beneficial interest in securitized financial assets should recognize the excess of all cash flows attributed to the beneficial interest estimated at the acquisition date over the initial investment as interest income over the life of the beneficial interest using the effective yield method.

~~122.~~125. In 2009, the Working Group adopted a substantively-revised SSAP No. 43R (effective September 30, 2009). The focus of the substantive revisions was to revise the valuation and impairment requirements based on the cash flows expected to be collected for the securities, rather than fair value. Although the focus of the revisions was inclusion of impairment guidance based on whether an entity has an intent to sell, whether an entity does not have the intent and ability to hold a security, and when there is a non-interest related decline if there is no intent to sell and the entity has the intent and ability to hold, the revisions resulted in a significant rewrite of the guidance in SSAP No. 43R, including the guidance for beneficial interests. This guidance expanded the prior scope inclusion from "beneficial interests from the sale of LBSS," to include "purchased beneficial interests in securitized financial assets."

~~123.~~126. In agenda item 2010-12, Clarify Definitions of Loan-Backed and Structured Securities, the Working Group received a regulator-sponsored, nonsubstantive Form A with a proposal to revise the definitions of a loan-backed and structured security (LBSS). As a result of this proposal, the definition was revised to eliminate the reference to "securitized loans" and instead refer to "securitized assets." These revisions were adopted with an effective date of January 1, 2011.

a. Although the agenda item simply identifies that this item was exposed in August 2010, and then adopted after a single exposure in October 2010, with an effective date of January 1, 2011, there were significant comments received during the exposure period. In short summary, these comments highlighted that the scope of the changes were intended to move fixed-income assets that had been accounted for as bonds under SSAP No. 26 to SSAP No. 43R as LBSS. Particularly, the comments noted concerns with the movement of equipment trust certificates and credit tenant loans from the accounting provisions of SSAP No. 26 to the accounting rules of SSAP No. 43R. These comments stated that "instruments with radically different sources of cash flows and risk characteristics utilize trust structures, and not all should be classified as loan-backed." There were no changes incorporated to the proposed guidance as a result of these comments, and the revisions were adopted as exposed.

~~124.~~127. In 2019, revisions to the definition and scope section were also adopted to clarify the identification of affiliate/related party transactions (agenda Item 2019-03) as well as to explicitly capture mortgage-referenced securities issued from a government sponsored enterprise in scope of SSAP No. 43R (Agenda Item 2018-17). The inclusion of mortgage-referenced securities was a distinct departure from the "trust" structure required in determining inclusion within scope of SSAP No. 43R, but was incorporated as the securities (with the referenced pool of assets), functions similarly to the securities held in trust and the referenced pool of assets can be assessed for the underlying credit risk

~~125.~~128. Between the adoption of agenda item 2010-12 and the items adopted in 2019, there were several revisions to SSAP No. 43R, but those revisions did not impact the definition / scope of the statement. Those revisions included changes to incorporate price-point NAIC designations, guidance for interim financials for RMBC/CMBS, clarification of disclosures, updating Q/A guidance, and guidance for prepayment fees.

~~126.~~129. Definition of loan-backed and structured securities in the "As of March 2020" AP&P Manual:

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

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

4. Loan-backed securities are issued by special-purpose corporations or trusts (issuer) established by a sponsoring organization. The assets securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee until the issuer's obligation has been

fully satisfied. The investor only has direct recourse to the issuer's assets, but may have secondary recourse to third parties through insurance or guarantee for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying assets. Some sponsors do guarantee the performance of the underlying assets.

a. In determining whether a loan-backed structure is a related party investment, consideration shall be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security. For example, although a loan-backed security may be acquired from a non-related issuer, if the assets held in trust predominantly[3] reflect assets issued by affiliates of the insurance reporting entity, and the insurance reporting entity only has direct recourse to the assets held in trust, the transaction shall be considered an affiliated investment, and the transaction shall also subject to the accounting and reporting provisions in *SSAP No. 25—Affiliates and Other Related Parties*.

5. Mortgage-referenced securities do not meet the definition of a loan-backed or structured security but are explicitly captured in scope of this statement. In order to qualify as a mortgage-referenced security, the security must be issued by a government sponsored enterprise[4] in the form of a "credit risk transfer" in which the issued security is tied to a referenced pool of mortgages. These securities do not qualify as "loan-backed securities" as the pool of mortgages are not held in trust and the amounts due under the investment are not backed or secured by the mortgage loans. Rather, these items reflect instruments in which the payments received are linked to the credit and principal payment risk of the underlying mortgage loan borrowers captured in the referenced pool of mortgages. For these instruments, reporting entity holders may not receive a return of their full principal as principal repayment is contingent on repayment by the mortgage loan borrowers in the referenced pool of mortgages. Unless specifically noted, the provisions for loan-backed securities within this standard apply to mortgage-referenced securities.

6. Investments within the scope of this statement are also subject to the provisions and disclosure requirements of SSAP No. 25 if the SSAP No. 43R transaction is a related party arrangement[5]. Loan-backed and structured securities meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement and SSAP No. 25.

7. The scope of this statement encompasses all types of loan-backed and structured securities, including, but not limited to, the following:

a. Loan-backed and structured securities acquired at origination,

b. Loan-backed and structured securities acquired subsequent to origination for which it is probable, at acquisition, that the reporting entity will be able to collect all

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

[4] Currently, only Fannie Mae and Freddie Mac are the government sponsored entities that issue qualifying mortgage-referenced securities. However, this guidance would apply to mortgage-referenced securities issued by any other government sponsored entity that subsequently engages in the transfer of residential mortgage credit risk.

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

contractually required payments receivable, and are accounted for at acquisition under SSAP No. 103R,

c. Loan-backed and structured securities for which it is probable, either known at acquisition or identified during the holding period[6], that the reporting entity will be unable to collect all contractually required payments receivable, and

d. Transferor's beneficial interests in securitization transactions that are accounted for as sales under SSAP No. 103R and purchased beneficial interests in securitized financial assets[7].

Benefits of Reporting in Scope of SSAP No. 43R – Before the Principles-Based Definition

~~127.~~130. There are a variety of benefits for reporting investments as bonds on Schedule D-1. Also, with regards to bifurcated impairment, capturing an investment in scope of SSAP No. 43R may be more advantageous than capturing in scope of *SSAP No. 26R—Bonds*. These benefits include:

a. Capturing an investment in scope of SSAP No. 26R or SSAP No. 43R results with reporting the investment on Schedule D-1, Long-Term Bonds. By reporting on this bond schedule, the investment is generally not subject to investment limitations, the asset is admitted and the investment has the benefit of lower risk-based capital (RBC) charges based on NAIC designation. (Moving held equity instruments from Schedule BA into a SSAP No. 43R trust has been particularly noted as providing "regulatory capital relief.")

b. Capturing an investment in scope of SSAP No. 26R or SSAP No. 43R may result in amortized cost reporting and a delay in recognizing decreases in value or other-than-temporary impairments than if the assets held in trust were reported separately on the statutory financial statements.

i. Under the SSAP No. 43R bifurcated impairment model, an entity is not required to recognize an OTTI or deviate from an amortized cost measurement as long as the entity can assert that they have the intent and ability to hold the 43R security to recover the amortized cost basis and there is no non-interest related decline. (This has been a key factor in the PPN design, as a high-quality bond is placed in trust (along with other assets), and the bond – over several years – will single-handedly satisfy the contractual requirements of the 43R issued security, preventing any recognition of OTTI or a reduction of NAIC designation even when the other securities held in trust could completely default to zero.)

ii. The SSAP No. 43R bifurcated impairment can be considered an advantage over SSAP No. 26R as under SSAP No. 43R, if there is an intent and ability to hold the asset, a reporting entity only has to recognize an OTTI for the portion of the non-interest related loss. Under SSAP No. 26R, if there is any assessed OTTI (despite if interest or credit related), a reporting entity must recognize an OTTI down to the then-current fair value for the security.

iii. Prior to the principles-based bond project, guidance in SSAP No. 43R did not differentiate between different types of tranches or payment streams for the issued

[6] Securities classified within the type of paragraph 7.a. or 7.b. may be required to change classification to type 6.c. when it becomes probable that the reporting entity will be unable to collect all contractually required payments receivable.

[7] The accounting requirements related to these types of securities included in paragraphs 22-25 shall be determined at acquisition or initial transfer.

securities. This is easiest to illustrate through the "equity" tranche of a SSAP No. 43R investment but could be a factor if payments are provided sequentially. (Sequential payments are used to pay the senior notes first, until paid in full, before payments are allocated to junior notes.) For the "equity" tranche, which is a term that refers to the junior-most layer of issued SSAP No. 43R securities, this tranche is the first-loss position and only receives payment after all other layers have been satisfied. Without prior guidance in SSAP No. 43R for this layer, entities were able to classify these residual tranches as "bonds" on Schedule D-1, which did not properly reflect the nature of those investments.

c. SSAP No. 43R permits admittance of the security without any verification to the assets held in trust. As such, if a reporting entity was to derecognize a joint venture or LLC from Schedule BA, and reacquire through the ownership of a SSAP No. 43R security, the reporting entity would be permitted to admit the security without any verification of the joint venture or LLC held in trust. Under *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, assets must have audited support (audited U.S. GAAP financials, audited reconciliation to U.S. GAAP, audited IFRS financials or audited U.S. tax basis equity) in order to be admitted in the statutory financial statements.

Key Issues with Scope / Definition Application of SSAP No. 43R – Before the Principles-Based Definition

~~128.~~131. With the existing guidance in SSAP No. 43R, there are no restrictions to the assets that can be placed in trust and used to support securities issued from the trust structure. Although these structural designs are referred to as "securitizations" and reported as debt instruments, these investment structures may not reflect actual securitizations in which cash flows from multiple contractual debt obligations held in trust are used to pay principal and interest payments on the trust-issued security. The assets being securitized may include assets that are not cash flow producing, creating reliance on an underlying collateral valuation risk. Or, there may be no economic substance to the use of the securitization structure, such that the insurer is in the same economic position as owning the underlying assets directly. As a result, there is a regulatory concern that assets being represented as bonds may contain unidentifiable risks that regulators would not traditionally associate with bond risk.

~~129.~~132. As an additional issue of the existing guidance, questions have been raised on whether securities captured in scope of SSAP No. 43R would be "asset-backed securities" as defined by the Code of Federal Regulations (17 CFR 229.1101(c)). These questions have arisen as an SEC identified nationally recognized statistical rating organization (NRSRO) must be specifically approved to provide ratings of "asset-backed securities." Since the CFR definition is different than what is permitted in scope of SSAP No. 43R, a rating from an NRSRO approved as a credit rating provider (CRP) that may not be approved by the SEC for "asset-backed securities" could provide a valid rating for a SSAP No. 43R instrument permitted as "filing exempt" if that asset was not an "asset-backed security." This has caused questions as regulators have identified designations given by CRPs not SEC approved to provide "ABS" designations and have questioned the use of these CRP ratings in determining the NAIC designation.

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

Issue: Review of INT 03-02*: Modification to an Existing Intercompany Pooling Arrangement*

Check (applicable entity):

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

Description of Issue:
This agenda item provides a review of Interpretation (INT) 03-02*: Modification to an Existing Intercompany Pooling Arrangement*, because of conflicts between INT 03-02 and *SSAP No. 25—Affiliates and Other Related Parties.* This agenda item was prompted by the recent focus of Statutory Accounting Principles (E) Working Group on related party transactions, recent queries to NAIC about how broadly to apply the guidance in INT 03-02 and the review of the SSAP No. 62R, paragraph INT 03-02 addresses the valuation of bonds in instances when bonds are used instead of cash for the payment among affiliates for amounts due on modifications to existing intercompany reinsurance pooling contracts. The discrepancy between the INT 03-02 and SSAP No. 25 has been identified through recent discussions evaluating related party transactions. Key excerpts of INT 03-02 are in the Authoritative Literature section below.

The primary accounting question that is a concern for this agenda item is INT 03-02, paragraph 11b which asks, "What is the appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement?" The response provided in INT 03-02, paragraph 13 is, "The appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement is statutory book value for assets and statutory value for liabilities. Book value is defined in the glossary of the *Accounting Practices and Procedure Manual*."

INT 03-02 lists that it is an interpretation of the following three reinsurance statements: *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*, *SSAP No. 62R—Property and Casualty Reinsurance* and *SSAP No. 63—Underwriting Pools. SSAP No. 25—Affiliates and Other Related Parties* is not listed as an interpreted statement. However, as described below, the consensus in INT 03-02, paragraph 13 is not consistent with the guidance in SSAP No. 25 regarding economic transactions between related parties.

The result of the consensus in INT 03-02, paragraph 13 allows assets used in affiliated payments for reinsurance contracts, which modify existing intercompany reinsurance pooling agreements, to be transferred using statutory book value. Note that in most cases, this means that bonds which are likely the primary assets that would be used, would typically have a statutory book value that reflects amortized cost. The valuation of assets using statutory book value on transfer to an affiliate, can result in substantial differences from the cash equivalent (fair value) for the payment due. For example, bonds reported at amortized cost book value could have a corresponding fair value that is materially higher or lower. This difference in valuation can result in an unacknowledged dividend or with the passing on of an investment loss.

SSAP No. 25 describes economic transactions and non-economic transactions (See Authoritative Literature). Economic transactions are defined as arm's-length transactions which results in the transfer of the risks and rewards of ownership and represents a consummated act thereof, i.e., "permanence." SSAP No. 25, paragraph 18 indicates that economic transactions between related parties shall be recorded at fair value at the date of the transaction and also notes that to the extent that the related parties are affiliates under common control, the controlling reporting entity shall defer the effects of such transactions that result in gains or increases in surplus until such time that the asset is sold outside the group.

It is quite possible, by using transfers at book value instead of fair value, to design a transaction with a very significant economic effect. The following example illustrates the concern with the results of the guidance in INT 03-02. For this example, $100 million is due on an existing intercompany reinsurance pooling agreement. INT 03-02 would allow bonds to be settled using statutory book value which may not be reflective of the fair value equivalent of a cash settlement.

Asset used to settle	Book Value (millions) measurement for settlement	Fair Value (millions)	Result	Consistent with SSAP No. 25 for an economic transaction?
Cash	$100	$100	No difference in basis	Yes
Bonds	$100	$ 85	$15 difference in fair value means the paid party received an amount less than what is actually owed. This approach could allow reporting entities to transfer impaired assets to affiliates in lieu of assessing OTTI.	No
Bonds	$100	$110	$10 difference in fair value means the paid party has received an asset greater than what was owed. This dynamic could result in an unrecognized gain or dividend.	No

The INT 03-02 direction to use statutory book value for the transfer of bonds between affiliated entities in most instances would conflict with the primary guidance on affiliated transactions contained in *SSAP No. 25—Affiliates and Other Related Parties.* For example, economic transactions between related parties are valued using fair value. (There are more nuances in SSAP No. 25 when payments have the possibility of being economic for one entity and noneconomic for an upper-level parent). NAIC staff recommends that the treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different if assets are transferred instead of cash for intercompany reinsurance.

Under INT 03-02, for intercompany reinsurance transactions, takes an approach that either SSAP No. 25 or SSAP No. 62R may apply, but multiple Working Group discussions have noted that SSAP No. 25 provides the overarching guidance that is relevant in evaluating all related party transactions. INT 03-02, paragraph 8 indicates that the statutory accounting intention is to avoid surplus gains for the ceding entity as a result of implementing a modification to an intercompany pooling arrangement. However, the guidance in SSAP No, 62R, paragraph 37 uses a more punitive method of accounting if there is a gain in surplus to the ceding entity as a result of the intercompany reinsurance transaction. Therefore, NAIC staff would characterize the SSAP No. 62R guidance as imposing an accounting penalty if there is a gain, rather than seeking to avoid recognizing such a gain. The INT also characterizes SSAP No. 25 as being for isolated transactions, which is inconsistent with discussions of the Working Group on the applicability of SSAP No. 25.

SSAP No. 62R, paragraph 36d (see Authoritative Literature) includes an exception to retroactive reinsurance accounting which allows prospective accounting treatment for intercompany reinsurance agreements and any amendments thereto, among companies 100% owned by a common parent or ultimate controlling person <u>provided there is no gain in surplus as a result of the transaction.</u> Paragraph 37 provides that if there is a gain to the ceding entity that a more restrictive method of accounting is required which is less beneficial to the financial statements. Whereas the INT tries to argue that statutory intent is to avoid surplus gain, NAIC staff would note that the goal is not to avoid gain as a result of the reinsurance transaction, but to impose a different accounting if there is a gain.

NAIC staff would characterize evaluating reinsurance agreements for SSAP No. 62R, paragraph 36d or paragraph 37 as using the cash flows or corresponding equivalent fair value (cash equivalent) of the amounts payable or receivable in the reinsurance transactions to determine if there is a gain or loss to the ceding entity. The reinsurance cash flows evaluated should be the same as if the bond was sold for fair value and resulting cash equivalent obligation was paid. The fact that the bond sold has a gain or loss is not part of the reinsurance contract evaluation, the reinsurance contract that is an economic transaction evaluation is based on the cash equivalent value of the assets transferred less the liabilities transferred. The evaluation of gain or loss on the intercompany reinsurance transaction should give the same answer if either cash or assets were transferred.

Existing Authoritative Literature:

03-02*: Modification to an Existing Intercompany Pooling Arrangement* is attached in full. The following excerpts are from INT 03-02:

> 8. Therefore, based on the foregoing guidance and background, the statutory accounting intent is to avoid surplus gains for the ceding entity as a result of implementing a modification to an intercompany pooling arrangement. On that basis, such a modification does not represent an economic transaction to the insurance group or to the impacted companies. As such, the transfer of both the assets and the liabilities valued at statutory book value ensures that there is no impact to surplus as a result of implementing a modification to an existing pooling arrangement.

> 11. The accounting issues are:
>
> a. What is the relevant guidance for modifications to intercompany pooling arrangements?
>
> b. What is the appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement?
>
> The Working Group reached a consensus as follows:
>
> 12. SSAP No. 62R provides accounting for property and casualty reinsurance agreements including specific guidance on intercompany pooling agreements. SSAP No. 62R provides two methods of accounting for changes in intercompany pooling agreements, depending on whether or not the pooling results in a gain in surplus.
>
> 13. The appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement is statutory book value for assets and statutory value for liabilities. Book value is defined in the glossary of the *Accounting Practices and Procedure Manual*.

SSAP No. 25—Affiliates and Other Related Parties

> **Transactions Involving the Exchange of Assets or Liabilities**
>
> 14. An arm's-length transaction is defined as a transaction in which willing parties, each being reasonably aware of all relevant facts and neither under compulsion to buy, sell, or loan, would be willing to participate. A transaction between related parties involving the exchange of assets or liabilities shall be designated as either an economic transaction or non-economic transaction. An economic transaction is defined as an arm's-length transaction which results in the transfer of the risks and rewards of ownership and represents a consummated act thereof, i.e., "permanence." The appearance of permanence is also an important criterion in assessing the economic substance of a transaction. In order for a transaction to have economic substance and thus warrant revenue (loss) recognition, it must appear unlikely to be reversed. If subsequent events or transactions reverse the effect of an earlier transaction prior to the issuance of the financial statements, the reversal shall be considered in determining whether economic substance existed

in the case of the original transaction. Subsequent events are addressed in SSAP No. 9—Subsequent Events. An economic transaction must represent a bonafide business purpose demonstrable in measurable terms. A transaction which results in the mere inflation of surplus without any other demonstrable and measurable betterment is not an economic transaction. The statutory accounting shall follow the substance, not the form of the transaction.

15. In determining whether there has been a transfer of the risks and rewards of ownership in the transfer of assets or liabilities between related parties, the following—and any other relevant facts and circumstances related to the transaction—shall be considered:

a. Whether the seller has a continuing involvement in the transaction or in the financial interest transferred, such as through the exercise of managerial authority to a degree usually associated with ownership;

b. Whether there is an absence of significant financial investment by the buyer in the financial interest transferred, as evidenced, for example, by a token down payment or by a concurrent loan to the buyer;

c. Whether repayment of debt that constitutes the principal consideration in the transaction is dependent on the generation of sufficient funds from the asset transferred;

d. Whether limitations or restrictions exist on the buyer's use of the financial interest transferred or on the profits arising from it;

e. Whether there is retention of effective control of the financial interest by the seller.

16. A transaction between related parties may meet the criteria for treatment as an economic transaction at one level of financial reporting, but may not meet such criteria at another level of financial reporting. An example of such a transaction is a reporting entity purchasing securities at fair value from an affiliated reporting entity that carried the securities at amortized cost. This transaction meets the criteria of an economic transaction at this level of financial reporting, and therefore, the selling reporting entity would record a gain and the acquiring reporting entity would record the securities at their cost (fair value on the transaction date). At the common parent level of reporting, this transaction has resulted in the mere inflation of surplus, and therefore, is a non-economic transaction. The parent reporting entity shall defer the net effects of any gain or increase in surplus resulting from such transactions by recording a deferred gain and an unrealized loss. The deferred gain shall not be recognized by the parent reporting entity unless and until arms-length transaction(s) with independent third parties give rise to appropriate recognition of the gain.

17. A non-economic transaction is defined as any transaction that does not meet the criteria of an economic transaction. Similar to the situation described in paragraph 16, transfers of assets from a parent reporting entity to a subsidiary, controlled or affiliated entity shall be treated as non-economic transactions at the parent reporting level because the parent has continuing indirect involvement in the assets.

18. When accounting for a specific transaction, reporting entities shall use the following valuation methods:

a. Economic transactions between related parties shall be recorded at fair value at the date of the transaction. To the extent that the related parties are affiliates under common control, the controlling reporting entity shall defer the effects of such transactions that result in gains or increases in surplus (see paragraph 16);

b. Non-economic transactions between reporting entities, which meet the definition of related parties above, shall be recorded at the lower of existing book values or fair values at the date of the transaction;

c. Non-economic transactions between a reporting entity and an entity that has no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, shall be recorded at the fair value at the date of the transaction; however, to the extent that the transaction results in a gain, that gain shall be deferred until such time as permanence can be verified;

d. Transactions which are designed to avoid statutory accounting practices shall be reported as if the reporting entity continued to own the assets or to be obligated for a liability directly instead of through a subsidiary.

Examples of transactions deemed to be non-economic include security swaps of similar issues between or among affiliated companies, and swaps of dissimilar issues accompanied by exchanges of liabilities between or among affiliates.

Transactions Involving Services

19. Transactions involving services between related parties can take a variety of different forms. One of the significant factors as to whether these transactions will be deemed to be arm's length is the amount charged for such services. In general, amounts charged for services are based either on current market rates or on allocations of costs. Determining market rates for services is difficult because the circumstances surrounding each transaction are unique. Unlike transactions involving the exchange of assets and liabilities between related parties, transactions for services create income on one party's books and expense on the second party's books, and therefore, do not lend themselves to the mere inflation of surplus. These arrangements are generally subject to regulatory approval.

20. Transactions involving services provided between related parties shall be recorded at the amount charged[1]. Regulatory scrutiny of related party transactions where amounts charged for services do not meet the fair and reasonable standard established by Appendix A-440, may result in (a) amounts charged being recharacterized as dividends or capital contributions, (b) transactions being reversed, (c) receivable balances being nonadmitted, or (d) other regulatory action. Expenses that result from cost allocations shall be allocated subject to the same fair and reasonable standards, and the books and records of each party shall disclose clearly and accurately the precise nature and details of the transaction. See *SSAP No 70—Allocation of Expenses* for additional discussion regarding the allocation of expenses.

SSAP No. 62R—Property and Casualty Reinsurance provides the following (**bolding added for emphasis**):

36. The accounting principles for retroactive reinsurance agreements in paragraph 34 shall not apply to the following types of agreements (which shall be accounted for as prospective reinsurance agreements unless otherwise provided in this statement):

a. Structured settlement annuities for individual claims purchased to implement settlements of policy obligations;

b. Novations, (i.e., (i) transactions in which the original direct insurer's obligations are completely extinguished, resulting in no further exposure to loss arising on the business novated or (ii) transactions in which the original assuming entity's obligations are completely extinguished) resulting in no further exposure to loss arising on the business novated, provided that (1) the parties to the transaction are not affiliates (or if affiliates, that the transaction has the prior approval of the domiciliary regulators of the parties) and (2) the accounting for the original reinsurance agreement will not be altered from retroactive to prospective;

[1] The amount charged shall be reviewed when there are any modifications or waivers subsequent to the establishment of the contract terms. If waivers or modifications to amounts charged occur, the related party transaction shall be reassessed to determine whether the contract continues to reflect fair and reasonable standards. If the transaction was with a parent or other stockholder and the charge for services has been fully waived, then the guidance in SSAP No. 72 for recognition as contributed capital (forgiveness of reporting entity obligation) or as a dividend (forgiveness of amount owed to the reporting entity) shall apply.

c. The termination of, or reduction in participation in, reinsurance treaties entered into in the ordinary course of business;

d. Intercompany reinsurance agreements, and any amendments thereto, among companies 100% owned by a common parent or ultimate controlling person provided there is no gain in surplus as a result of the transaction; or

e. Reinsurance/retrocession agreements that meet the criteria of property/casualty run-off agreements described in paragraphs 102-105.

37. **Retroactive reinsurance agreements resulting in surplus gain to the ceding entity (with or without risk transfer)** entered into between affiliates or between insurers under common control (as those terms are defined in Appendix A-440) shall be reported as follows:

a. The consideration paid by the ceding entity shall be recorded as a deposit and reported as a nonadmitted asset; and

b. No deduction shall be made from loss and loss adjustment expense reserves on the ceding entity's balance sheet, schedules, and exhibits.

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

INT 03-02 was exposed in March of 2003 and adopted in June 2003. The interpretation was not subsequently amended. The final vote on this consensus had three members opposed. The March 2003 exposure received six different comment letters to the Emerging Accounting Issues (E) Working Group from: 1) Ohio (EAIWG member); 2) New Hampshire (EAIWG member); 3) Interested parties, 4) Liberty Mutual and 5) PriceWaterhouseCoopers (one of the very few letters ever submitted directly by the firm.) and 6) CNA. Five out of the six commenters noted concerns that the proposed guidance (which was ultimately adopted) would conflict with SSAP No. 25 guidance regarding economic transactions. While the interested parties comment letter was more neutral, the verbal comments provided supported the use of SSAP No. 25.

Several commenters recommended not adopting the guidance regarding the use of book value and instead following SSAP No. 25 guidance for economic and non-economic transactions. The commenters noted that SSAP No. 25 directs the use of fair value when such transactions meet the definition of an economic transactions and that tax regulations would provide a result similar to SSAP No. 25. Multiple comments noted concerns similar to those highlighted in the illustration above. Commenters also noted that intercompany pooling reinsurance transaction are economic transactions. They noted that when assets (such as bonds valued at amortized cost) are transferred, if the assets have a different fair value than book value, that difference should be recognized since the transferor no longer controls the assets. Commenters also noted that treatment for reinsurance transactions for asset transfers should not be different than the treatment for other intercompany transactions.

CNA comments were supportive of adopting the exposed consensus, the comment letter provided illustrations and noted that intercompany reinsurance agreements were subject to regulatory approval. The comments tried to illustrate concerns possibly having premature gain / surplus recognition. .

The June 2003 minutes Emerging Accounting Issues (E) Working Group discussion on the INT 03-02 are excerpted below.

> The working group was referred to INT 03-02: *Modification to an existing intercompany pooling arrangement* (Attachment D). Written comments were received from Ohio, New Hampshire and interested parties. Ohio and New Hampshire believe that the transfer of assets and liabilities in an intercompany pooling arrangement constitute an economic transaction and the accounting guidance in SSAP No. 25—*Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties* (SSAP No. 25), should be followed. As such, the assets should be transferred at fair value and the ceding entity should record a

realized gain or loss. Keith Bell (Travelers) spoke on behalf of interested parties. Interested parties commented that if the transaction was considered to be an economic transaction, SSAP No. 25 should be followed. If the modification of an intercompany pooling arrangement is considered a noneconomic transaction, the guidance in SSAP No.62—*Property and Casualty Reinsurance*(SSAP No. 62) is applied, as such, statutory book value should be used for assets and statutory value should be used for liabilities. Jeff Alton (CNA) presented his comments by summarizing the statements made in his comment letter. Mr. Alton stated that no revenue recognition should occur and suggested using a modified statutory book value for transferring assets and liabilities. Mr. Clark stated that the Statutory Accounting Principles Working Group must address the recommended transfer at modified statutory book value as this recommendation would require substantive adjustments to statutory accounting principles. Shelly Zimmerman (Liberty Mutual) provided comments which supported that intercompany pooling changes should follow the accounting guidance in SSAP No. 25 as these are economic transactions between affiliates. Jean Connelly (PriceWaterhouseCoopers) provided comments that summarize those outlined in the comment letter. Ms. Connelly stated that intercompany pooling arrangements are economic transactions and that INT 03-01 provides a substantive change to SSAP No. 25.

Mr. Johnson then stated that he believes there is a stronger case for non-economic transaction treatment and as such, statutory book value is appropriate for valuation purposes. Additionally, all these transactions are subject to regulatory review under the Insurance Holding Company Act, affording regulators some control over the approval of these transactions. Mr. Fritsch commented that if this guidance is not adopted in the form of a new interpretation, SSAP No. 25 should be followed. Mr. Alton stated that he believes the current guidance in effect for intercompany pooling arrangements exists in SSAP No. 62, paragraph 30d which supports surplus neutrality: hence, the need is for an interpretation of paragraph 30d. Mr. Johnson stated that language clarification in SSAP No.61—*Life, Deposit-Type and Accident and Health Reinsurance*(SSAP No. 61) and SSAP No. 62 should be addressed as a project of the reinsurance subgroup of the SAPWG. Mr. Johnson made a motion to adopt Interpretation 03-02 with deletion of the first two sentences in paragraph 11. Mr. Stolte seconded the motion. Mr. Johnson requested a roll call vote. There were 9 yeas from Alabama, Connecticut, Florida, Illinois, Louisiana, Michigan, Texas, Pennsylvania and Virginia. There were 3 nays from New York, Ohio, and Wisconsin. Therefore, the working group adopted Interpretation 03-02 by consensus. Mr. Johnson also made a motion to refer to the Reinsurance Subgroup of the SAPWG, review of the current guidance in SSAP No. 61, SSAP No. 62 and SSAP No. 63—*Underwriting Pools and Associations Including Intercompany Pools.* Mr. Ford seconded the motion. The working group unanimously adopted the referral.

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

Convergence with International Financial Reporting Standards (IFRS): Not Applicable

Staff Review Completed by: Robin Marcotte – NAIC Staff, July - 2022

Staff 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 nullify INT 03-02, as it is inconsistent with SSAP No. 25 guidance regarding economic and non-economic transactions between related parties. The guidance in INT 03-02 can result with in essence, unrecognized gains (dividends) or losses through the using the statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements. Treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions.

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 the intent to nullify INT 03-02.

On December 13, 2022, the Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and re-exposed the intent to nullify INT 03-02. This re-exposure requested industry to provide comments on specific instances in which the interpretation was being applied. In addition, the following key points were noted for consideration during the exposure in response to some of the comments received.

1. In the current interest rate environment, the fair value of many bonds is below book value. For example, a bond with an amortized cost of 100 with a fair value of 85. The way INT 03-02 is written a bond with a fair value of 85 could be used to settle an intercompany reinsurance pooling obligation of 100. If the reporting entity paid with cash, they would be required to pay $100. The actual cash value of obligations when they are extinguished is a relevant measure of the transaction.

2. Using book value for measurement of payments between affiliates can result in either unrecognized of in effect dividend or losses. SSAP No. 25 requires such transfers of assets between affiliates to use fair value. If a subsidiary can pay the parent with assets that have a lower fair value than book value (ex, owes $100 but pays with a bond of 85), this has a similar effect as an unrecognized capital contribution to the subsidiary. SSAP No. 72 requires a capital contribution to be valued using fair value.

3. At the ultimate parent level such transfer of assets (in accordance with SSAP No. 25 guidance) may be noneconomic in that the parent continues to hold an interest in the same assets. Therefore, at the parent level, such transfers of assets may result in the deferral of gains. Staff believes that losses would not be deferred at the ultimate parent level.

4. While it may be more expedient to pay intercompany reinsurance pooling transactions with assets, the valuation used should be similar to if the obligation was extinguished with cash. Therefore, an entity can still choose to pay with assets, they just need to be valued consistently with SSAP No. 25 guidance.

5. SSAP No. 62R, paragraph 36d provides an exception to retroactive reinsurance accounting guidance which allows for prospective accounting treatment for intercompany reinsurance among 100% owned affiliated provided there is no gain to the ceding entity. If there is again to the ceding entity, there is guidance in SSAP No. 62R, paragraph 37 which requires a more punitive method of accounting than either prospective or retroactive reinsurance accounting. Therefore, NAIC staff comment is that the statutory accounting objective is to provide different treatment for retroactive reinsurance contracts if there is a gain to the ceding entity. This is another reason that the guidance in INT 03-02 is problematic. The object is to correctly measure the effects of the contract, which drives the accounting. The objective is not to obscure whether there is a gain to the ceding entity, which can happen in the event that the assets used in payment are not measured correctly.

6. Interested parties noted that modifications to intercompany pooling arrangements are typically effective retroactive to the beginning of the year. Staff notes that the payment value when the transaction is settled should be equivalent to the cash value of what is owed on the date of extinguishment of the liability.

7. Many of the interested parties' comments regarding GAAP use of book value are more relevant to consolidated basis accounting which is not consistent with the legal entity basis of statutory accounting.

8. Interested parties' comments noted that there is a difference in treatment for intercompany pooling participants who are not 100% owned by a common parent. NAIC staff notes that retroactive pooling agreement changes with participants that are not 100% under common control do not meet the exception to retroactive accounting provided in SSAP No. 62R, paragraph 36d. NAIC staff notes that SSAP No. 62R, paragraph 37 provides guidance for retroactive reinsurance agreements among affiliates where there is a gain to the ceding entity. Therefore, the regulatory objective is not to avoid gain but to properly account for intercompany retroactive contracts that include gains.

On March 22, 2023, the Working Group re-exposed the intent to nullify INT 03-02, effective December 31, 2023. The nullification is proposed as INT 03-02 is inconsistent with SSAP No. 25 guidance regarding economic and non-economic transactions between related parties. The guidance in INT 03-02 can result with, in essence, unrecognized gains (dividends) or losses through the using the statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements. Treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions.

On August 13, 2023, the Working Group re-exposed the intent to nullify INT 03-02 and directed NAIC staff to work with industry regarding some of their comments and examples to be submitted by industry.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/8-13-23 Summer National Meeting/Exposures/22-12 - Review INT 03-02.docx

Interpretation of the Emerging Accounting Issues (E) Working Group

INT 03-02: Modification to an Existing Intercompany Pooling Arrangement

NOTE: The Statutory Accounting Principles (E) Working Group has exposed the intent to nullify this Interpretation.

INT 03-02 Dates Discussed

March 9, 2003; June 22, 2003; August 10, 2022; December 13, 2022; March 22, 2023; August 13, 2023

INT 03-02 References

Current:
SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance
SSAP No. 62R—Property and Casualty Reinsurance
SSAP No. 63—Underwriting Pools

INT 03-02 Issue

1. Insurance groups that utilize intercompany pooling arrangements often modify these arrangements from time to time for various business reasons. These business reasons commonly include mergers, acquisitions, dispositions or a restructuring of the group's legal entity structure. As an insurance group's business objectives and strategies evolve, it may be necessary for the insurance group's legal entity structure to similarly evolve in order to address the insurance group's business needs.

2. SSAP No. 63, paragraphs 5 and 7, defines and describes intercompany pooling as an arrangement among affiliated entities whereby "all of the pooled business is ceded to the lead entity and then retroceded back to the pool participants in accordance with their stipulated shares." This arrangement is established through "a conventional quota share reinsurance agreement…" Arrangements whereby there is one lead company that retains 100% of the pooled business and all or some of the affiliated companies have a 0% net share of the pool may qualify as intercompany pooling."

3. Therefore, in order to effectuate a modification to the existing intercompany pooling arrangement, companies must either 1) amend the existing reinsurance agreement, or 2) execute new agreements. The latter scenario may entail executing at least two agreements: a commutation of the existing agreement, and a new quota share agreement(s) that covers both past and future periods.

4. To illustrate, in order to effectuate a relatively simple modification, such as changing pooling participation percentages without changing the pool participants, companies often simply amend the existing pooling agreement. Alternatively, in order to effectuate a more complex modification, such as changing (by adding or removing) the number of pool participants, a company must commute the existing pooling agreement and execute a new quota share agreement(s). In conjunction with executing the appropriate reinsurance agreements, a transfer of assets and liabilities amongst the impacted affiliates is also required in order to implement the new reinsurance agreement(s). At issue is the appropriate valuation basis to be used for assets and liabilities that are transferred pursuant to the new reinsurance agreement(s).

5. Since SSAP No. 63 does not specifically address modifications to intercompany pooling arrangements, insurance groups that modify their intercompany pooling arrangements must refer elsewhere in Statutory Accounting Principles (SAP) for relevant guidance. The obvious guidance for such transactions is SSAP No. 62R since an intercompany pooling arrangement is, by definition, affiliated reinsurance. There is, however, a minority opinion that *SSAP No. 25—Affiliates and Other Related*

Parties appears to apply due to the affiliated nature of these transactions. Since the guidance and intent of SSAP No. 62R and SSAP No. 25 provide for different valuation bases, this interpretation serves to provide definitive guidance as to which SSAP is relevant for these transactions and, therefore, clarify the appropriate valuation basis to be used for assets and liabilities transferred pursuant to a modification to an intercompany pooling arrangement.

SSAP No. 62R Approach:

6. This approach refers to the guidance and statutory accounting intent from SSAP No. 62R since intercompany pooling arrangements are defined and established through reinsurance. Further, since modifications to intercompany pooling agreements typically involve the transfer of net liabilities incurred since the inception of the existing pooling agreement (i.e., prior to the effective date of the new agreement), the retroactive reinsurance accounting guidance in paragraphs 33-39 of SSAP No. 62R is applicable. Paragraph 33 states that this special accounting treatment is warranted "due to the potential abuses involving the creation of surplus to policyholders and the distortion of underwriting results…" However, paragraph 36.d. specifically applies to intercompany reinsurance arrangements, and amendments to intercompany reinsurance agreements, since the reinsurance agreement is among companies 100% owned by a common parent. This paragraph allows prospective accounting treatment for intercompany reinsurance agreements that do not result in a gain in surplus as a result of the transaction.

7. To provide historical perspective, prior to the adoption (with modification) of FASB *Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* (FAS 113) as SAP, paragraph 36.d. was added as one of the SAP modifications. The intent of adding paragraph 36.d. was to specifically exclude intercompany reinsurance agreements among entities 100% owned by a common parent from retroactive reinsurance accounting requirements as a result of amending or modifying these agreements, provided there is no surplus gain. The presumption in this intent was that there would be no gains to the ceding entity resulting from implementing amendments or modifications to these types of reinsurance agreements.

8. Therefore, based on the foregoing guidance and background, the statutory accounting intent is to avoid surplus gains for the ceding entity as a result of implementing a modification to an intercompany pooling arrangement. On that basis, such a modification does not represent an economic transaction to the insurance group or to the impacted companies. As such, the transfer of both the assets and the liabilities valued at statutory book value ensures that there is no impact to surplus as a result of implementing a modification to an existing pooling arrangement.

SSAP No. 25 Approach:

9. An approach different from that which refers to reinsurance accounting guidance is to refer to the guidance in SSAP No. 25 since some may view a modification to an intercompany pooling agreement as a related party transaction involving the exchange of assets or liabilities. In this case, paragraphs 14-18 of SSAP No. 25 would appear applicable. This guidance specifies differing valuation bases, depending on whether the transaction is considered an economic or a non-economic transaction. SSAP No. 25, paragraph 14, states that "…The appearance of permanence is also an important criterion is assessing the economic substance of a transaction. In order for a transaction to have economic substance and thus warrant revenue (loss) recognition, it must appear unlikely to be reversed …" Since insurance groups often modify intercompany pooling arrangements, this type of transaction is not permanent, and may be construed as a non-economic transaction. SSAP No. 25, paragraph 18.b., states that "non-economic transactions … shall be recorded at the lower of existing book value or fair value at the date of the transaction."

10. It appears that this guidance is intended to address matters involving discrete or isolated transfers of assets and/or liabilities between affiliates rather than transfers of assets and liabilities effected in relation to executing reinsurance transactions (the guidance for which is SSAP No. 62R). Additionally,

application of this guidance would result in a change to the surplus of the insurance group as a result of implementing a modification to an existing intercompany pooling arrangement. As previously stated, the statutory accounting intent is to avoid surplus gains for the insurance group as a result of implementing a modification to an intercompany pooling arrangement.

11. The accounting issues are:

    a. What is the relevant guidance for modifications to intercompany pooling arrangements?

    b. What is the appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement?

INT 03-02 Discussion

The Working Group reached a consensus as follows:

12. SSAP No. 62R provides accounting for property and casualty reinsurance agreements including specific guidance on intercompany pooling agreements. SSAP No. 62R provides two methods of accounting for changes in intercompany pooling agreements, depending on whether or not the pooling results in a gain in surplus.

13. The appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement is statutory book value for assets and statutory value for liabilities. Book value is defined in the glossary of the *Accounting Practices and Procedure Manual*.

INT 03-02 Status

14. No further discussion is planned.

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

Issue: New Market Tax Credits

Check (applicable entity):

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

Description of Issue: The New Market Tax Credits (NMTC) Program was established by Congress in December 2000 and permits individual and corporate taxpayers to receive a non-refundable tax credit against federal income taxes for making equity investments in financial intermediaries known as Community Development Entities (CDEs). CDEs that receive the tax credit allocation authority under the program are domestic corporations or partnerships that provide loans, investments, or financial counseling in low-income urban and rural communities. The tax credit provided to the investors total 39% of the total cost of the investment and is claimed over a seven-year period. The CDEs in turn use the capital raised to make investments in low-income communities. CDEs must apply annually to the CDFI Fund to compete for NMTC allocation authority. The NMTC program is currently subject to expiration but has been extended to Dec. 31, 2025. The NMTC Extension Act of 2021 (introduced February 2021) would make the NMTC program permanent, modify the credit to provide for an inflation adjustment to the limitation amount for the credit after 2021, and allow an offset against the alternative minimum tax for the credit.

The success of the federal NMTC program has led to states adopting their own NMTC legislation. Per one noted article, the majority of state NMTC programs follow the federal rules with some modifications that vary from state to state. State modifications have been noted to specifically target smaller businesses, simplifying the application process, prohibiting the use of real estate business, and capping the amount of tax credits that can be allocated to one project. The economic impact of the state NMTC programs is typically less than the impact of federal NMTC programs because the economic return to investors for state tax credits is generally lower than what they receive for federal credits. Some states require that state tax credits can only be used in conjunction with federal credits. Pairing federal and state programs is beneficial to the qualifying business as they keep more of the investment without an obligation to return as the investors gets more tax credits.

Overview of Federal Program:

- Federal government authorizes an annual credit authority for NMTCs (amount of tax credits available).

- The Community Development Fund Institutions (CDFI fund) is a division of the U.S. Treasury responsible for implementing the NMTC program. Since there are limited tax credits each year, the CDFI fund has a competitive application process for the right to grant tax credits to investors and to make qualified NMTC investments.

- The right to grant tax credits is referred to as "NMTC Allocation" and is awarded to Community Development Entities (CDEs) that invest in low-income communities. The CDEs offer the tax credits to cash investors, and then use the cash to make investments (typically loans to a qualifying project – a "Qualifying Active Low-Income Community Business" - QALICB) that further the mission and objectives of the NMTC program.

- The program specifies that the investor must provide cash as an equity investment (qualified equity investment – QEI) and it must stay invested in the CDE and the resulting NMTC qualifying project (QALICB) for a period of seven years.

    - The restrictions are specific that the investment is an equity investment as stock (other than nonqualified preferred) in an entity that is a corporation for federal tax purposes or any capital interest in an entity that is a partnership for federal tax purposes. (The investor is generally a 99.99% or 100% equity owner.)

- NMTC investments must remain in a qualified business for a seven-year period. Any principal amount repaid during that period must be reinvested by the CDE until the seven-year period expires. Most CDEs and investors avoid the reinvestment requirement and structure interest-only loans that prohibit principal repayment within the seven-year timeframe.

    - The 39% tax credit is provided as 5% of the investment in the first 3 years and then 6% of the investment for the next 4 years.

    - For tax purposes, the basis adjustment in the qualified equity investment is reduced by the amount of any new market tax credits on each credit allowance date.

    - Programs that cease to qualify are subject to tax credit recapture.

- Investors enter these transactions recognizing that the original investment amount will not be fully returned. Rather, a portion (or perhaps all) of the equity investment will be unpaid without an obligation to return from the borrowing business. NMTC investments with these terms have specific maturing terms / actions. One approach could be that an option (put/call) is held by the investor that gives them the right to sell its equity investment to the borrower for a nominal price.

- The designs are often complex and introduce leverage lenders to maximize tax credits to the equity investor:
    - Equity investor provides $3M to acquire 100% equity interest in an investment fund.
    - Investment fund borrows $7M from a leverage lender.
    - This results with a $10M qualifying NMTC transaction, resulting with the equity investor receiving $3.9M in tax credits over 7 years from an initial $3M investment.
    - The investment fund provides two loans to the qualified low-income business (QALICB). The first loan is for the $7M leverage loan, the second is for the $3M equity investment.
    - Both loans only pay interest for the seven-year period to meet the NMTC terms.
    - At the conclusion of the 7 years, the project sponsor purchases the second loan via a ‘put/call’ agreement, converting the $3M into a permanent subsidiary for the project.
    - The borrower / project sponsor refinances the $7M loan to repay the leverage lender.
    - The ultimate result is that the equity investor received $3.9M over 7 years in tax credits for $3M.

- Example without leverage lender:
    - Investor provides a $10M NMTC Investment
    - Investor receives $3.9M in tax credits over seven years.
    - Investors receives $7.4M of original investment at the end of the seven years.
    - Borrower keeps $2.6M of the original investment to further their low-income qualifying activities.
    - Investor receives a net return of $1.3M. ($10M less $3.9M tax credits less return of 7.4M principal.)

<u>FASB Discussion</u>
The FASB has a current Emerging Issues Task Force project to assess whether the proportional amortization method of accounting, which is used for Low-Income Housing Tax Credits (LIHTC), should be expanded to investments in tax credit structures beyond LIHTC. The proportional amortization method results in the tax credit investment being amortized in proportion to the allocation of tax credits in each period and allows the investment amortization and tax credits to be presented on a net basis within the income tax line item. Currently, investments in other tax credit structures are typically accounted for using the equity method or the cost method. Under the equity and cost methods, investment gains/losses and tax credits are presented on a gross basis on an entity's income statement. The FASB has received two requests asking that the proportional amortization method be made applicable to New Market Tax Credit Structures as well as other investment structures that are made primarily for the purpose of receiving tax credits and other tax benefits. The FASB added a project to the Emerging Issues Task Force agenda on Sept. 22, 2021. The FASB Task Force reached a consensus-for-exposure on June 16, 2022, that the proportional amortization method can be elected on a tax credit program by tax credit program basis. This proposed ASU was exposed in August 2022, with comments due Oct. 6, 2022. A final ASU is expected later in 2022 or early in 2023 (ASU 2023-02 was issued in March of 2023).

<u>IRS Provisions</u> – The NMTC is captured as a nonrefundable 'general business credit' and is limited to tax liability. If tax liability is not sufficient to take the credit, then the tax credit is subject to carryforward / carryback provisions. Per instructions from the *2021 Instructions for Form 3800 – General Business Credit*, general business credits that cannot be used because of a tax liability limit are first carried-back 1 year through an amended return. If there are unused credits after carrying back 1 year, the tax credit can be carried forward to each of the 20 tax years after the year of the credit.

<u>Inflation Reduction Act Provisions</u> – The Inflation Reduction Act was signed by President Biden on Aug. 16, 2022. Although there are several elements within the Act, it includes a 15% corporate minimum tax rate for corporations with at least $1 billion in income and includes numerous investments in climate protection, clean energy production and tax credits aimed at reducing carbon emissions. Although the Act has been signed, several elements are pending further application guidance. From preliminary information, the act allows for general business credits, such as the low-income housing tax credit (LIHTC), new markets tax credit (NMTC), historic tax credit (HTC) and renewable energy tax credits (RETCs) to be taken against the minimum tax. **However, further monitoring of application / interpretation guidance that is still forthcoming is required to assess the actual application and impact of tax credits on companies subject to the minimum tax.**

<u>Statutory Accounting Considerations:</u>

- Although the design is an equity investment of stock or interest in a corporation or partnership, which would normally be subject to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, the intent of NMTC investments is for tax credits and not equity returns. As such, this structure is closer to the existing low-income housing tax credits guidance in SSAP No. 93 than the partnership / LLC guidance in SSAP No. 48.

- Although *SSAP No. 93—Low Income Housing Tax Credit Property Investments* provides guidance for an equity investment, that provides tax credits with a limited (or zero) residual investment value, the guidance in SSAP No. 93 is specific to LIHTC programs.

- It has been identified that there are structures that have been designed to resemble fixed-income notes that do not pay regular cash interest, but rather provide NMTC tax credits as interest returns. These structures are in substance that same as other investments in NMTC, with an underlying equity interest in the CDE that generates tax credits. However, they have been structured with a guarantee for compensatory interest in the form of cash for the amount of the tax credit expected to have been received that year. These structures are also being considered within scope of this agenda item. Such structures have to meet specific criteria to qualify for tax credits under the IRS rules.

Existing Authoritative Literature:

SSAP Authoritative Guidance:

- **<u>SSAP No. 93—Low Income Housing Tax Credit Property Investments</u>**
  This statement establishes accounting principles for investments in federal certain state sponsored Low Income Housing Tax Credit (LIHTC) properties owned through limited liability entities that are flow-through entities for tax purposes. The guidance requires LIHTC investments to be initially recorded at cost and carried at proportional amortized cost unless the investment is identified as impaired. Under the proportional amortization method, amortization of the LLC investment is recognized in the income statement as a component of net investment income/expense and the current tax credit is accounted for as a component of income tax expense:

    - Federal tax credits are recognized in the income statement as an offset to federal taxes in the tax reporting year in which the tax credit is utilized in accordance with *SSAP No. 101—Income Taxes*.

    - State tax credits shall be recognized in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax-reporting year in which the credit is utilized.

    - Tax benefits received, other than tax credits, shall be accounted for pursuant to SSAP No. 101.

  SSAP No. 93 indicates that immediate recognition of the entire benefit of the tax credit to be received during the term of the investment in a low-income housing project is not appropriate. It also indicates that low-income housing tax credits shall not be recognized in the financial statements before their inclusion in the investor's tax return.

- **<u>SSAP No. 94R—Transferable and Non-Transferable State Tax Credits</u>**
  This statement establishes accounting principles for investments transferable and non-transferable state tax credits, with an explicit exclusion for LIHTCs (or similar tax credits) captured in scope of SSAP No. 93.

  Guidance for admittance of state tax credits under this statement varies based on whether it is transferable or non-transferable:

  <u>Transferable – Per the SSAP, all the following criteria must be met for admittance:</u>

  1) The holder of the transferable state tax credit may sell or otherwise transfer the transferable state tax credit to another entity, which can likewise sell or transfer the credit;
  2) The transferable state tax credit will expire is not used by a predetermined date; and
  3) The transferable state tax credit can be applied against either state income tax or state premium tax.

  <u>Non-Transferable – Per the SSAP, all the following criteria must be met for admittance:</u>

  1) Successive holder of a state tax credit must redeem the credit by April 15 of the subsequent year to the entity's acquisition of the state tax credit and is not permitted to carry-over, carry-back, obtain a refund, sell or assign the credit;
  2) The non-transferable state tax credit will expire if not used by the predetermined date; and
  3) The non-transferable state tax credits can be applied against either state income tax or state premium tax.

<u>Review of Existing Statutory Accounting Guidance for NMTC and Overall Application:</u>

- Existing statutory accounting guidance does not encompass federal NMTC (or other federal tax credits), as SSAP No. 93 is limited to LIHTC and SSAP No. 94 is specific to state tax credits.

- Provisions in SSAP No. 93 do not fully address earned (received) tax credits that carryforward for future use.

- The admittance criteria in SSAP No. 94 are applied to characteristics that perhaps may not be factors that would impact admittance:

    - A tax credit that does not expire would be precluded as an admitted asset under the guidance.

    - A non-transferable tax credit that can be carried-forward, carried-back, able to be refunded or that can be sold or assigned is precluded as an admitted asset under the guidance.

Statutory Accounting Reporting Guidance:

Guaranteed and non-guaranteed federal low-income housing tax credits have separate reporting lines on Schedule BA along with an "all other" low-income housing tax credit line. The guidance is specific that these lines are only for low-income tax credits (or tax credits for affordable housing) that are in the form of a partnership or limited liability company. Non-qualifying LIHTC are to be reported in the "All Other" category. With this current guidance, there is no explicit reporting provision for tax credits that are not captured in LIHTC.

<u>Reporting Lines and Instructions:</u>

Guaranteed Federal Low Income Housing Tax Credit
- Unaffiliated 3599999
- Affiliated 3699999

Non-Guaranteed Federal Low Income Housing Tax Credit
- Unaffiliated 3799999
- Affiliated 3899999

Guaranteed State Low Income Housing Tax Credit
- Unaffiliated 3999999
- Affiliated 4099999

Non-Guaranteed State Low Income Housing Tax Credit
- Unaffiliated 4199999
- Affiliated 4299999

All Other Low Income Housing Tax Credit
- Unaffiliated 4399999
- Affiliated 4499999

<u>Low Income Housing Tax Credit</u>

Include: All Low Income Housing Tax Credit Investments (LIHTC or affordable housing) that are in the form of a Limited Partnership or a Limited Liability Company including those investments that have the following risk mitigation factors:

A. Guaranteed Low Income Housing Tax Credit Investments. There must be an all-inclusive guarantee from a CRP-rated entity that guarantees the yield on the investment.

B. Non-guaranteed Low Income Housing Tax Credit Investments.

    I. A level of leverage below 50%. For a LIHTC Fund, the level of leverage is measured at the fund level.

II. There is a Tax Credit Guarantee Agreement from General Partner or managing member. This agreement requires the General Partner or managing member to reimburse investors for any shortfalls in tax credits due to errors of compliance, for the life of the partnership. For a LIHTC Fund, a Tax Credit Guarantee is required from the developers of the lower tier LIHTC properties to the upper tier partnership and all other LIHTC investments.

III. There are sufficient operating reserves, capital replacement reserves and/or operating deficit guarantees present to mitigate foreseeable foreclosure risk at the time of the investment.

Non-qualifying LIHTCs should be reported in the "All Other" category

Statutory Accounting RBC Impact:

Life: The RBC factor for LIHTC are captured as part of the real estate on LR007:

(17)	Federal Guaranteed Low Income Housing Tax Credits	AVR Equity Component Column 1 Line 75	0.0014
(18)	Federal Non-Guaranteed Low Income Housing Tax Credits	AVR Equity Component Column 1 Line 76	0.0260
(19)	State Guaranteed Low Income Housing Tax Credits	AVR Equity Component Column 1 Line 77	0.0014
(20)	State Non-Guaranteed Low Income Housing Tax Credits	AVR Equity Component Column 1 Line 78	0.0260
(21)	All Other Low Income Housing Tax Credits	AVR Equity Component Column 1 Line 79	0.1500
(22)	Total Schedule BA Real Estate	Lines (16) + (17) + (18) + (19) + (20) + (21)	

P/C and Health: The RBC factors for LIHTC are captured as components of other long-term assets. The reporting lines and factors are the same as they are for life (as shown above).

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

Recommendation:
NAIC staff recommend that the Working Group expose additional revisions described below to SSAP No. 93 and SSAP No. 94R. Staff also recommends that the Working Group expose changes to *SSAP No. 34—Investment Income Due and Accrued* and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, which detail miscellaneous changes which update the scope of each statement for the proposed updates to SSAP No. 93 and SSAP No. 94R. The following are key revisions to SSAP No. 93R and 94R are proposed for exposure:

- *SSAP No. 93R—Investments in Tax Credit Structures* – NAIC staff recommends the following revisions in response to comments, from interested parties, public comments and NAIC staff internal review:
    - Various editorial changes to the admittance test described in paragraph 18 to clarify technical aspects of the assessment.
    - Addition of a Glossary of key terms at the end of the SSAP.
    - Revised guidance effective date to be 1/1/2025, applied prospectively without option to early adopt.
    - Added a new paragraph to the Impairment of Tax Credit Investments section to provide guidance on tax credit programs which allocate variable amounts of tax credits.

- Clarified in footnote 4 that tax credit strips derived from tax equity investments are not an example of an investment structure exempt from the audit requirement.
- Added disclosures for unused tax credits allocated from tax credit investments as these tax credits would not be within the scope of SSAP No. 94R disclosures.

- *SSAP No. 94R—State and Federal Tax Credits* – NAIC staff recommends the following revisions in response to comments, from interested parties, public comments and NAIC staff internal review:
    - Revised guidance effective date to be 1/1/2025 with early adoption permitted.
    - Added language to clarify that awarded tax credits (neither purchased nor allocated from an investment) are not within the scope of SSAP No. 94R.
    - Added commitment and contingency guidance to the Accounting and Disclosure sections.

- Other SSAPs – In response to the proposed revisions to SSAP Nos 93 and 94R, NAIC staff recommends the following:
    - *SSAP No. 34—Investment Income Due and Accrued* – Staff proposes revisions to clarify that tax credits earned or purchased are not within the scope of SSAP No. 34.
    - *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* – Staff proposes revisions which update paragraph 2 for the new tax credit investment language.

Interested parties' comment letter recommended revisions which would narrow the scope of the paragraph 18 admittance test to only tax credit investments which allocate non-transferable tax credit and prohibit the sale of ownership interests. NAIC staff did not revise the SSAP No. 93R draft for these recommendations but intends to continue working with industry to address their concerns that the new guidance may non-admit previously admitted tax credit investments.

Additionally, NAIC staff requests comments on the annual statement reporting categories for tax credit investment RBC. The current RBC categories are LIHTC Investment specific and are mapped to the real estate grouping.

Staff Review Completed by: William Oden and Julie Gann - NAIC Staff, May 2023

Status:
December 13, 2022 - Fall National Meeting Recommendation:
NAIC staff recommends that the Working Group direct NAIC staff to draft statutory accounting guidance in the form of a new or revised SSAP that expands the current LIHTC guidance for equity investments that general federal business tax credit and state premium tax credits. Although this agenda item is focusing on NMTC, it is recommended that consideration be given to guidance that does not name specific designs, such as NMTC or other specific tax credits, so that it can be applicable for all qualifying tax equity investments. This guidance will consider the proposed FASB guidance as well as admittance and impairment provisions, recognizing that tax credits cannot be used to provide direct payment to policyholders, but rather are utilized to impact a reporting entity's tax liability. This agenda item also recommends a review of SSAP No. 94—Transferable and Non-Transferable State Tax Credits to ensure the guidance properly reflects items that should be captured in scope and appropriate admittance provisions. With the proposal of a new or revised SSAP, this agenda item is proposed to be captured as a 'New SAP Concept' with a corresponding issue paper. Along with statutory accounting revisions, a resulting blanks proposal and a potential RBC referral are anticipated to update blanks reporting and RBC references accordingly. As detailed within, all Schedule BA reporting lines and RBC instructions (for both federal and state) only reference Low-Income Housing Tax Credits. The BA instructions also need to be updated as the concept for 'guaranteed' provisions from a CRP-rated entity seems to only be applicable to limited NMTC designs, as a guarantee may disqualify an entity from being able to use tax credits under IRS provisions.

On December 13, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a new SAP concept, and exposed a discussion document to expand current statutory accounting guidance for low-income housing tax credits to capture all tax equity investments that provide general federal business tax credit and state premium tax credits if they meet specified criteria.

On February 10, 2023, NAIC staff received Interested Parties' comment letter on the exposed discussion document which were presented to the Working Group:

> Interested parties agree with having uniformity in accounting and reporting for equity investments for which the return is earned primarily through tax credits. Interested parties agree that the proportional amortization method is an appropriate method to use for any type of investment (debt or equity) where the return is primarily earned through tax credits. We are providing responses to the questions exposed in the Discussion Paper in this document. There are two key take aways from our responses:
>
> 1. Interested parties ask the Working Group to consider allowing for the reporting of both the amortization of the investments and the use of the tax credits themselves in the same income statement line similar to what is required under U.S. GAAP.
>
> 2. Interested parties have concerns regarding tax credit investments that are issued in debt form and requiring those investments to be reported on Schedule BA instead of Schedule D. Interested parties believe that tax credit investments issued in debt form are better suited for Schedule D reporting.

March 22, 2023 – Spring National Meeting Recommendation:
NAIC staff recommends that the Working Group direct NAIC staff to proceed with drafting revised statutory accounting guidance and a related issue paper to expand the guidance in SSAP No. 93 for tax credits, as well as to draft revisions to SSAP No. 94—Transferable and Non-Transferable State Tax Credits for future Working Group discussion. NAIC staff proposes to consider the feedback from interested parties on the discussion document as well as the revised FASB guidance, which is expected to be issued in the near future, in updating the proposed revised statutory accounting guidance for subsequent exposure consideration.

On March 22, 2023, the Statutory Accounting Principles (E) Working Group directed NAIC staff to draft statutory accounting guidance in the form of a new or revised SSAP that expands the current LIHTC guidance for equity investments that general federal business tax credit and state premium tax credits.

May 16, 2023 – Interim Meeting Recommendation:
NAIC staff recommend that the Working Group include this item on their maintenance agenda as a new SAP concept and expose the draft revisions to SSAP No. 93 and SSAP No. 94R, which intend to capture all tax equity investments that provide federal business tax credit and state premium tax credits if they meet specified criteria.

On May 16, 2023, the Statutory Accounting Principles (E) Working Group exposed revisions to SSAP No. 93 and 94R. The revisions to SSAP No. 93 propose adoption with modification of *ASU 2023-02–Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method* and expansion of the SSAP scope to include all tax credit programs and tax investment structures. The revisions to SSAP No. 94R expand the scope of the SSAP to include all state and federal tax credits whether purchased or allocated, and that tax received should be recorded at face value with losses realized immediately and gains deferred.

On June 20, 2023, NAIC staff received Interested Parties' comment letter on the exposed revisions to SSAP Nos. 93 and 94R. Interested Parties provided several comments on both SSAPs which are summarized below along with NAIC Staff responses.

The comments provided on SSAP No. 93 were:

1. Interested Parties noted that paragraph 3 does not provide specific direction for which SSAPs would be applicable for tax credit investment which do not fall within SSAP No. 93.

   a. NAIC Staff agreed with the recommendation and updated paragraph 3 to provide readers with specific SSAPs which could apply to non-qualifying equity or debt structure tax credit investments.
2. Interested Parties noted that the current draft directed readers to refer to SSAP 94R for how to account for tax credits allocated from tax credit investments. They felt that this cross-reference was confusing and could potentially lead to conflicting interpretations.
   a. To reduce confusion, NAIC Staff opted to remove the paragraph directing readers to SSAP 94R and instead pulled in the specific paragraphs from SSAP 94R which would be applicable to tax credits allocated from tax credit investments.
3. Interest Parties noted that they were unclear on whether the tax credits earned, or the tax credit investments were subject to the admittance criteria detailed in Paragraphs 18(a)-(c). Interested Parties feels that admissibility concerns are adequately addressed by the tax opinion and audit requirements. Additionally, if NAIC Staff's concern is the admittance of tax credits carried forward to a future period, then this should be adequately addressed by the admittance rules detailed in *SSAP No. 101–Income Taxes* for Deferred Tax Assets. Interested Parties suggested that paragraphs 18(a)-(c) be deleted in full.
   a. NAIC Staff noted that the admittance rules detailed in paragraphs 18(a)-(c) do NOT provide guidance on the admittance of allocated tax credits. For tax credit investment structures to fall within the scope of SSAP 93, substantially all benefits must be from tax credits or other tax benefits which essentially means that balance of a tax credit investment represents a future stream of tax credits and tax benefit. As such, the admittance rules in paragraph 18(a)-(c) would require a company to assess its ability to utilize that future stream of tax credits to what amount of the tax credit investment would be non-admitted. If the company's projections determine it will be unable to substantially utilize the future stream of tax credits (i.e., the tax credit investment balance) then potentially all or a portion of the tax credit investment would be considered non-admitted as the company is unable to utilize the future stream of tax credits to offset tax liabilities.
4. Interested Parties noted that GAAP requires retrospective adoption of ASU 2023-02 and that this would result in GAAP vs. Statutory accounting differences.
   a. NAIC Staff noted that prospective adoptions of accounting updates are often simpler to implement than retrospective adoptions. However, since this would lead to unintended variance between GAAP and Stat NAIC Staff has updated SSAP 93 to be adopted on the retrospective basis to conform with the GAAP adoption requirements.

<u>The comments provided on SSAP No. 94R were:</u>

1. Interest Parties requested that paragraph 1 of the scope of statement section be amended to clarify which types of tax credits are within scope of SSAP No. 94R. Interested Parties feel that the key difference between SSAP 94R and SSAP 93 is that the former is for purchased tax credits and the ladder is for tax credits earned from investments.
   a. NAIC Staff generally agree with the comments provided but opted to remove the term "certificate" from the requested changes. The intent of SSAP No. 94R is to provide guidance on all purchased state and federal tax credits, not just certificated tax credits. NAIC Staff also included language to clarify the scope of SSAP No. 94R for allocated tax credits, as detailed in the next bullet point.
2. Interested Parties noted that they do not believe allocated tax credits from SSAP No. 93 investments should be within the scope of SSAP No. 94R as the guidance was confusing and could potentially lead to conflicting interpretations. Additionally, Interested Parties believe that tax credits from investments vs. purchased tax credits are distinctly different assets. The only similarity in accounting for the tax credits relates to instances when the credits earned under a SSAP No. 93 investment cannot be utilized in the current year. Under that scenario, a DTA would be recorded, which would be subject to the admissibility rules under SSAP No. 101.
   a. NAIC Staff elected to remove tax credits allocated from SSAP No. 93 investments from the scope of SSAP No. 94R to avoid confusion. However, NAIC Staff note that tax credits earned from investments bear many similarities to purchased tax credits. Irrespective of how the tax credit are acquired, they represent the same type of financial instruments which can be utilized as an offset to tax liabilities, sold, or redeemed for cash as a tax refund. Additionally, irrespective of how the

tax credits are earned they are recorded at face value upon acquisition. The only significant difference is that tax credits purchased at a premium or discount may result in a recognized loss or deferred gain, respectively, whereas any premium or discount on an allocated tax credit is recognized as part of proportional amortization calculation.

b. NAIC Staff amended the draft to exclude tax credits allocated from SSAP No. 93 investments in response to the Interested Party comments on SSAP No. 93. However, NAIC Staff did include language noting that allocated tax credits earned from tax credit investments NOT within the scope of SSAP No. 93 should refer to SSAP 94R for guidance on how to record allocated tax credits. NAIC staff noted that without this language there would be no guidance within Accounting Practices and Procedures Manual for allocated tax credits from investments which fall outside the scope of SSAP No. 93.

3. Interested Parties noted that most tax certificates reduce a reporting entity's tax liability and do not directly impact the income statement at the time they are used. In addition, interested parties believe that upon purchase, the tax credits should be reported as an other-than-invested asset since the asset represents a right to receive future benefits. As the tax credits become available for use, a reduction to the insurer's income tax payable or premium/state taxes payable should take place.
   a. NAIC Staff disagrees with this proposed change as purchased federal tax credits would be reported as other-than-invested assets, versus allocated federal tax credits which would reported as a deferred tax asset. This would result in the same type of asset being reported on two separate lines based on the manner in which it was acquired. As noted above, NAIC Staff's position is that allocated and purchased tax credits are substantially the same assets irrespective of the way in which they are acquired. Additionally, the Interested Parties also proposes that if a tax credit cannot be utilized in the same period in which it was purchased it should be transferred to Deferred Tax Assets. NAIC Staff notes that this does not resolve the short-term reporting discrepancy noted previously and adds further complications to the accounting process by requiring a reporting line transfer if the asset is held for longer than a year.
4. Interested Parties noted that the accounting for purchased tax credits in the SSAP No. 94R exposure is different from the current guidance in that the credits will be recorded at face value instead of at cost. This is not an issue perse but Interested Parties did want to point out this discrepancy as compared to the accounting treatment for other assets like bonds and mortgage loans.
   a. NAIC Staff's position is that tax credits, whether received via purchase or allocation, do not represent investments, and has opted to propose accounting guidance that differs from bonds or mortgage loans. The position that tax credits do not represent investments was the main reason for the original SSAP No. 94R guidance which required state tax credits be recorded to Other Than Invested Assets and effectively required companies tax credits purchased at a discount at cost and effectively defer the gain off the balance sheet. NAIC Staff felt that it would be less confusing and provide a more accurate financial picture to record the tax credit at face value and defer any gains from discount purchases on the balance sheet.
5. Interested Parties proposed changes to Exhibit B to reflect a pro-rata utilization of purchased tax credits in relation to the quarterly accrual of income tax liabilities. The main purpose of these changes were to reflect Interested Parties' proposed changes in item #2.
   a. NAIC Staff made these changes to Exhibit B and believe that this method of recognizing tax credit utilization is applicable to exposed draft of SSAP No. 94R.

Outside of the changes made in response to Interested Parties' Comment Letter, both Exhibits in SSAP No. 93 were revised to provide example journal entries of the Proportional Amortization method. Additionally, the assumptions in Exhibit B were revised so it would provide a journal entry example for a residual sale at the end of the proportional amortization period. A new footnote was also added to SSAP No. 94R on page 2 based verbal comments received from the public. The new footnote provides clarification on what processes constitute a purchase vs an allocation of tax credits.

August 13, 2023 - Summer National Meeting Recommendation:

NAIC staff recommend that the Working Group expose additional revisions described below to SSAP No. 93 and SSAP No. 94R. Additionally, NAIC staff recognizes that revisions to the annual statement Schedule BA reporting lines will need to be considered, as well as how those reporting lines flow through to the AVR. NAIC staff recommends that the Working Group direct staff to work with interested parties throughout the interim to discuss to allow subsequent (or interim) exposure.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group exposed additional revisions made to SSAP No. 93 and SSAP No. 94R. Additionally, the Working Group directed NAIC staff to work with interested parties to draft revisions to the annual statement instructions and reporting updates.

On September 29, 2023, NAIC received Interested Parties' comment letter on the exposed revisions to SSAP No. 93 and 94R. Interested Parties provided several comments on both SSAPs which are summarized below along with NAIC Staff responses (effective October 11, 2023). The comments provided on SSAP No. 93 are below and have been summarized for brevity and clarity:

1) Interested Parties noted that SSAP 93 Paragraph 18 requires reporting entities to annually assess the future utilization of the unallocated tax credits associated with an entity's ownership interest in a tax credit investment project to determine if the investment can be admitted. However, Interested Parties suggest that this admittance criteria only be applicable to investments which do not allocate transferable or refundable tax credit and if the reporting entity is contractually restricted from selling its ownership interest. Additionally, Interested Parties suggest deleting paragraphs 18a and 18b as admissibility is adequately addressed through the impairment analysis required in paragraph 25; mainly that since both the tax credits and investment are saleable there is not a significant concern about the reporting entity's ability to utilize these investments and their tax credit returns for policyholder liabilities.

    i. NAIC staff noted that Interested Parties' argument is twofold, first is that the usage of the investment fair value as a carve out in paragraphs 18a and 18b are confusing due to the requirement to test for impairment based on fair value. NAIC staff amended paragraph 18a to clarify that the carve out allows for admittance of the fair value of <u>unallocated</u> transferable/certificated tax credits rather than the fair value of the tax credit investment. The tax credit investment balance includes other tax benefits which cannot be sold apart from the investment ownership. The intent of paragraph 18a is to allow a reporting entity to at least admit the fair value of the tax credits which can be sold, which is potentially higher than the admitted amount calculated in paragraph 18.

    ii. The second part of Interested Parties' argument is that since these investments may be sold, the admittance assessment of the reporting entity's ability to utilize the tax credits is not needed unless the reporting entity contractually restricted from the selling the investment. As part of this comment, it was noted that these investments may be actively managed and are readily saleable. NAIC staff noted that acquiring tax credit investments with the intent of re-sale puts an insurance company in a similar position as a syndicator in which tax credit investments are developed or acquired for the purpose of sale. SSAP 93 was revised under the assumption that tax credit investments are acquired for the purpose of obtaining returns through the receipt of tax credits and other tax benefits rather than through the sale of the tax credit investment. NAIC staff does not believe the paragraph 18 admittance criteria should be amended to provide a carve out for actively managed tax credit investments as it is not feasible to delineate between tax credit investments purchased for sale vs. purchased for generation of tax benefits without introducing some kind of available-for-sale and held-to-maturity framework which is not compatible with statutory accounting concepts. NAIC staff noted that restrictions which prevent investors from selling their ownership represent a minority of tax credit programs. As such, limiting the scope of paragraph 18 to only tax credit investments which cannot be sold would effectively carve out the majority of tax credit investment structures from its scope. Additionally, the assertion that these investments are readily saleable does not change the fact that the balance sheet value of a tax credit investment is predicated on the assumption that the company can use the tax credits and benefits and if they company cannot use these tax credits then the investment returns have no value. Until the investment has been sold, its ability to satisfy future policyholder obligations is beholden to the company's ability to utilize the generated tax credits and benefits. Interested Parties noted that there are other investments which do not have as stringent admittance criteria as have been proposed in paragraph 18. NAIC staff note that other investments generate returns primarily through the receipt of fungible cash income or by providing a claim to the entity's earnings and assets (bonds, stocks, joint ventures, partnerships and LLCs). In comparison, the main purpose of a tax credit investment is to provide returns in the form of tax credits and other tax benefits, and this purpose is further borne out by the commonly used partnership flip structure for tax credit investments and that once the tax credits have been fully allocated the residual value of a tax credit investment is typically nominal.

iii. Additionally, the requirement to assess tax credit investments by looking at the company's ability to realize future tax credits is not a new concept. Under existing OTTI guidance companies are required to record OTTI if the company determines it is probable that future tax benefits will not be received as expected (SSAP No. 93 paragraph 17, sentence 1). Per SSAP No. 93 paragraph 17, to determine if OTTI has occurred companies are required to assess whether the investment will continue to issue the tax credits as anticipated (see sentence 5) AND whether the company will be able to realize/utilize the future tax benefits to be received (see sentences 2 and 3). As part of the re-write of SSAP No. 93 Staff moved the requirement to assess the company's ability to utilize future tax credits out of impairment to admissibility. As currently revised, the impairment test specifically addresses the functionality of the investment whereas the paragraph 18 admittance test specifically addresses the ability of the company to realize/utilize the future tax benefits. This change intended to simplify the impairment analysis by focusing on investment functionality, but also because Staff felt that the company's ability to utilize/realize future tax benefits was more accurately characterized as an admittance concern rather than an impairment of the investment itself.

2) Interested Parties suggested a number of editorial changes to affect clearer guidance in paragraphs 18 and 18a. These included clarifying that the paragraph 18 assessment of unallocated tax credit utilization should be performed over the life of the tax credits rather than the life of the investments, including its carryforward periods. Interested Parties also suggested clarifying in paragraph 18 that tax planning strategies are to be used when assessing the utilization of unallocated tax credits, similar to the valuation allowance requirements under SSAP No. 101. In paragraph 18a Interested Parties suggested removing the sentence detailing what to do if fair value is not non-determinable.

i. NAIC staff agreed with substantially all the editorial clarifications suggested by Interested Parties and updated accordingly.

3) Interested Parties suggested adding a definitions section to the guidance regarding the following terminology:

<u>"unallocated tax credits"</u> - the portion of tax credits expected to be earned and allocated to the reporting entity through the investment structure.

<u>"current portion"</u> - the credits to be allocated within one year of the reporting period.

i. NAIC staff agreed with the suggestion by Interested Parties to add definitions and updated accordingly with some minor modifications. NAIC staff also added some additional definitions to provide clarifications on other terms used in SSAP 93.

4) Interested Parties suggested that the new SSAP 93 be applied prospectively effective 1/1/2025, but no early adoption.

i. NAIC staff agreed with the changes suggested by Interested Parties and updated accordingly.

The comments provided on SSAP No. 94R are below and have been summarized for brevity:

5) Interested parties suggested that the revised SSAP 94R also be applied prospectively effective 1/1/2025 with early adoption permitted. Additionally, Interested Parties suggested a clarification of the scope of SSAP 94R by adding the following language to paragraph 1:

"This statement establishes statutory accounting principles for state and federal tax credits that are purchased by the reporting entity without being ~~an~~ <u>bond or equity</u> investor in the entity from which the tax credit were purchased."

i. NAIC staff agrees with prospective application of SSAP 94R with an effective date of 1/1/2025, however we have elected to not include the changes to the scope of SSAP 94R. The reasoning is that this guidance intends to exclude tax credits allocated from SSAP 93 investments, which does not specifically identify which tax credit investment structures are within scope of the guidance. However, NAIC staff did make other adjustments to the scope paragraph to better clarify that tax credits from SSAP No. 93 investments are not within scope of SSAP 94R.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/Maintenance/Active Form A's/2022/22-14 - NMTC.docx

Note: *The initial revisions made to SSAP No. 93—Low-Income Housing Tax Credit Property Investments were exposed on May 16, 2023, in a clean format rather than through tracked changes to prioritize readability for initial comment as the revisions are for all intent and purposes comprehensive.*

Revisions made subsequent to the August 13th Summer National Meeting draft exposure are shown as tracked changes in grey below. The issue paper will include the final revisions shown as tracked changes and is anticipated to be completed in fall of 2023.

Statements of Statutory Accounting Principles No. 93 - Revised

Investments in Tax Credit Structures

STATUS

Type of Issue	Common Area
Issued	June 13, 2005; Substantively revised XX XX, 2023
Effective Date	January 1, 2006; Substantive revisions detailed in Issue Paper No. xxx effective XX XX, 2023
Affects	No other pronouncements
Affected by	No other pronouncements
Interpreted by	INT 06-07
Relevant Appendix A Guidance	None

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SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for qualifying tax credit investments[1] in programs made primarily for the purpose of receiving allowable general business federal tax credits and or state tax credits, including state premium tax credit programs. Although these investments are often in the form of equity, this statement shall be applied to all investments (regardless of the structure of the investment) that qualify pursuant to paragraph 1.

2. A reporting entity that invests in projects or programs that generate general business federal tax credits, corresponding state tax credits or state premium tax credits that meet the following conditions at the time of initial investment are required to capture the investment in scope of this statement:

a. It is probable that the tax credits allocable to the investor will be available.

b. Reporting entity investor does not have the ability to exercise significant influence over the operating and financial policies of the underlying projects.

c. Substantially all the projected benefits are from tax credits and other tax benefits, determined on a discounted basis using a discount rate that is consistent with the cash flow assumptions utilized by the reporting entity for the purpose of deciding to invest in the project.

d. The reporting entity's projected yield based solely on the cash flows from the tax credits and other tax benefits is positive.

3. Tax credit investments that do not meet the conditions in paragraph 2 shall be captured within the statutory accounting statement that addresses the underlying investment structure. Equity structured tax credit investments would generally fall within *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*. Debt structured tax credit investments should be assessed in accordance with *SSAP No. 26R—Bonds* to determine eligibility for reporting as a bond. ~~Investments in tax credit structures that do not meet the conditions in paragraph 2 shall be captured within the statutory accounting statement applicable to the investment held.~~

4. Investments in a CAPCO (Certified Capital Company), organized as a partnership or an LLC, which is a company, authorized by state statute that borrows from investors, to make venture capital investments in "qualified" businesses, are not within the scope of this statement. Although associated with tax credits, the reporting entity is paid principal and interest on its investment with the CAPCO. Depending upon the terms of the CAPCO offering, principal and interest payments to the reporting entity will come from the CAPCO and/or the state. The CAPCO will make cash payments directly to the investors while the state will make payments in the form of premium or income tax credits. Investments in a CAPCO shall be accounted for in accordance with *Interpretation (INT) 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)* and specific statutory accounting guidance addressing CAPCOs.

SUMMARY CONCLUSION

5. Investments in tax credit structures are generally acquired to obtain a positive yield through tax credits and other tax benefits. The value of the investment is primarily based on the value of the remaining stream of tax credits and deductible expenses available to the reporting entity investor. The primary purpose of investing in these tax credit structures is to generate tax credits which benefit reporting entities most

[1] The scope of *ASC 323-740–Investments—Equity Method and Joint Ventures—Income Taxes—Proportional Amortization Method* only extends to tax equity investments, whereas this statement is intended to capture all tax credit investments which meet criteria 2.a-2.d, regardless of structure. This includes, but is not limited to, tax equity investments and tax credit debt investments.

commonly through a reduction in tax liability or, when transferability is permitted, through the sale/transfer of the tax credits.

6. Investments in tax credit structures held by reporting entities meet the definition of an asset as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and are admissible assets to the extent that they comply with the requirements of this statement.

Accounting

7. At initial recognition, investments in scope of this statement shall be recorded at cost. This guidance addresses the methodology for measuring an investment that is accounted for using the proportional amortization method.

8. Subsequent to initial recognition, the investment shall be carried at proportional amortized cost. Under the proportional amortization method, the reporting entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits allocated to the investor. The amortization amount shall be calculated as follows (ASC 323-740-35-2):

a. The initial investment balance less any expected residual value of the investment, multiplied by,

b. The percentage of actual tax credits and other tax benefits allocated to the reporting entity in the current period divided by the total estimated tax credits and other tax benefits expected to be received by the reporting entity over the amortization timeframe (life of the investment)~~the life of the investment~~.

9. Reporting entities shall recognize tax credits in the period they are allocated to the investor for tax purposes. Unless all tax credits are allocated to the reporting entity at the date of initial investment, immediate recognition of the entire benefit of the tax credits to be received during the term of the investment project that generates tax credits and other tax benefits is not permitted. Tax credits shall not be recognized in the financial statements before the year in which the credit arises. (ASC 323-740-25-5)

10. Any expected residual value of the investment shall be excluded from the proportional amortization calculation. Non-tax related benefits received from the investment shall be included as a component of net investment income when realized or realizable. Gains or losses on the sale of the investment, if any, shall be included as a capital gain or loss at the time of the sale. (ASC 323-740-35-5) Determination of gain or loss will depend on the reported value (e.g., residual value at the end of the amortization timeframe) compared to the amount received in exchange for the investment. Liquidation of the investment commonly occurs at the end of the tax credit timeframe through a put or call agreement, often reflecting a nominal residual value that was established at the time of acquisition. The liquidation amount from such agreements shall reflect the expected residual value when available.

11. At the end of the amortization timeframe~~ (life of the investment)~~, if the reporting entity retains the investment, the investment shall be subsequently measured and assessed within the statutory accounting statement applicable to the investment held. Retained investments will remain on Schedule BA until disposal and cannot exceed the initial expected residual value.

12. Exhibit A illustrates the application of accounting guidance in two examples that generate tax credit and tax benefits using the proportional amortization method. The first example illustrates the application of a standard project. The second example illustrates the application of accounting guidance in a project that generates non-tax related benefits in addition to tax credits and other tax benefits using the proportional amortization method. (ASC 323-740-35-3)

Application of Proportional Amortization Method

13. Under the proportional amortized cost method, the amortization of the investment is to be recognized in the income statement as an expense component of the net investment income calculation. Non-tax related benefits received from operations, or sale of the investment should be accounted for in accordance with paragraph 10.

14. Tax credits and other tax benefits, not to include amortization of the investment, shall be reflected as follows:

a. ~~Tax credits allocated are to be recorded, and assessed for admittance, in accordance with *SSAP No. 94R Transferable and Non-Transferable Tax Credits*.~~Tax credits shall be recognized in the period that they are allocated to the reporting entity for tax purposes:

i. Federal tax credits that can be utilized in the year allocated shall be reported in the income statement as an offset to federal taxes in accordance with *SSAP No. 101—Income Taxes*. Federal tax credits that cannot be utilized in the year allocated are carried forward to a future tax year shall be reported as a deferred tax asset (DTA) in accordance with SSAP No. 101.

ii. State tax credits that can be utilized in the year allocated shall be reported in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax-reporting year in which the credit is utilized. State tax credits that cannot be utilized in the year allocated are carried forward to a future tax year shall be reported gross of any related state tax liabilities and reported in the category of other-than-invested-assets (not to be reported net).

~~i.~~iii. Tax credits carried forward to a future period shall be reflected as an offset to the corresponding income or premiums tax in the tax reporting year in which the tax credit is utilized. The admissibility of tax credits are subject to SSAP No. 101.

b. Federal tax benefits other than tax credits (e.g., tax benefits from investment depreciation) shall be recognized in the year allocated pursuant to SSAP No. 101~~—*Income Taxes*~~. When utilized the federal tax benefits are recognized as a component of income tax expense.

c. State tax benefits other than tax credits shall be recognized in the year allocated shall be recognized in the year allocated gross of any related state tax liabilities pursuant to SSAP No. 101. When utilized, the state tax benefits are recognized as a component of taxes, licenses, and fees.

Admittance ~~Requirements~~of Tax Credit Investments

15. Although investments in tax credit programs do not represent investments that can be directly liquidated for policyholder claims, the reduction of tax liability or transfer of tax credits represents a benefit that supports admittance of these investments, but only if the tax credit will be received and can be utilized by the reporting entity. Investments in tax credit programs that will not result in any of the anticipated tax credits or that will result in tax credits which cannot be utilized or transferred by the reporting entity shall be considered impaired and should refer to paragraphs 26 and 27.

16. Reporting entities shall, at initial investment, obtain a clean[2] fund level tax opinion[3] on the validity of the credits and structure of the underlying program and investment fund. Investments not supported by an initial tax opinion shall be nonadmitted. If the program is a permitted syndicated program with a yield guarantee, the opinion must verify that the investment and guarantee has been properly structured under IRS rules and the guarantee does not disqualify the reporting entity from obtaining federal general business tax credits.

17. Reporting entities shall annually obtain U.S. GAAP or U.S. tax basis audited financial statements on the investment fund. In the event audited U.S. GAAP or U.S. tax basis financial statements are not obtained or the audit receives an opinion other than unqualified, the asset shall be nonadmitted. If the audited financial statements are in-process but not completed as of the annual statement filing deadline, the reporting entity may admit the investment based on the results of the immediately preceding prior year audited financial statements. A lag in reporting shall be consistent from period to period.

a. Other tax credit investments – If the reporting entity has a tax credit investment which by virtue of its structure cannot be audited, the investment is exempt from the annual audit requirement. One example of this type of investments would be tax credit debt investments[4] which do not involve any amount of equity ownership as a component of the investment. This type of tax credit debt investment is exempt from the annual audit requirement, but the reporting entity is still required to obtain a clean tax opinion to support admittance at initial investment.

18. ~~A r~~Reporting entities~~y~~ ~~is~~ are required to annually assess ~~tax credit investments for~~ the future ~~realization~~ utilization of the investment's current portion of unallocated tax credits against the estimated tax liabilities~~y~~ for both the tax year in which the tax credits can be initially utilized as well as any~~in accordance with~~ applicable ~~carry-forward and/or~~ carryback periods~~ to determine the extent the investments can be admitted~~. Based on this assessment, i~~I~~f ~~a~~ the reporting entity does not expect to ~~fully~~ substantially utilize the current portion of unallocated investment tax credits~~ in the upcoming tax year or for a carryback year~~, the reporting entity shall ~~perform an~~ perform an expanded assessment to determine the extent that it will be able to utilize all of the~~the~~ investment's unallocated tax credits over the life of the ~~investment~~tax credits. If assessment projections identify that the investment's unallocated tax credits~~ from investments in tax credit programs~~ will exceed what can be utilized under IRS or state tax provisions (current and ~~other applicable tax~~carryforward periods), the reporting entity shall nonadmit investments as necessary so that investments in scope of this statement (in aggregate) are only admitted to the extent tax credits are expected to be utilized within current and carryforward periods. Additionally, if the assessment indicates that the next three years of investment tax credits cannot be substantially utilized within the carryforward periods then the entire investment shall be nonadmitted. In making this assessment, the reporting entity is not permitted to assume increased operations (e.g., expanded product sales) beyond those allowed under prudent and feasible tax-planning strategies ~~actual experience~~ to conclude that additional federal or state tax liability will exist that would allow additional utilization of tax credits. A reporting entity ~~can~~ may subsequently admit a previously nonadmitted tax credit investment, based on subsequent assessments in which the reporting entity determines that they will be able to utilize the tax credits.

[2] While not quantified or defined in either the Internal Revenue Code or state regulations, common industry standards consider a "should" opinion to be the minimum degree of confidence associated with a clean tax opinion. For the purposes of this statement, a "should" opinion must represent a probability of success no less 70%. Any tax opinion with a degree of confidence less than "should" is to be nonadmitted.

[3] A fund level tax opinion for the purposes of this statement is defined as a full IRS Circular 230 tax opinion which covers from the fund level through to the underlying assets generating the tax credit benefits. The fund level is defined as the entity, or level, at which the investor comes directly into the investment without any intermediaries.

[4] Common examples of tax credit debt investments are Tax Credit Strips derived from tax credit bonds, Qualified Tax Credit Bonds, and Build America Tax Credit Bonds. Tax opinions received on these tax credit investments are also referred to as "bond counsels." Tax Credit Strips derived from tax equity investments would not qualify for the paragraph 17.a carve out as the source of the stripped tax credits is auditable.

~~18.~~19. As an exception to the admittance assessment detailed above, if the tax credit investment allocates tax credits with the following features the reporting entity may perform a secondary assessment to determine if additional amounts of the tax credit investment may be admitted:

a. Tax credit investments which allocate tax credits which are certificated or transferable in accordance with permitted IRS or state tax provisions ~~are~~ shall admit~~ted~~ up to the lesser of the proportional amortized cost, or fair value of the unallocated tax credits. ~~If the fair market value is not determinable, then the reporting entity may only admit the amount calculated in paragraph 18.~~

b. Tax credit investments which allocate tax credits eligible for direct payment ~~are~~ shall admit~~ted~~ up to the lesser of the proportional amortized cost, or the estimated proceeds from unallocated tax credits.

~~c. For all other tax credits, if a reporting entity does not expect to fully utilize investment tax credits in the upcoming tax year or for a carryback year, the reporting entity shall perform an assessment to determine the extent it will be able to utilize the tax credits over the life of the investment. If assessment projections identify that the tax credits from investments in tax credit programs will exceed what can be utilized under IRS or state tax provisions (current and other applicable tax periods), the reporting entity shall nonadmit investments as necessary so that investments in scope of this statement (in aggregate) are only admitted to the extent tax credits are expected to be utilized. Additionally, if the assessment indicates that the next three years of investment tax credits cannot be substantially utilized then the entire investment shall be nonadmitted. In making this assessment, the reporting entity is not permitted to assume increased operations (e.g., expanded product sales) beyond actual experience to conclude that additional federal or state tax liability will exist that would allow additional utilization of tax credits. A reporting entity can subsequently admit a previously nonadmitted tax credit investment, based on subsequent assessments in which the reporting entity determines that they will be able to utilize the tax credits.~~

~~19.~~20. For tax credit investments which have an amortization timeframe greater than the tax credit allocation timeframe (as demonstrated in ~~both examples within~~ Exhibit A), the reporting entity would perform the same assessment detailed in paragraph 18 but on the reporting entity's ability to utilize the remaining stream of anticipated tax benefits.

Future Contributions and Additional Tax Credits

~~20.~~21. Many tax credit investments require future contributions by the investor, that may be contingent on a variety of conditions, such as receiving representations, contract performance, meeting occupancy requirements, etc. A liability shall be recognized for delayed equity contributions which result in additional tax credits that are unconditional and legally binding, and a liability shall also be recognized for equity contributions which result in additional tax credits that are contingent upon a future event when that contingent event becomes probable pursuant to the loss contingency guidance in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*. (ASC 323-740-25-3) Liabilities or loss contingencies recognized for future contributions which result in additional tax credits shall be reported as 'Payable for Securities' until remitted or until the obligation is otherwise eliminated.

~~21.~~22. If a commitment to provide future contributions is not required to be recognized pursuant to paragraph 21, the commitment shall be disclosed in the notes to the financial statements with other commitments.

~~22.~~23. Additional contributions that do not result in additional tax credits for the reporting entity investor shall be immediately expensed as a component of net investment income.

~~23.~~24. If additional contributions result in additional tax credits for the reporting entity, the proportional amortization method for the tax credit investment shall be adjusted, on a prospective basis, to reflect the increased cost with the revised expected income tax credits and income tax benefits.

25. In the event a reporting entity obtains additional tax credits without the reporting entity making additional contributions, the reporting entity shall not adjust the book adjusted carrying value of the tax credit investment. (The proportional amortization method shall not be adjusted to reflect the expected additional tax credits.) Rather, the tax credit shall be recognized when allocated pursuant to paragraph 14.

Impairment of Tax Credit Investments

~~24.~~26. Reporting entities with investments in tax credit programs shall complete and document an impairment analysis at each reporting period. For this analysis, the reporting entity shall compare the current book adjusted carrying value to the fair value of the investment. (~~In lieu of~~If fair value is not determinable, an entity can compare book adjusted carrying value to the present value of future tax credits and other tax benefits discounted at a risk-free rate of return.) If book adjusted carrying value is higher, the difference between book adjusted carrying value and fair value shall be recognized as an other-than-temporary impairment (INT 06-07) to the tax credit investment. This will result in a new cost basis and the amount of the write-down shall be accounted for as a realized loss. The new cost basis shall not be changed for subsequent recoveries in fair value (discounted value present value).

~~25.~~27. An other-than-temporary impairment shall also be considered to have occurred if a previously allocated tax credit has been recaptured or if it is probable that future tax credits will not be allocated as expected. If a project no longer qualifies for tax credits, the entire investment, less any residual established at initial recognition, shall be written off as other-than-temporarily impaired. If the reporting entity experiences a tax credit recapture, the reporting entity shall assess whether future tax credits and other benefits will qualify for use by the reporting entity. If future credits will not be generated or will be subject to future recapture, then the reporting entity shall write-off the investment as other-than-temporarily impaired so that the resulting investment value only reflects expected qualifying tax credits and other benefits expected to be allocated. This will result in a new cost basis and the amount of the write-down shall be accounted for as a realized loss. The new cost basis shall not be changed for subsequent recoveries or revision to tax credit expectations.

~~26.~~28. Certain tax credit programs allocate variable amounts of tax credits (for example, clean energy production tax credit programs) which will result in regular differences between actual allocated tax credits and estimated tax credit allocations as calculated upon acquisition of the investment. Variable tax credits allocated in excess of estimates should be accounted for in accordance with paragraph 25. If the allocated variable tax credits are less than estimates by more than 10% or consistently allocate less than the estimated amounts over multiple allocation periods, then the reporting entity must either recognize an other-than-temporary impairment or specifically address within its impairment analysis the reason why consistently diminished tax credit returns do not represent an impairment event. Note that if the company determines it is probable that the total amount of anticipated variable tax credits will not be received, it would still be considered an other-than-temporary impairment in accordance with paragraph 27.

Disclosures

~~27.~~29. A reporting entity shall disclose information that enables users of its financial statements to understand the following information about its tax investments in projects that generate tax credits and other tax benefits from tax programs captured in scope of this statement: (ASC 323-740-50-1)

a. The nature of its investments in projects that generate tax credits and other tax benefits.

b. The effect of the recognition and measurement of its investments in projects that generate tax credits and other tax benefits and the related tax credits on its financial position and results of operations.

~~28.~~30. To meet the objective of paragraph 29, a reporting entity shall disclose the following information about its tax investments in projects that generate tax credits and other tax benefits from a tax credit program in scope of this statement:

a. The amount of tax credits and other tax benefits recognized during the period.

b. The balance of the investments recognized in the statement of financial position for the reporting period(s) presented.

c. The amount of investment amortization and non-income tax related activity recognized as a component of net investment income, and other returns allocated that were recognized outside of income tax expense.

d. An aggregate schedule of tax credits expected to be generated each year for the subsequent five years and thereafter, disaggregated by transferable/certificated and non-transferable.

e. Any commitment or contingent commitment (e.g., guarantees or commitments to provide additional capital contributions) including the amount of contributions that are contingent commitments related to tax credit investments and the year(s) that contingent commitments are expected to be paid shall be disclosed.

~~29.~~31. The following disclosures shall be included if applicable to tax credit investments:

a. If the underlying property is currently subject to any regulatory reviews and the status of such review. (Example: Investigations by the housing authority.)

b. Significant modifications or events that resulted in a change in the nature of the investment or a change in the relationship with the underlying project for investments in scope. (ASC 323-740-50-1A)

~~30.~~32. A reporting entity that recognizes an impairment loss shall disclose the following in the financial statements that include the period of the impairment write-down:

a. A description of the impaired assets and the facts and circumstances leading to the impairment; and

b. The amount of the impairment and how fair value was determined.

33. The following disclosures pertain only to those tax credits allocated from tax credit investments and unused as of the reporting period. For purposes of this disclosure, total unused tax credits represent the entire tax credits available:

a. Carrying value of tax credits, disaggregated by transferable/certificated and non-transferable, gross of any related tax liabilities by jurisdiction and in total.

b. Total unused tax credits by jurisdiction, disaggregated by transferable/certificated and non-transferable.

c. Method of estimating utilization of remaining tax credits or other projected recovery of the current carrying value.

d. Impairment amount recognized in the reporting period, if any.

e. Identify tax credits by transferable/certificated and non-transferable classifications and identify the admitted and nonadmitted portions of each classification.

~~31.~~34. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

~~32.~~35. This statement adopts with modification *Accounting Standards Update (ASU) 2023-02, Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method*. The ASU is modified for the following statutory concepts:

a. This statement is applicable to all federal and state tax credit programs earned through any tax credit investment structure that meets the requirements in paragraph 2. Under the ASU, use of the proportional amortization method is an election and only pertains to income tax equity investment structures in which the reporting entity does not exercise significant influence. With this statement, the U.S. GAAP election to use the proportional amortization method is rejected and use of proportional amortization for investments within the scope of this statement is required. The guidance is expanded for state premium tax credits.

b. Investments that meet the criteria of this statement are required to use a proportional amortization method as prescribed in this statement. This method requires the tax credits and benefits to be recognized in proportion to the percentage of actual tax credits and other tax benefits allocated to the reporting entity in the current period divided by the total estimated tax credits and other tax benefits expected to be allocated by the reporting entity over the life of the investment. This statement requires a gross presentation on the financial statements. Under the ASU, a practical expedient is allowed for the calculation of proportional amortization but has been rejected with this statement.

c. Federal tax credits shall be recognized in the income statement as an offset to federal income taxes in the tax reporting year in which the tax credit is utilized in accordance with SSAP No. 101. State tax credits shall be recognized in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax reporting year in which the credit is utilized.

d. Tax benefits allocated, other than tax credits, shall be accounted for pursuant to SSAP No. 101. Amortization shall be reported as a component of net investment income.

e. Reporting entities shall follow the guidance in paragraphs 21 and 22 regarding the recognition of contingent commitments from SSAP No. 5R to equity contributions.

f. This statement has specific impairment and nonadmittance requirements.

g. For statutory accounting purposes, deferred taxes are not reported as a component of income from continuing operations in the income statement; rather deferred taxes are recognized as a separate component of gains and losses in unassigned funds (surplus).

h. Disclosures should be followed as indicated in the disclosures section in this statement.

~~h.~~i. The examples detailed in Exhibit A were modified to better illustrate the statutory accounting method for tax credit investments.

Effective Date and Transition

~~33.~~36. This statement is effective for reporting periods beginning on or after January 1, 2006. Early adoption is permitted. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3–Accounting Changes and Corrections of Errors*. The guidance previously in paragraph 3 of this statement superseded paragraph 1 of SSAP No. 48. In 2011, this guidance was moved to SSAP No. 48 and deleted from this statement. The original guidance included in this standard is retained for historical purposes in Issue Paper No. 125. The guidance from ASU 2014-01 is effective for reporting periods beginning on or after January 1, 2015, with early adoption permitted.

37. In XXX 2024, new SAP concept revisions, as detailed in Issue Paper No. XXX, were adopted. These revisions, effective January 1, 2025, expanded the scope of SSAP No. 93 to include all federal and state tax credit investment structures and provide new guidance on the accounting, recognition, and reporting of tax credit investment structures. As of the effective date, reporting entities shall prospectively modify the recognition, accounting, and reporting of tax credit investment structures to reflect the guidance in the conceptual revisions. Additionally, all tax credit investment structures which fall within the scope of this statement not currently reported on Schedule BA are to be transferred to Schedule BA as of the effective date.

Glossary

38. The following definitions are provided for the purposes of this statement.

a. Unallocated tax credits – The portion of tax credits expected to be earned and allocated to the reporting entity through the tax credit investment structure.

b. Current portion – The tax credits to be allocated within one year of the reporting period.

c. Transferable/Certificated – The tax credits are certified for sale (certificated tax credits) or saleable through the execution of a state or federal transfer form (transferable tax credits).

REFERENCES

Relevant Issue Papers

- Issue Paper No. 125—Accounting for Low-Income Housing Tax Credit Property Investments
- Issue Paper No. XX—XXX

EXHIBIT A – APPLICATION OF PROPORTIONAL AMORTIZATION METHOD

Example 1: ***~~Application of Proportional Amortization Method for Qualifying Investment~~Qualifying Tax Credit Investment Structure***

~~This example is based on paragraph 323-740-55-5 of the Accounting Standards Codification which illustrates the application of a standard project. The amount and timing of amortization in the proportional amortization method is consistent with the statutory modifications; therefore, the table incorporated in this exhibit is based on the proportional amortization table. The statutory income statement requires a gross presentation on the income statement, with proportional amortization of the initial cost of the investment in investment income and the tax credits and benefits included in income tax expense.~~

~~Terms:~~
~~Date of Investment: January 1, 20X1~~
~~Purchase Price of Investment: $100,000~~
On January 1, 20X1, ABC Insurance Company purchases a 5% equity stake in a tax credit investment structure for $100,000. The allocated tax credits are transferable, and ABC anticipates that all tax credits received will be fully utilized prior to expiration of the tax credit carryover period.

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.
7. For simplicity, the project will operate with break-even pretax cash flows including debt service during the first 15 years of operations.
8. The project's taxable loss will be equal to depreciation expense. The cumulative book loss (and thus the cumulative depreciation expense) recognized by the investor is limited to the $100,000 investment.
9. It is assumed that all requirements are met to retain allocable tax credits so there will be no recapture of tax credits.
10. The investor expects that the estimated residual value of the investment will be zero.

Proportional Amortization Method with Statutory Modifications

Year	Net Investment (1)	Amortization of Investment (2)	Tax Credits (3)	Net Losses/Tax Depreciation (4)	Other Tax Benefits from Tax Depreciation (5)	Tax Credits and Other Tax Benefits (6)
	100,000					
1	90,909	9,091	8,000	7,273	2,909	10,909
2	81,818	9,091	8,000	7,273	2,909	10,909
3	72,727	9,091	8,000	7,273	2,909	10,909
4	63,636	9,091	8,000	7,273	2,909	10,909
5	54,545	9,091	8,000	7,273	2,909	10,909
6	45,454	9,091	8,000	7,273	2,909	10,909
7	36,363	9,091	8,000	7,273	2,909	10,909
8	27,272	9,091	8,000	7,273	2,909	10,909
9	18,181	9,091	8,000	7,273	2,909	10,909
10	9,090	9,091	8,000	7,273	2,909	10,909
11	6,666	2,424		7,273	2,909	2,909
12	4,242	2,424		7,273	2,909	2,909
13	1,818	2,424		7,273	2,909	2,909
14	0	1,818		5,451	2,183	2,183
15	0					0
Total		100,000	80,000	100,000	40,000	120,000

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

(2) Initial investment of $100,000 x (total tax benefits allocated during the year in Column (6)/total anticipated tax benefits over the life of the investment of $120,000).

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

(4) Depreciation (on $200,000 tax basis of the underlying assets) using the straight-line method over 27.5 years up to the amount of the initial investment of $100,000.

(5) Column (4) x 40% tax rate.

(6) Column (3) + Column (5).

Initial Year			
	Tax credit investment	100,000	
	Cash		100,000
	To record the purchase of tax credit investment		

Years 1-10			
	Amortization expense	9,091	
	Tax credit investment		9,091
	Federal tax credits	8,000	
	Income tax expense		8,000
	To record annual receipt of allocated tax credits and proportional amortization of investment.		

	Income taxes payable	8,000	
	Federal tax credits		8,000
	To record annual utilization of allocated tax credits.		
Year 11-13			
	Amortization expense	2,424	
	Tax credit investment		2,424
	To record annual proportional amortization of tax credit investment.		
Year 14			
	Amortization expense	1,818	
	Tax credit investment		1,818
	To record annual proportional amortization of tax credit investment.		

Example 2: Qualifying Tax ~~Equity~~ Credit Investment~~s~~ Structure with Non-Income Tax Related Benefits

~~This example is based on paragraphs 323-740-55-11 through 323-740-55-14 of the Accounting Standards Codification and illustrates a tax equity investment that generates non-income-tax-related benefits in addition to tax credits and other income tax benefits.~~

~~The amount and timing of amortization in the proportional amortization method is consistent with the statutory modifications; therefore, the table incorporated in this exhibit is based on the proportional amortization table. The statutory income statement requires a gross presentation on the income statement, with proportional amortization of the initial cost of the investment in investment income and the tax credits and benefits included in income tax expense.~~

~~Terms:~~
~~Date of Investment: January 1, 20X1~~
~~Purchase Price of Investment: $100,000~~
On January 1, 20X1, T&A Insurance Company purchased a 5% equity stake in a tax credit investment structure for $100,000. The allocated tax credits are non-transferable, and T&A anticipates that all tax credits received will be fully utilized prior to expiration of the tax credit carryover period.

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 will receive production tax credits based on the energy the project produces. The credits will be allocated over a four-year period.

5. The tax equity investor will receive cash proceeds based on 2 percent of the project's cash generated during the life of the ~~project~~investment.

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

7. All requirements are met to retain allocable income tax credits such that there will be no recapture of income tax credits.

~~8. The investor expects that the estimated residual value of the investment will be zero.~~

~~9.~~8. All of the conditions are met to require use of the proportional amortization method.

9. After 10 years, the tax equity investor has a right to require that the project sponsor purchase the tax equity investor's equity interest for a nominal amount. It is assumed that the Put option will be exercised and has a contractually agreed upon residual value of $1,000.

10. In Years 1-3 the investor is able to utilize all allocated tax credits in the same period they were received. In Year 4, the investor is only able to utilize half of that year's allocated tax credit and defers the remainder for utilization in Year 5.

Proportional Amortization Method with Statutory Modifications

Year	Net Investment (1)	Amortization of Investment (2)	Tax Credits (3)	Net Losses/Tax Depreciation (4)	Other Tax Benefits from Tax Depreciation (5)	Tax Credits and Other Tax Benefits (6)	Non-Tax Related Cash Returns (7)
	100,000						
1	79,399	20,601	20,000	8,300	3,320	23,320	58
2	58,799	20,601	20,000	8,300	3,320	23,320	58
3	38,198	20,601	20,000	8,300	3,320	23,320	58
4	17,597	20,601	20,000	8,300	3,320	23,320	58
5	14,664	2,933		8,300	3,320	3,320	58
6	11,731	2,933		8,300	3,320	3,320	58
7	8,799	2,933		8,300	3,320	3,320	58
8	5,866	2,933		8,300	3,320	3,320	58
9	2,933	2,933		8,300	3,320	3,320	58
10	0	2,933		8,300	3,320	3,320	58
Total		100,000	80,000	83,000	33,200	113,200	580

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

(2) Initial investment of $100,000 x (total tax benefits allocated during the year in Column (6)/total anticipated tax benefits over the life of the investment of $113,200).

(3) These tax credits have been generated through the production of electricity, which generates production tax credits. The tax equity investor is not receiving renewable energy credits or carbon offsets.

(4) Depreciation /other tax losses passed on to the investor.

(5) Column (4) x 40% tax rate.

(6) Column (3) + Column (5).

(7) Non-income-tax-related benefits recognized in current-period pre-tax earnings when allocated. This represents the cash proceeds allocated by the tax equity investor based on the cash generated from the project~~.~~

Initial Year

Tax credit investment	100,000	
Cash		100,000
To record the purchase of tax credit investment		

Years 1-3

Amortization expense	20,601	
Tax credit investment		20,601
Federal tax credits	20,000	
Income tax expense		20,000
Cash	58	
Investment Income		58

To record annual receipt of allocated tax credits, proportional amortization of investment, and receipt of non-tax cash returns.

Income taxes payable	20,000	
Federal tax credits		20,000

To record annual utilization of allocated tax credits.

Year 4

Amortization expense	20,601	
Tax credit investment		20,601
Federal tax credits	20,000	
Income tax expense		20,000
Cash	58	
Investment Income		58

To record annual receipt of allocated tax credits, proportional amortization of investment, and receipt of non-tax cash returns.

Income taxes payable	10,000	
Federal tax credits		10,000
Income tax expense	10,000	
Deferred tax expense		10,000

To record the portion of allocated tax credits utilized in the current year and defer the remainder. (Federal tax credit account should be mapped to the DTA reporting line as any balance remaining at year-end would be a DTA)

Year 5

Amortization expense	2,933	
Tax credit investment		2,933
Cash	58	
Investment Income		58

To record annual proportional amortization of tax credit investment and receipt of non-tax cash returns.

Income taxes payable	10,000	
Federal tax credits		10,000
Deferred tax expense	10,000	
Income tax expense		10,000

To record utilization of deferred tax credit.

Years 6-9

Amortization expense	2,933	
Tax credit investment		2,933
Cash	58	
Investment Income		58

To record annual proportional amortization of tax credit investment and receipt of non-tax cash returns.

Year 10

Amortization expense	2,933	
Tax credit investment		2,933
Cash	58	
Investment Income		58
To record annual proportional amortization of tax credit investment and receipt of non-tax cash returns.		
Cash	1,000	
Gain on sale of investment		1,000
To record sale of interest in tax credit investment at stated residual value.		

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/12-1-23 Fall National Meeting/Hearing/11 - 22-14a - SSAP No. 93R - Investments in Tax Credit Structures.docx

Note: *Revisions made after the August 13, 2023, exposure draft of SSAP No. 94R have been shown as tracked changes highlighted in grey.*

Statements of Statutory Accounting Principles No. 94 - Revised

~~Transferable and Non-Transferable~~ State and Federal Tax Credits

STATUS

Type of Issue	Common Area
Issued	June 12, 2006; Substantively revised December 7, 2011. Conceptually revised ~~-~~XXXX.
Effective Date	December 31, 2006; Substantive revisions detailed in Issue Paper No. 145 effective December 31, 2011; New SAP concept revisions detailed in Issue Paper No. XXX effective XXX.
Affects	No other pronouncements
Affected by	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS **1**
SCOPE OF STATEMENT **2**
SUMMARY CONCLUSION **2**
Accounting .... 4~~3~~
Admittance 5
Impairment 5
Disclosures 5
Effective Date and Transition .... 6~~5~~
REFERENCES **6**
Relevant Issue Papers 6
EXHIBIT A – ACCOUNTING FOR TRANSFERABLE TAX CREDITS **7**
EXHIBIT B – ACCOUNTING FOR NON-TRANSFERABLE TAX CREDITS **8**

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for ~~transferable and non-transferable~~ state and federal tax credits that are purchased[1] by the reporting entity ~~without being an investor in the entity from which the tax credit were earned/purchased~~. Tax credits allocated from investments NOT within the scope of *SSAP 93R—Investments in Tax Credit Structures* should refer to this statement for tax credit accounting guidance. ~~Additionally, Tax credits that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).~~Tax credits which have been awarded[2] to the reporting entity are not within the scope of this statement and should refer to *SSAP No. 101–Income Taxes*.

2. Tax credits allocated from and ~~I~~investments in ~~Low-Income Housing Tt~~tax ~~Credits credits~~ credit structures,s as discussed in SSAP No. 93R ~~SSAP No. 93R—*Low-Income Housing Tax Credit Property Investments*~~~~*Investments in Tax Credit Structures*,~~ which involve investments in projects or programs that generate general business federal tax credits or state tax credits, are not within the scope of this statement. ~~However, the tax credits received from tax credit investments are within the scope of this statement.~~

3. Investments in a CAPCO (Certified Capital Company), organized as a partnership or an LLC, which is a company, authorized by state statute that borrows from investors ~~(insurance companies)~~, in order to make venture capital investments in "qualified" businesses, are not within the scope of this statement. Although associated with tax credits, the insurance company is paid principal and interest on its investment with the CAPCO. Depending upon the terms of the CAPCO offering, principal and interest payments to the ~~insurance company~~investors will come from the CAPCO and/or the state. The CAPCO will make cash payments directly to the ~~insurance company~~investors while the state will make payments in the form of premium or income tax credits. Investments in a CAPCO shall be accounted for in accordance with *Interpretation (INT) 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)* and specific statutory accounting guidance addressing CAPCOs.

SUMMARY CONCLUSION

4. Both state and federal governments have enacted laws that create programs by which tax credits are granted to entities under certain specified conditions. The terms of these tax credits vary based on the issuing jurisdiction and from program to program.~~The criteria in paragraphs 5 and 6 are for transferable state tax credits (i.e., credits which may be sold or assigned). The criteria in paragraphs 7 and 8 are for non-transferable state tax credits (i.e., those which cannot be sold or assigned to other parties).~~

~~5. Some states have enacted laws that create programs by which transferable state tax credits are granted to entities under certain specified conditions (e.g., an entity makes an investment in a particular industry). The terms of these state tax credits vary from state to state and, within a state, from program to program. However, many of these transferable state tax credit programs share the following four characteristics:~~

~~a. The tax credit is nonrefundable;~~

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[1] The process to purchase a tax credit typically involves the acquisition of a tax credit certificate (certificated tax credits) or the execution of a state or federal transfer form (transferable tax credits). Tax credits which have been received through other means are indicative of tax credits allocated from an investment (For example, if the tax credits are received through a schedule K-1) and may be within scope of SSAP No. 93.

[2] For the purposes of this statement, awarded tax credit are tax credits issued to the reporting entity which were neither purchased nor allocated from an investment structure. A common example of an awarded tax credit are Job Creation tax credits which are a type of performance-based tax credit program.

~~b. The holder of the transferable state tax credit may sell or otherwise transfer the transferable state tax credit to another entity, which can likewise resell or transfer the credit;~~

~~c. The transferable state tax credit will expire if not used by a predetermined date; and~~

~~d. The transferable state tax credit can be applied against either state income tax or state premium tax.~~

~~6. For purposes of this statement, such programs will be referred to as "transferable state tax credits." The criteria in paragraphs 5.b., 5.c. and 5.d. must be present in order for the transferable state tax credit to receive the accounting treatment described in this statement. When a reporting entity purchases a transferable state tax credit from another entity, the transaction does not result in a continuing investment in a business entity (i.e. limited partnership).~~

~~**Non-Transferable State Tax Credits**~~

~~7. If the original or subsequent holder of the transferable tax credit is not able to transfer the tax credit, then the admissibility criteria in paragraph 8 for non-transferable tax credits apply. These non-transferable state tax credits share the following characteristics:~~

~~a. The tax credit is nonrefundable;~~

~~b. The successive holder of a state tax credit must redeem the credit by April 15 of the subsequent year to the entity's acquisition of the state tax credit and is not permitted to carry-over, carry-back, obtain a refund, sell or assign the credit;~~

~~c. The non-transferable state tax credit will expire if not used by the predetermined date; and~~

~~d. The non-transferable state tax credit can be applied against either state income tax or state premium tax.~~

5. ~~The criteria in paragraphs 7.b., 7.c. and 7.d. must be present in order for the non-transferable state tax credit to receive the accounting treatment described in this statement.~~For the purposes of this statement, "tax credits" must be issued by either a federal or state governmental entity and must be refundable[3] or can be applied against income tax or premium tax in accordance with permitted IRS or state tax provisions. Tax credits which may be sold or otherwise transferred to another entity are referred to as "transferable tax credits" whereas all other tax credits are referred to as "non-transferable."

6. When a reporting entity purchases a transferable or certificated tax credit from another entity, the transaction does not result in a continuing investment in a business entity (i.e., limited partnership)~~.~~. Direct payment elections are non-revocable and supersede the transferability of tax credits, as such, once the election has been made the tax credit would be considered a non-transferable tax credit.

~~**Transferable and non-transferable state tax credits as defined within this SSAP held by reporting entities meet the definition of assets as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and**~~

[3] Direct payment tax credits are synonymous with refundable tax credits, as such the terms are used interchangeably within this statement.

~~**are admissible assets to the extent that they comply with the requirements of this statement. If the criteria in paragraphs 6 or 8 are not met, the tax credits are nonadmitted.**~~

~~Acquisition~~Accounting

7. All tax credits within the scope of the statement must be recognized in the period they are allocated to or purchased by the reporting entity for tax purposes and must be recorded at face value upon receipt. ~~Transferable and non-transferable state tax credits are recorded at cost at the date of acquisition.~~Tax credits acquired at a premium or discount to their face value must record the gain/loss as follows:

a. Tax credits acquired at a discount must defer the gain as a miscellaneous liability upon receipt of the tax credit.

b. Tax credits acquired at a premium must realize the loss within the income statement upon receipt of the tax credit.

8. Deferred g~~G~~ains on ~~transferable and nontransferable~~ tax credits are deferred until the value of the ~~state~~ tax credits utilized exceeds the initial acquisition cost of the tax credits, or until the ~~state~~ tax credits are transferred to other entities or the direct payment election is utilized and the payment(s) or refund ~~is greater than~~exceed the initial ~~carrying~~ acquisition ~~value~~cost.

~~**Balance Sheet Treatment**~~

9. Tax credits shall be recognized in the period that they are purchased or allocated to the reporting entity for tax purposes:

a. Federal tax credits that can be utilized in the year allocated or purchased shall be reported in the income statement as an offset to federal taxes in accordance with *SSAP No. 101–Income Taxes*. Federal tax credits that cannot be utilized in the year allocated or purchased and are carried forward to a future tax year shall be reported ~~net of~~as a deferred tax asset (DTA) in accordance with SSAP No. 101.

b. State tax credits that can be utilized in the year allocated or purchased shall be reported in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax-reporting year in which the credit is utilized. State tax credits that cannot be utilized in the year allocated or purchased and are carried forward to a future tax year shall be reported gross of any related state tax liabilities and reported in the category of other-than-invested-assets (not to be reported net).

10. Use of carried forward tax credits in a future period shall be reflected as an offset to the corresponding income or premiums tax in the tax reporting year in which the tax credit is utilized.

~~8. Transferable and non-transferable state tax credits shall be established gross of any related state tax liabilities and reported in the category of other-than-invested assets (not reported net).~~

~~9. As transferable and non-transferable state tax credits are redeemed, the carrying value of the tax credits is reduced dollar for dollar by the amount of state tax credits applied toward the reporting entity's applicable state tax liability.~~

~~Income Statement Treatment~~

~~10. Gains on transferable and non-transferable state tax credits are deferred until the value of the state tax credits utilized exceeds the cost of the state tax credits or until the state tax credits are sold to other entities and the payment received is greater than the book value.~~

~~11. Losses on transferable and non-transferable state tax credits are recognized when known.~~

11. Gains and losses on ~~transferable and non-transferable state~~ tax credits are reflected in other income when realized.

12. A tax credit asset is considered purchased or allocated once the tax credit is received and available for use. If the reporting entity determines a commitment to purchase tax credits has met the definition of a liability, then the asset would be reported in other-than-invested assets as tax credits receivable.

Admittance

13. ~~Transferable and non-transferable t~~Tax credits as defined within this SSAP held by reporting entities meet the definition of assets as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and are admissible assets to the extent that they comply with the requirements of this statement. The admissibility of tax credits are subject to SSAP No. 101.

Impairment

~~12.~~14. An impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to recover the book adjusted carrying value ~~amount~~ of the ~~transferable or non-transferable state~~ tax credits. T~~State t~~ax credits should be evaluated for impairment at each reporting date.

~~13.~~15. When there is a decline in the realizability of a ~~transferable or non-transferable state~~ tax credit owned by the reporting entity that is other than temporary, the asset shall be written down to the expected realizable amount and the amount of the write down shall be accounted for as a realized loss. The expected realizable value is the new cost basis.

~~14.~~16. The new cost basis shall not be changed for subsequent recoveries in realizability.

Disclosures

~~15.~~17. The following disclosures shall be made in the financial statements. For purposes of this disclosure, total unused ~~transferable and non-transferable state~~ tax credits represent the entire ~~transferable and non-transferable state~~ tax credits available:

a. Carrying value of ~~transferable and non-transferable state~~ tax credits, disaggregated by transferable/certificated and non-transferable, gross of any related ~~state~~ tax liabilities by ~~state~~ jurisdiction and in total.~~,~~

b. Total unused ~~transferable and non-transferable state~~ tax credits by ~~state~~jurisdiction, disaggregated by transferable/certificated and non-transferable.~~;~~

c. Method of estimating utilization of remaining ~~transferable and non-transferable state~~ tax credits or other projected recovery of the current carrying value.

d. Impairment amount recognized in the reporting period, if any.

e. Identify ~~state~~ tax credits by transferable/certificated and non-transferable classifications~~,~~ and identify the admitted and ~~N~~nonadmitted portions of each classification.

~~16.~~18. Any commitment or contingent commitment to purchase tax credits shall be disclosed.

Effective Date and Transition

19. This statement is effective for reporting periods ending on or after December 31, 2006. Early adoption is permitted. 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. Substantive revisions to 1) revising the title; 2) incorporating the criteria for non-transferable state tax credits as described in paragraphs 7 and 8; 3) adding a disclosure; and 4) updating terminology throughout the document as appropriate, are effective for reporting periods ending on or after December 31, 2011.

20. In XXX, 20XX, new SAP concept revisions, as detailed in Issue Paper No. XXX, were adopted. These revisions, effective January 1, 2025, with early adoption permitted, expanded the scope of SSAP No. 94R to include all state and federal tax credits and provide new guidance on the accounting, recognition, and reporting for state and federal tax credits. As of the effective date, reporting entities shall prospectively modify the recognition, accounting, and reporting of tax credits within the scope of this statement to reflect the guidance in the conceptual revisions. For unutilized tax credits which were carried forward from prior to the effective date:

a. Federal tax credits in other-than-invested assets are to be transferred and reported net of deferred tax asset (DTA) in accordance with SSAP No. 101.

~~a.~~b. Tax credits previously recorded at acquisition cost should be adjusted to reflect the face value of the acquired tax credits with the corresponding loss immediately recognized or the gain deferred.

REFERENCES

Relevant Issue Papers

- Issue Paper No. 126—Accounting for Transferable State Tax Credits
- Issue Paper No. 145—Accounting for Transferable and Non-Transferable State Tax Credits
- Issue Paper No. XXX—XXX

EXHIBIT A – ACCOUNTING FOR TRANSFERABLE ~~STATE~~ TAX CREDITS

On 1/1/X1 SAM Insurance Company purchased transferable state tax credits for a cost of $100,000. The transferable state tax credits are redeemable for $160,000 and expire at the end of 12/31/X4. SAM initially expects to utilize the tax credits before expiration in their state of domicile in the amount of $40,000 per year. In year X4, SAM sells the remaining $30,000 in transferable state tax credits for $20,000.

1/1/x1	Transferable state tax credits	~~100~~160,000	
	Deferred gains on acquired tax credits		60,000
	Cash		100,000
	To record the purchase of the tax credits		
6/30/x1	Premium tax expense	40,000	
	Premium taxes payable to domiciliary state		40,000
	To record premium tax expense and accrue the liability in Year 1.		
10/1/x1	Premium tax payable	40,000	
	Transferable state tax credits		40,000
	To record the use of tax credits in Year 1. The reporting entity expects to be able to utilize remaining tax credits before expiration.		
6/30/x2	Premium tax expense	60,000	
	Premium taxes payable to domiciliary state		60,000
	To record premium tax expense and accrue the liability in Year 2.		
9/30/x2	Premium tax payable	60,000	
	Transferable state tax credits		60,000
	To record the use of taxes credits in Year 2. The reporting entity expects to be able to utilize remaining tax credits before expiration.		
6/30/x3	Premium tax expense	30,000	
	Premium taxes payable to domiciliary state		30,000
	To record premium tax expense and accrue the liability in Year 3.		
9/30/x3	Premium tax payable	30,000	
	Transferable state tax credits~~Other income~~		30,000
	Deferred gains on acquired tax credits	30,000	
	Other income		30,000
	To record the use of premium tax credits in excess of cost and recognize a gain on premium tax credits in other income. The Company intends to sell the remaining tax credits in year 4.		
6/30/x4	Cash	20,000	
	Other income	10,000	
	Transferable state tax credits		30,000
	Deferred gains on acquired tax credits	30,000	
	Other income		~~20~~30,000
	To record the sale of the remaining tax credits.		

EXHIBIT B – ACCOUNTING FOR NON-TRANSFERABLE ~~STATE~~ TAX CREDITS

On 7/1/X1 LJW Insurance Company purchased non-transferable ~~state~~ federal tax credits for a cost of $100,000. The ~~state~~ federal tax credits are redeemable for $110,000~~, are not transferable~~ and expire on, April 15, 20x2. LJW expects to utilize the tax credits before expiration ~~in their state of domicile~~ in the amount of $110,000. Tax credits are utilized pro-rata, approximately $36,666 every quarter, from acquisition date to expiration date. The illustration below assumes that LJW Insurance Company's quarterly income tax liability equals the amount of credits that were purchased.

7/1/x1	~~State~~ Federal tax credits	11~~0~~0,000	
	Deferred gains on acquired tax credits		10,000
	Cash		100,000
	To record the purchase of the tax credits		
9/30/x1	~~Premium~~ Income tax expense	~~200,000~~36,666	
	Income ~~Premium~~ taxes payable ~~to domiciliary state~~		~~200,000~~36,666
	To record quarterly ~~premium tax expense and accrue the~~income tax liability.		
10/1/x1	Income taxes payable	36,666	
	Federal tax credits		36,666
	To record the use of tax credits in the quarter.		
12/31/x1	Income tax expense	36,666	
	Income taxes payable		36,666
	To record quarterly income tax liability.		
1/1/x2	Income taxes payable	36,666	
	Federal tax credits		36,666
	To record the use of tax credits in the quarter.		
3/31/x2	Income tax expense	36,668	
	Income taxes payable		36,668
	To record quarterly income tax liability.		
~~3/15/x2~~	~~Premium tax payable~~	~~110,000~~	
4/1/x2	Income taxes payable	36,668	
	Deferred gains on acquired tax credits	10,000	
	Other Income		10,000
	Federal tax credits		36,668
	~~Other Income~~		~~10,000~~
	~~Federal tax credits~~		~~100110,000~~
	To record the use of ~~premium~~ tax credits in the quarter. ~~in excess of cost and recognize a gain on premium tax credits in other income. (The additional $90,000 of premium taxes payable would still be due.)~~		

Other SSAPs

The following revisions are shown as tracked changes and intended to update related SSAPs for the proposed changes to SSAP Nos. 93 and 94R.

Proposed revisions to ***SSAP No. 34—Investment Income Due and Accrued***

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for investment income due and accrued. This statement does not address the accounting for tax credits earned or purchased, which are discussed in *SSAP No. 94R—State and Federal Tax Credits*.

Proposed revisions to ***SSAP No. 48R—Joint Ventures, Partnerships and Limited Liability Companies***

SCOPE OF STATEMENT

2. 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 joint ventures, partnerships, and ~~and~~ limited liability companies that invest in tax credit programs ~~that~~ and are in the scope of~~hold an equity interest in either a tax syndication structure or tax equity fund invest in Low-Income Housing Tax Credit Properties as discussed in~~ *SSAP No. 93R*~~*—Low-Income Housing Tax Credit Property Investments*~~*Investments in Tax Credit Structures*.

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

Issue: ***SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve***

Check (applicable entity):

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

Description of Issue: This agenda item has been developed as a broad concept agenda item with the ultimate goal to incorporate accounting guidance for the asset valuation reserve (AVR) and the interest maintenance reserve (IMR) into *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. Historically, this statement has included brief overview of the AVR and IMR with the calculation and reporting guidance determined as directed by individual SSAPs or in accordance with the Annual Statement (A/S) Instructions for Life, Accident and Health / Fraternal Companies. As the SSAPs are highest in the statutory hierarchy as level 1, and the A/S instructions are level 3, the governing accounting concepts should be captured in the SSAPs.

It has also been noted that are some disconnects between the SSAPs and the IMR/AVR guidance included in the Annual Statement Instructions. This is likely due to SSAP accounting revisions, such as with the measurement of preferred stock, not being carried to the specific IMR/AVR guidance in the Annual Statement. This agenda item, and the intent to ensure accounting concepts are in the SSAPs, intends to address those aspects and should help mitigate future disconnects with guidance going forward.

Lastly, it has also been identified that there are limited financial reporting cross-checks to the reporting within the AVR. Although the instructions are specific as to how reporting lines should map to the AVR, instances have been noted in which a company has reported on one specific line for the investment schedule and then did not carry those amounts to the appropriate AVR reporting category. Although these may be inadvertent reporting errors, as the RBC for life companies pulls from the AVR reporting, it is imperative that the reporting per the investment schedules be reflected properly in the AVR. As such, this agenda item also proposes cross-checks to ensure consistent and accurate reporting.

Existing Authoritative Literature:

- ***SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*** **(included in entirety)**

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for an asset valuation reserve (AVR) and an interest maintenance reserve (IMR) for life and accident and health insurance companies, excluding separate accounts. Separate account AVR/IMR reporting is addressed in *SSAP No. 56—Separate Accounts.*

SUMMARY CONCLUSION

2. Life and accident and health insurance companies shall recognize liabilities for an AVR and an IMR. The AVR is intended to establish a reserve to offset potential credit-related investment losses on all invested asset categories excluding cash, policy loans, premium notes, collateral notes and income receivable. The IMR defers recognition of the realized capital gains and losses resulting from changes in the general level of interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the investments sold. The IMR also applies to certain liability gains/losses related to changes in interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the liability released.

3. The IMR and AVR shall be calculated and reported as determined per guidance in the SSAP for the specific type of investment (e.g., SSAP No. 43R for loan-backed and structured securities), or if not

specifically stated in the respective SSAP, in accordance with the NAIC *Annual Statement Instructions* for Life and Accident and Health Insurance Companies.

Effective Date and Transition

4. 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*.

- ***SSAP No. 56—Separate Accounts* (Excerpt for AVR and IMR included)**

Separate Account AVR and IMR Reporting

18. An AVR is generally required for separate accounts when the insurer, rather than the policyholder/contractholder, suffers the loss in the event of asset default or fair value loss. An AVR is required unless:

    a. The asset default or fair value risk is borne directly by the policyholders; or

    b. The regulatory authority for such separate accounts already explicitly provides for a reserve for asset default risk, where such reserves are essentially equivalent to the AVR.

19. Assets supporting traditional variable annuities and variable life insurance generally do not require an AVR because the policyholders/contractholders bear the risk of change in the value of the assets. However, an AVR is required for that portion of the assets representing the insurer's equity interest in the investments of the separate account (e.g., seed money).

20. Assets supporting typical modified guaranteed contracts, market value adjusted contracts, and contracts with book value guarantees similar to contracts generally found in the general account do require an AVR because the insurer is responsible for credit related asset or fair value loss.

21. Certain separate accounts are also required to maintain an Interest Maintenance Reserve (IMR). The IMR requirements for investments held in separate accounts are applied on an account by account basis. If an IMR is required for a separate account, all of the investments in that separate account are subject to the requirement. If an IMR is not required for a separate account, none of the investments in that separate account are subject to the requirement.

22. An IMR is required for separate accounts with assets recorded at book value, but is not required for separate accounts with assets recorded at fair value. For example, separate accounts for traditional variable annuities or variable life insurance do not require an IMR because assets and liabilities are valued at fair value.

23. If an IMR is required for investments held by separate accounts, it is kept separate from the general account IMR and accounted for in the separate accounts statement.

24. The AVR and IMR shall be calculated and reported in accordance with the NAIC *Annual* Statement Instructions *for Life, Accident and Health Insurance Companies*.

- **A/S Instructions – Life, Accident and Health / Fraternal Companies**
  (Due to the size of the instructions, these have not been duplicated within this agenda item.)

- **A/S Instructions – Separate Account**
  Instructions within the Separate Account section of the Life instructions also exist and are provided below:

  > Interest Maintenance Reserve (IMR) requirements for investments reported in the Separate Accounts Statement are applied on an account-by-account basis. If an IMR is required for a separate account, all of the investments in that separate account are subject to the requirement. If an IMR is not required for a separate account, none of the investments in that separate account are subject to the requirement.
  >
  > An IMR is required for separate accounts valued at book but is not required for separate accounts valued at market. For example, separate accounts for traditional variable annuities, or variable life insurance do not require an IMR because assets and liabilities are valued at market.
  >
  > If an IMR is required for investments in the Separate Accounts Statement, it is kept separate from the General Account IMR and accounted for in the Separate Accounts Statement.
  >
  > The instructions for completion of the IMR for the Separate Accounts Statement are incorporated in the instructions for completion of the IMR of the General Account Statement. Refer to those instructions for guidance.

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 2022-19: Negative IMR, identified that the accounting guidance for IMR, including the provisions on negative IMR, are currently captured in the Annual Statement Instructions. *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*, points to the Annual Statement Instructions for the IMR and AVR calculation.

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 recommend that the Working Group include this item on their maintenance agenda as a new SAP concept and expose this agenda item with the overall concept for a long-term project to capture accounting guidance for AVR and IMR in SSAP No. 7. Although it is anticipated that this project may take time, particularly with the assessment of admittance / nonadmittance for negative IMR as a long-term concept, it is noted that interim revisions (within specific agenda items) will be proposed to ensure progress towards consistent application and address potential areas where credit losses may be reported as IMR.

Although revisions may be considered and adopted to allow focus on specific discussion aspects, ultimately, the movement of the accounting guidance to SSAP No. 7, and any revisions from the A/S instructions when incorporating SSAP guidance, is proposed to be captured as a new SAP concept with a corresponding issue paper to detail the revisions.

Discussion topics expected to include as part of the broad project, include but are not limited to:

- **<u>Absolutes in Allocating between IMR and AVR</u>**
  With the recent focus of IMR admittance, NAIC staff has been contacted with questions to verify the allocation to IMR because a company was successful in selling a bond prior to the official NAIC designation downgrade (regional bank failures) and when a mortgage loan with an established valuation allowance (as the reporting entity does not expect to collect all amounts due according to the terms of the agreement) is sold before it is formally 90-days past due. These instances clearly reflect credit declines, but with the existing IMR instructions, there is guidance that direct these allocations to IMR instead of AVR.

- **<u>Bond IMR / AVR Allocation</u>**
  The current guidance in *SSAP No. 26R—Bonds* allocates all gains or losses to the IMR or the AVR based on whether there has been more than one NAIC designation change. This is different from *SSAP No. 43R—Loan-Backed and Structured Securities* in which all actions that result in realized gains / losses (sales / OTTI) are reviewed and bifurcated and/or divided between IMR and AVR. Furthermore, with the guidance to expand to 20 NAIC designations, the current A/S instructions are not clear as to what constitutes a designation change. Under current interpretation, a security could move through many levels from changes in the designation modifiers, which reflect credit changes, but not be considered to have moved beyond more than 1 designation. The non-bifurcation approach that currently exists for bonds, as well as the potential for many credit-quality changes within a designation level, may result with credit-related losses being captured in IMR. (The IMR/AVR instructions also continue to reference bond mutual funds, but that classification has been eliminated from statutory accounting.)

- **<u>Allocation of Perpetual Preferred Stock</u>**
  The IMR/AVR guidance for perpetual preferred stock has not been reviewed since the adoption of guidance that prescribes fair value for perpetual preferred stock. The guidance is still allocated entirely based on the NAIC designation. For preferred stock, a designation of 4-6, at any time during the holding period for both redeemable and perpetual, results in an allocation to AVR.

- **<u>Delineation of Non-Interest (Credit) / Interest and Realized / Unrealized</u>**
  The IMR/AVR guidance is predicated on a division between interest and non-interest changes, as well as the reporting of unrealized and realized changes. For the long-term project, it is proposed that principle-based concepts be established to assist with the allocation between IMR/AVR based on these fundamental concepts to ensure consistency and verification of allocation across reporting entities.

- **<u>Derivative Guidance</u>**
  There is ambiguity on intended guidance detailed in the A/S instructions and the guidance in *SSAP No. 86—Derivatives* for the allocation of derivatives held at fair value that are deemed to be hedging interest rate risk. (These derivatives do not qualify as effective derivatives under SSAP No. 86.)

- **<u>Reinsurance Ceded / Assumed</u>**
  Although the A/S instructions include guidance for removal of IMR for reinsurance ceded, and the acquisition of IMR for reinsurance assumed, the impact of reinsurance – particularly with the dissolution of reinsurance agreements when IMR had initially been transferred – is a common question on determining IMR and AVR for reporting entities.

- **<u>AVR / IMR Cross Checks</u>**
  The AVR is often used as the direct pull to the RBC instructions for life companies. It has been identified that there are no crosschecks to ensure that items are being mapped to the AVR correctly from other schedules. For example, residuals reported on Schedule BA should map to the residual reporting lines in the AVR. However, it was identified that there were variations between Schedule BA and the AVR for the residual lines. As the AVR reporting is pulled for RBC, it is important for the reporting in the AVR to correctly reflect what is in the schedules to ensure that the appropriate charges are applied. Cross checks are expected to ensure the reporting flows through the schedules as intended.

- **<u>Overall IMR and AVR Reporting in the General and Separate Accounts</u>**
  The reporting of IMR and AVR, including how positive balances in one account impacts negative balances in another account, as well as the treatment of net negative IMR, are expected as a long-term focus. It is anticipated that the complete guidance for both general accounts and separate accounts, once established, will be captured in SSAP No. 7, with a reference from *SSAP No. 56—Separate Accounts* to SSAP No. 7.

Staff Review Completed by: Julie Gann - NAIC Staff, July 2023

Status:
On August 13, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a new SAP concept and exposed this agenda item with the overall concept for a long-term project to capture accounting guidance for AVR and IMR in SSAP No. 7. Although revisions may be considered and adopted to allow focus on specific discussion aspects, ultimately, the movement of the accounting guidance to SSAP No. 7, and any revisions from the annual statement instructions when incorporating SAP guidance, is proposed to be captured as a new SAP concept with a corresponding issue paper to detail the revisions. The agenda item identifies discussion topics to be included in this project.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/8-13-23 Summer National Meeting/Exposures/23-14 - IMR AVR.docx

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

Issue: IMR / AVR Specific Allocations

Check (applicable entity):

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

Description of Issue: This agenda item has been developed to update guidance for IMR / AVR in the Annual Statement (A/S) Instructions that currently establish specific allocation guidance. The principal concept of the IMR and AVR is that interest-related losses go to IMR, and non-interest-related losses go to AVR. This agenda is to correct instructions that appear to direct an entity to allocate non-interest-related losses to IMR rather than correctly to the AVR.

Although the presence of examples for illustration or guiding purposes are beneficial, the current annual statement instructions have permitted unintended allocations that do not reflect the intent of the principles. These have been specifically noted through inquiries to NAIC staff, particularly within the last year. NAIC staff believes these inquiries have been spurred by the discussions regarding the industry request to admit net negative IMR, therefore creating an incentive to allocate losses to IMR instead of AVR.

This agenda item will focus on the following specific allocations within the A/S instructions:

1) NAIC Designation Changes for Debt Securities (excluding LBSS)
2) Mortgage Loans

1) <u>NAIC Designation Change:</u>

IMR: Include realized capital gains (losses) on Debt securities (excluding loan-backed and structured securities) and preferred stocks whose National Association of Insurance Commissioners (NAIC)/Securities Valuation Office (SVO) designation at the end of the holding period is **NOT** different from its NAIC designation at the beginning of the holding period by more than one NAIC designation. Exclude any such gains (losses) exempt from the IMR.

AVR: Report all realized capital gains (losses), net of capital gains tax, on each debt security (excluding loan-backed and structured securities) whose NAIC/SVO designation at the end of the holding period is different from its NAIC/SVO designation at the beginning of the holding period by more than one NAIC/SVO designation. The holding period is defined as the period from the date of purchase to the date of sale. For end of period classification, the most recent available designation should be used. For bonds acquired before Jan. 1, 1991, the holding period is presumed to have begun on Dec. 31, 1990

NAIC Discussion: NAIC staff have historically been contacted on the application of this guidance, particularly when the reporting entity rushes to sell a security prior to an official credit rating or SVO designation downgrade has occurred. For 2023, this was evident from questions received with the downgrade of several regional banks. With a literal read of the guidance, if a Credit Rating Provider (CRP) downgraded banks on April 21, 2023, a reporting entity that expected such downgrades and sold the security at a loss prior to the downgrade would be permitted to report the loss through IMR as the downgrade did not occur during the reporting entity's "holding period." Similar questions have occurred in prior years in situations where it was evident that a downgrade was forthcoming (e.g., PG&E in response to the California wildfires). Although the guidance could be retained as an absolute for reporting to AVR, as a "credit loss" is presumed to occur when there has been a more-than-one designation change, it is NAIC staff's interpretation that this guidance should not permit inappropriate allocation of non-interest related declines to IMR simply because a sale is able to occur prior to the official downgrade.

2) **Mortgage Loans:**

IMR: Include realized capital gains (losses) on: Mortgage loans where:1) Interest is NOT more than 90 days past due, or 2) The loan is NOT in process of foreclosure, or 3) The loan is NOT in course of voluntary conveyance, or 4) The terms of the loan have NOT been restructured during the prior two years.

AVR: In addition, all gains (losses), net of capital gains tax, on mortgage loans where 1) Interest is more than 90 days past due, or 2) The loan is in the process of foreclosure, or 3)The loan is in course of voluntary conveyance, or 4)The terms of the loan have been restructured during the prior two years would be classified as non-interest-related gains (losses).

NAIC Discussion: NAIC staff has recently been contacted as the current IMR / AVR guidance is specific that a mortgage loan must be 90 days past due or in process of foreclosure to report the loss to AVR. As such, if a reporting entity has established a valuation allowance under *SSAP No. 37—Mortgage Loans*, because the loan is impaired and they do not believe it is probable that they will collect all amounts due according to the contractual terms of the mortgage loan, and the reporting entity sells the mortgage loan before it is 90-days past due, a literal read of the guidance permits the loss to be fully allocated to IMR. Similar to the discussion on the NAIC designation change, such situations exist when the reporting entity has an expectation of expected credit loss (as a valuation allowance is only established when a mortgage loan is impaired), but the provisions of the A/S instructions direct to IMR.

Existing Authoritative Literature:

- **SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve (included in entirety)**

SCOPE OF STATEMENT
This statement establishes statutory accounting principles for an asset valuation reserve (AVR) and an interest maintenance reserve (IMR) for life and accident and health insurance companies, excluding separate accounts. Separate account AVR/IMR reporting is addressed in *SSAP No. 56—Separate Accounts.*

SUMMARY CONCLUSION
Life and accident and health insurance companies shall recognize liabilities for an AVR and an IMR. The AVR is intended to establish a reserve to offset potential credit-related investment losses on all invested asset categories excluding cash, policy loans, premium notes, collateral notes and income receivable. The IMR defers recognition of the realized capital gains and losses resulting from changes in the general level of interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the investments sold. The IMR also applies to certain liability gains/losses related to changes in interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the liability released.

The IMR and AVR shall be calculated and reported as determined per guidance in the SSAP for the specific type of investment (e.g., SSAP No. 43R for loan-backed and structured securities), or if not specifically stated in the respective SSAP, in accordance with the NAIC *Annual Statement Instructions* for Life and Accident and Health Insurance Companies.

Effective Date and Transition
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*.

- **A/S Instructions – Life, Accident and Health / Fraternal Companies**

Interest Maintenance Reserve (IMR)

Line 2 – Current Year's Realized Pre-tax Capital Gains (Losses) of $______ Transferred into the Reserve Net of Taxes of $______

Include interest-rate-related realized capital gains (losses), net of capital gains tax thereon. All realized capital gains (losses) transferred to the IMR are net of capital gains taxes thereon. Exclude non-interest-related (default) realized capital gains and (losses), realized capital gains (losses) on equity investments, and unrealized capital gains (losses).

All realized capital gains (losses), due to interest rate changes on fixed income investments, net of related capital gains tax, should be captured in the IMR and amortized into income (Column 2, Lines 1 through 31) according to Table 1 or the seriatim method. Realized capital gains (losses) must be classified as either interest (IMR) or non-interest (AVR) related, not a combination except as specified in *SSAP No. 43R—Loan-Backed and Structured Securities*. Purchase lots with the same CUSIP are treated as individual assets for IMR and Asset Valuation Reserve (AVR) purposes.

Exclude those capital gains and (losses) that, in accordance with contract terms have been used to directly increase or (decrease) contract benefit payments or reserves during the reporting period. The purpose of this exclusion is to avoid the duplicate utilization of such gains and (losses).

Capital gains tax should be determined using the method developed by the company to allocate taxes used for statutory financial reporting purposes. By capturing the realized capital gains (losses) net of tax, the capital gains tax associated with those capital gains (losses) due to an interest rate change is charged or credited to the IMR and amortized in proportion to the before-tax amortization.

Include realized capital gains (losses) on:

Debt securities (excluding loan-backed and structured securities) and preferred stocks whose National Association of Insurance Commissioners (NAIC)/Securities Valuation Office (SVO) designation at the end of the holding period is **NOT** different from its NAIC designation at the beginning of the holding period by more than one NAIC designation. Exclude any such gains (losses) exempt from the IMR.

Exchange Traded Funds (ETFs) as listed on the SVO Identified Bond ETF List (thereafter subject to bond IMR guidelines) and the SVO Identified Preferred Stock ETF List (thereafter subject to preferred stock IMR guidelines). Include any capital gains (losses) realized by the Company, whether from sale of the ETF or capital gains distributions by the ETF. If the ETF is removed from either SVO ETF list, the ETF is reported and treated as common stock, with any capital gains/(losses) excluded from the IMR.

SVO Identified Funds designated for systematic value

Called bonds, tendered bonds, and sinking fund payments.

Mortgage loans where:

- Interest is **NOT** more than 90 days past due, or
- The loan is **NOT** in process of foreclosure, or
- The loan is **NOT** in course of voluntary conveyance, or
- The terms of the loan have **NOT** been restructured during the prior two years.

Additional Provisions for Including/Excluding Gains (Losses) from IMR:

Mortgage loan prepayment penalties are not included in IMR. Treat them as regular investment income.

Interest-related gains (losses) realized on directly held capital and surplus notes reported on Schedule BA should be transferred to the IMR in the same manner as similar gains and (losses) on fixed income assets held on Schedule D. A capital gain (loss) on such a note is classified as an interest rate gain if the note is eligible for amortized-value accounting at both the time of acquisition and the time of disposition.

Determination of IMR gain (loss) on multiple lots of the same securities should follow the underlying accounting treatment in determining the gain (loss). Thus, the designation, on a purchase lot basis, should be compared to the designation at the end of the holding period to determine IMR or AVR gain or (loss).

Realized capital gains (losses) on any debt security (excluding loan-backed and structured securities) that has had an NAIC/SVO designation of 6 at any time during the holding period should be excluded from the IMR and included as a non-interest-related gain (loss) in the AVR.

Realized capital gains (losses) on any preferred stock that had an NAIC/SVO designation of RP4, RP5 or RP6 or P4, P5 or P6 at any time during the holding period should be reported as non-interest-related gains (losses) in the AVR.

The holding period for debt securities (excluding loan-backed and structured securities) and preferred stocks is defined as the period from the date of purchase to the date of sale. For the end of period classification, the most recent available designation should be used. For bonds acquired before Jan. 1, 1991, the holding period is presumed to have begun on Dec. 31, 1990. For preferred stocks acquired before Jan. 1, 1993, the holding period is presumed to have begun on Dec. 31, 1992. For SVO Identified ETFs, the holding period is defined as one calendar year to expected maturity. For SVO Identified Funds designated for systematic value, the holding period is the weighted-average life of the underlying bonds.

In accordance with *SSAP No. 26R—Bonds*, securities with other-than-temporary impairment losses shall be recorded entirely to either AVR or IMR and not bifurcated between interest and non-interest components.

Asset Valuation Reserve (AVR)

Line 2 – Realized Capital Gains (Losses) Net of Taxes – General Account

Report all realized non-interest-related (default) and equity capital gains (losses), net of capital gains tax, applicable to the assets in each component and sub-component. All realized capital gains (losses) transferred to the AVR are net of capital gains taxes thereon. Exclude all interest rate-related capital gains (losses) from the AVR.

Capital gains tax should be determined using the method developed by the company to allocate taxes used for statutory financial reporting purposes.

Report all realized capital gains (losses), net of capital gains tax, on each debt security (excluding loan-backed and structured securities) whose NAIC/SVO designation at the end of the holding period is different from its NAIC/SVO designation at the beginning of the holding period by more than one NAIC/SVO designation. The holding period is defined as the period from the date of purchase to the date of sale. For end of period classification, the most recent available designation should be used. For bonds acquired before Jan. 1, 1991, the holding period is presumed to have begun on Dec. 31, 1990.

Determination of AVR gain (loss) on multiple lots of the same fixed income securities should follow the underlying accounting treatment in determining gain (loss). Thus, the designation, on a purchase lot basis, should be compared to the designation at the end of the holding period to determine IMR or AVR gain or (loss).

In accordance with *SSAP No. 26R—Bonds*, securities with other-than-temporary impairment losses shall be recorded entirely to either AVR or IMR and not bifurcated between interest and non-interest components.

In accordance with *SSAP No. 43R—Loan-Backed and Structured Securities*, for loan-backed and structured securities only:

- Other-Than-Temporary Impairment – Non-interest-related other-than-temporary impairment losses shall be recorded through the AVR. If the reporting entity wrote the security down to fair value due to the intent to sell or does not have the intent and ability to retain the investment for a period of time sufficient to recover the amortized cost basis, the non-interest-related portion of the other-than-temporary impairment losses shall be recorded through the AVR; the interest related other-than-temporary impairment losses shall be recorded through the IMR. The analysis for bifurcating impairment losses between AVR and IMR shall be completed as of the date when the other-than-temporary impairment is determined.

- Security Sold at a Loss Without Prior OTTI – An entity shall bifurcate the loss into AVR and IMR portions depending on interest- and non-interest-related declines in accordance with the analysis performed as of the date of sale. As such, an entity shall report the loss in separate AVR and IMR components as appropriate.

- Security Sold at a Loss with Prior OTTI – An entity shall bifurcate the current realized loss into AVR and IMR portions depending on interest- and non-interest-related declines in accordance with the analysis performed as of the date of sale. An entity shall not adjust previous allocations to AVR and IMR that resulted from previous recognition of other-than-temporary impairments.

- Security Sold at a Gain with Prior OTTI – An entity shall bifurcate the gain into AVR and IMR portions depending on interest and non-interest factors in accordance with the analysis performed as of the date of sale. The bifurcation between AVR and IMR that occurs as of the date of sale may be different from the AVR and IMR allocation that occurred at the time of previous other-than-temporary impairments. An entity shall not adjust previous allocations to AVR and IMR that resulted from previous recognition of other-than-temporary impairments.

- Security Sold at a Gain Without Prior OTTI – An entity shall bifurcate the gain into AVR and IMR portions depending on interest and non-interest factors in accordance with the analysis performed as of the date of sale.

In addition, all gains (losses), net of capital gains tax, on mortgage loans where:

- Interest is more than 90 days past due, or
- The loan is in the process of foreclosure, or
- The loan is in course of voluntary conveyance, or
- The terms of the loan have been restructured during the prior two years

Would be classified as non-interest-related gains (losses).

The gain (loss), net of capital gains tax, on any debt security (excluding loan-backed and structured securities) that has had an NAIC/SVO designation of "6" at any time during the holding period should be reported as a credit related gain (loss).

All capital gains (losses), net of capital gains tax, from preferred stock that had an NAIC/SVO designation of RP4, RP5 or RP6 or P4, P5 or P6 at any time during the holding period should be reported as on-interest-related gains (losses) in the AVR.

However, for a convertible bond or preferred stock purchased while its conversion value exceeds its par value, any gain (loss) realized from its sale before conversion must be included in the Equity Component of the AVR. Conversion Value is defined to mean the number of shares available currently or at next conversion date multiplied by the stock's current market price.

Report all realized equity capital gains (losses), net of capital gains tax, in the appropriate sub-components.

The following guidance pertains to instruments in Scope of *SSAP No. 86—Derivatives*:

- For derivative instruments used in hedging transactions, the determination of whether the capital gains (losses) are allocable to the IMR or the AVR is based on how the underlying asset is treated. Realized gains (losses), net of capital gains tax, on portfolio or general hedging instruments should be included with the hedged asset. Gains (losses), net of capital gains tax, on hedges used, as specific hedges should be included only if the specific hedged asset is sold or disposed of.

- For income generation derivative transactions, the determination of whether the capital gains (losses) are allocable to the IMR or the AVR is based on how the underlying interest (for a put) or covering asset (for a call, cap or floor) is treated. Realized gains (losses), net of capital gains tax should be included in the same sub-component where the realized gains (losses) of the underlying interest (for a put) or covering asset (for a call, cap or floor) is reported. Refer to *SSAP No. 86—Derivatives* for accounting guidance.

Realized gains (losses), net of capital gains tax, resulting from the sale of U.S. government securities and the direct or guaranteed securities of agencies which are backed by the full faith and credit of the U.S. government are exempt from the AVR. This category is described in the Investment Schedules General Instructions.

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 2022-19: Negative IMR, identified that the accounting guidance for IMR, including the provisions on negative IMR, are currently captured in the Annual Statement Instructions. *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*, points to the Annual Statement Instructions for the IMR and AVR calculation. This agenda item resulted with the issuance of INT 23-01T to provide a limited-time, optional, exception to the nonadmittance of net negative (disallowed) IMR.

- Agenda Item 2023-XX: SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve establishes a broad project to capture accounting guidance for AVR and IMR in SSAP No. 7.

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

Recommendation:
NAIC staff recommend that the Working Group include this item on their maintenance agenda as a new SAP concept and expose this agenda item with proposed revisions to the A/S instructions to remove the guidance that permits the allocation of non-interest related losses to IMR. (Although NAIC staff believes this guidance is clarifying the original intent of IMR/AVR allocation, the revisions reflect a distinct change in practice to reduce the allocation of non-interest-related losses to the IMR.)

This agenda item is focusing solely on the specific allocation "absolutes" that currently exists in the A/S instructions to ensure that the guidance does not inadvertently permit the allocation of non-interest-related changes to the IMR. This agenda item is addressing one of the specific discussion topics noted in agenda item 2023-XX. Further revisions and assessment on other aspects of the IMR/AVR allocation, including whether gains and losses from bonds (and other investments) should be bifurcated between IMR/AVR, will be addressed in subsequent agenda items. (Revisions will subsequently captured in the SSAPs as part of the long-term project, but these revisions are proposed for immediate clarification edits in the A/S instructions as that is where guidance currently resides.)

Interest Maintenance Reserve (IMR)

Line 2 – Current Year's Realized Pre-tax Capital Gains (Losses) of $______ Transferred into the Reserve Net of Taxes of $______

Include interest-rate-related realized capital gains (losses), net of capital gains tax thereon. All realized capital gains (losses) transferred to the IMR are net of capital gains taxes thereon. Exclude non-interest-related (default) realized capital gains and (losses), realized capital gains (losses) on equity investments, and unrealized capital gains (losses).

All realized capital gains (losses), due to interest rate changes on fixed income investments, net of related capital gains tax, should be captured in the IMR and amortized into income (Column 2, Lines 1 through 31) according to Table 1 or the seriatim method. Realized capital gains (losses) must be classified as either interest (IMR) or non-interest (AVR) related, not a combination except as specified in *SSAP No. 43R—Loan-Backed and Structured Securities*. Purchase lots with the same CUSIP are treated as individual assets for IMR and Asset Valuation Reserve (AVR) purposes.

Exclude those capital gains and (losses) that, in accordance with contract terms have been used to directly increase or (decrease) contract benefit payments or reserves during the reporting period. The purpose of this exclusion is to avoid the duplicate utilization of such gains and (losses).

Capital gains tax should be determined using the method developed by the company to allocate taxes used for statutory financial reporting purposes. By capturing the realized capital gains (losses) net of tax, the capital gains tax associated with those capital gains (losses) due to an interest rate change is charged or credited to the IMR and amortized in proportion to the before-tax amortization.

Include realized capital gains (losses) on:

Debt securities (excluding loan-backed and structured securities) and preferred stocks where the realized capital gains (losses) more predominantly reflect interest-related changes. By default, debt instruments whose National Association of Insurance Commissioners (NAIC)/Securities Valuation Office (SVO) designation at the end of the holding period, or within a reasonable amount of time after the reporting entity has sold/disposed of the instrument, are~~is~~ ~~**NOT**~~ different from its NAIC designation at the beginning of the holding period by more than one NAIC designation or NAIC designation category shall not be considered to reflect interest-related changes. Gains (losses) from those debt instruments shall NOT be reported in the IMR and shall be reported in the AVR ~~Exclude any such gains (losses) exempt from the IMR.~~

Exchange Traded Funds (ETFs) as listed on the SVO Identified Bond ETF List (thereafter subject to bond IMR guidelines) and the SVO Identified Preferred Stock ETF List (thereafter subject to preferred stock IMR guidelines). Include any capital gains (losses) realized by the Company, whether from sale of the ETF or capital gains distributions by the ETF. If the ETF is removed from either SVO ETF list, the ETF is reported and treated as common stock, with any capital gains/(losses) excluded from the IMR.

SVO Identified Funds designated for systematic value

Called bonds, tendered bonds, and sinking fund payments.

Mortgage loans where the realized gains (losses) more predominantly reflect interest-related changes. By default, mortgage loans that meet any of the following criteria shall not be considered to reflect interest-related losses. Realized gains (losses) from mortgage loans with these characteristics shall be reported in the AVR:

- Any mortgage loan sold/disposed with an established valuation allowance under SSAP No. 37, or
- Interest is ~~**NOT**~~ more than 90 days past due, or
- The loan is ~~**NOT**~~ in process of foreclosure, or
- The loan is ~~**NOT**~~ in course of voluntary conveyance, or
- The terms of the loan have ~~**NOT**~~ been restructured during the prior two years.

Additional Provisions for Including/Excluding Gains (Losses) from IMR:

Mortgage loan prepayment penalties are not included in IMR. Treat them as regular investment income.

Interest-related gains (losses) realized on directly held capital and surplus notes reported on Schedule BA should be transferred to the IMR in the same manner as similar gains and (losses) on fixed income assets held on Schedule D. A capital gain (loss) on such a note is classified as an interest rate gain if the note is eligible for amortized-value accounting at both the time of acquisition and the time of disposition.

Determination of IMR gain (loss) on multiple lots of the same securities should follow the underlying accounting treatment in determining the gain (loss). Thus, the designation, on a purchase lot basis, should be compared to the designation at the end of the holding period to determine IMR or AVR gain or (loss).

Realized capital gains (losses) on any debt security (excluding loan-backed and structured securities) that has had an NAIC/SVO designation of 6 at any time during the holding period should be excluded from the IMR and included as a non-interest-related gain (loss) in the AVR.

Realized capital gains (losses) on any preferred stock that had an NAIC/SVO designation of RP4, RP5 or RP6 or P4, P5 or P6 at any time during the holding period should be reported as non-interest-related gains (losses) in the AVR.

The holding period for debt securities (excluding loan-backed and structured securities) and preferred stocks is defined as the period from the date of purchase to the date of sale.

For the end of period classification, the most recent available designation should be used. For bonds acquired before Jan. 1, 1991, the holding period is presumed to have begun on Dec. 31, 1990. For preferred stocks acquired before Jan. 1, 1993, the holding period is presumed to have begun on Dec. 31, 1992. For SVO Identified ETFs, the holding period is defined as one calendar year to expected maturity. For SVO Identified Funds designated for systematic value, the holding period is the weighted-average life of the underlying bonds.

In accordance with *SSAP No. 26R—Bonds*, securities with other-than-temporary impairment losses shall be recorded entirely to either AVR or IMR and not bifurcated between interest and non-interest components.

Asset Valuation Reserve (AVR)

Line 2 – Realized Capital Gains (Losses) Net of Taxes – General Account

Report all realized non-interest-related (default) and equity capital gains (losses), net of capital gains tax, applicable to the assets in each component and sub-component. All realized capital gains (losses) transferred to the AVR are net of capital gains taxes thereon. Exclude all interest rate-related capital gains (losses) from the AVR.

Capital gains tax should be determined using the method developed by the company to allocate taxes used for statutory financial reporting purposes.

Report all realized capital gains (losses), net of capital gains tax, on each debt security (excluding loan-backed and structured securities) where the realized capital gains (losses) more predominantly reflect non-interest-related changes. By default, debt instruments whose NAIC/SVO designation at the end of the holding period, or within a reasonable amount of time after the reporting entity has sold/disposed of the instrument, is different from its NAIC/SVO designation at the beginning of the holding period by more than one NAIC designation or NAIC designation category shall be considered to reflect non-interest-related changes. Gains (losses) from those debt instruments shall be reported in the AVR ~~by more than one NAIC/SVO designation. The holding period is defined as the period from the date of purchase to the date of sale. For end of period classification, the most recent available designation should be used. For bonds acquired before Jan. 1, 1991, the holding period is presumed to have begun on Dec. 31, 1990.~~.

Determination of AVR gain (loss) on multiple lots of the same fixed income securities should follow the underlying accounting treatment in determining gain (loss). Thus, the designation, on a purchase lot basis, should be compared to the designation at the end of the holding period to determine IMR or AVR gain or (loss).

In accordance with *SSAP No. 26R—Bonds*, securities with other-than-temporary impairment losses shall be recorded entirely to either AVR or IMR and not bifurcated between interest and non-interest components.

In accordance with *SSAP No. 43R—Loan-Backed and Structured Securities*, for loan-backed and structured securities only:

- Other-Than-Temporary Impairment – Non-interest-related other-than-temporary impairment losses shall be recorded through the AVR. If the reporting entity wrote the security down to fair value due to the intent to sell or does not have the intent and ability to retain the investment for a period of time sufficient to recover the amortized cost basis, the non-interest-related portion of the other-than-temporary impairment losses shall be recorded through the AVR; the interest related other-than-temporary impairment losses shall be recorded through the IMR. The analysis for bifurcating impairment losses between

AVR and IMR shall be completed as of the date when the other-than-temporary impairment is determined.

- Security Sold at a Loss Without Prior OTTI – An entity shall bifurcate the loss into AVR and IMR portions depending on interest- and non-interest-related declines in accordance with the analysis performed as of the date of sale. As such, an entity shall report the loss in separate AVR and IMR components as appropriate.

- Security Sold at a Loss with Prior OTTI – An entity shall bifurcate the current realized loss into AVR and IMR portions depending on interest- and non-interest-related declines in accordance with the analysis performed as of the date of sale. An entity shall not adjust previous allocations to AVR and IMR that resulted from previous recognition of other-than-temporary impairments.

- Security Sold at a Gain with Prior OTTI – An entity shall bifurcate the gain into AVR and IMR portions depending on interest and non-interest factors in accordance with the analysis performed as of the date of sale. The bifurcation between AVR and IMR that occurs as of the date of sale may be different from the AVR and IMR allocation that occurred at the time of previous other-than-temporary impairments. An entity shall not adjust previous allocations to AVR and IMR that resulted from previous recognition of other-than-temporary impairments.

- Security Sold at a Gain Without Prior OTTI – An entity shall bifurcate the gain into AVR and IMR portions depending on interest and non-interest factors in accordance with the analysis performed as of the date of sale.

In addition, all gains (losses), net of capital gains tax, on mortgage loans where the realized gains (losses) more predominantly reflect non-interest-related changes. By default, mortgage loans that meet any of the following criteria shall be considered to reflect non-interest-related changes and realized gains (losses) from mortgage loans with these characteristics shall be reported in the AVR:

- Any mortgage loan sold/disposed with an established valuation allowance under SSAP No. 37, or
- Interest is more than 90 days past due, or
- The loan is in the process of foreclosure, or
- The loan is in course of voluntary conveyance, or
- The terms of the loan have been restructured during the prior two years

~~Would be classified as non-interest-related gains (losses).~~

The gain (loss), net of capital gains tax, on any debt security (excluding loan-backed and structured securities) that has had an NAIC/SVO designation of “6” at any time during the holding period should be reported as a credit related gain (loss).

All capital gains (losses), net of capital gains tax, from preferred stock that had an NAIC/SVO designation of RP4, RP5 or RP6 or P4, P5 or P6 at any time during the holding period should be reported as on-interest-related gains (losses) in the AVR.

However, for a convertible bond or preferred stock purchased while its conversion value exceeds its par value, any gain (loss) realized from its sale before conversion must be included in the Equity Component of the AVR. Conversion Value is defined to mean the number of shares available currently or at next conversion date multiplied by the stock’s current market price.

Report all realized equity capital gains (losses), net of capital gains tax, in the appropriate sub-components.

The following guidance pertains to instruments in Scope of *SSAP No. 86—Derivatives*:

- For derivative instruments used in hedging transactions, the determination of whether the capital gains (losses) are allocable to the IMR or the AVR is based on how the underlying asset is treated. Realized gains (losses), net of capital gains tax, on portfolio or general hedging instruments should be included with the hedged asset. Gains (losses), net of capital gains tax, on hedges used, as specific hedges should be included only if the specific hedged asset is sold or disposed of.

- For income generation derivative transactions, the determination of whether the capital gains (losses) are allocable to the IMR or the AVR is based on how the underlying interest (for a put) or covering asset (for a call, cap or floor) is treated. Realized gains (losses), net of capital gains tax should be included in the same sub-component where the realized gains (losses) of the underlying interest (for a put) or covering asset (for a call, cap or floor) is reported. Refer to *SSAP No. 86—Derivatives* for accounting guidance.

Realized gains (losses), net of capital gains tax, resulting from the sale of U.S. government securities and the direct or guaranteed securities of agencies which are backed by the full faith and credit of the U.S. government are exempt from the AVR. This category is described in the Investment Schedules General Instructions.

Staff Review Completed by: Julie Gann - NAIC Staff, July 2023

Status:
On August 13, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a new SAP concept, and exposed proposed revisions to the annual statement instructions to remove the guidance that permits the specific allocation of non-interest related losses to IMR.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/8-13-23 Summer National Meeting/Exposures/23-15 - IMR Specific Allocations.docx

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

Issue: Schedule BA Reporting Categories

Check (applicable entity):

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

Description of Issue: This agenda item has been developed to incorporate more detailed definitions for the annual statement reporting categories of *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* (SSAP No. 48) and residual interests on Schedule BA: Other Long-Term Invested Assets. These investments are reported on designated lines divided by the reporting entity's classification as to the underlying asset characteristics:

- Bonds / Fixed-Income Instruments*
- Common Stocks
- Real Estate
- Mortgage Loans
- Other

** Bonds / fixed-income instruments reported in scope of SSAP No. 48 as non-registered private funds, joint ventures, partnerships, or limited liability companies is divided between investments that have an NAIC designation assigned by the SVO and those that do not have an NAIC designation assigned by the SVO.*

The recent residual discussions have further identified that variations exist across industry on the types of investments that should be captured within each category. It has also been noted that the Annual Statement Instructions are limited with guidance and examples for determining reporting classification.

This agenda item has been drafted to propose revisions to the reporting category descriptions in the Annual Statement Instructions to improve consistency in reporting for both ease of industry classifications and for regulator assessment of the type and volume of investment types. The proposed revisions from the Statutory Accounting Principles (E) Working Group will be used to sponsor a blanks annual statement instruction change. The revisions within this agenda item will not result in statutory accounting revisions.

Existing Authoritative Literature:

- **A/S Instructions – Life, Accident and Health / Fraternal Companies**

Reporting Categories on Schedule BA:

Non-Registered Private Funds with Underlying Assets Having Characteristics of:
Bonds
NAIC Designation Assigned by the Securities Valuation Office (SVO)
Unaffiliated....................0799999
Affiliated....................0899999
NAIC Designation Not Assigned by the Securities Valuation Office (SVO)
Unaffiliated....................0999999
Affiliated....................1099999
Mortgage Loans

Unaffiliated....................1199999
Affiliated....................1299999

Other Fixed Income Instruments

Unaffiliated....................1399999
Affiliated....................1499999

Joint Venture, Partnership or Limited Liability Company Interests with Underlying Assets Having the Characteristics of:

Fixed Income Instruments

NAIC Designation Assigned by the Securities Valuation Office (SVO)

Unaffiliated....................1599999
Affiliated....................1699999

NAIC Designation Not Assigned by the Securities Valuation Office (SVO)

Unaffiliated....................1799999
Affiliated....................1899999

Common Stocks

Unaffiliated....................1999999
Affiliated....................2099999

Real Estate

Unaffiliated....................2199999
Affiliated....................2299999

Mortgage Loans

Unaffiliated....................2399999
Affiliated....................2499999

Other

Unaffiliated....................2599999
Affiliated....................2699999

Residual Tranches or Interests with Underlying Assets Having Characteristics of:

Fixed Income Instruments

Unaffiliated....................4699999
Affiliated....................4799999

Common Stock

Unaffiliated....................4899999
Affiliated....................4999999

Preferred Stock

Unaffiliated....................5099999
Affiliated....................5199999

Real Estate

Unaffiliated....................5299999
Affiliated....................5399999

Mortgage Loans

Unaffiliated....................5499999
Affiliated....................5599999

Other

Unaffiliated....................5699999
Affiliated....................5799999

Schedule BA Classification Instructions / Guidance:

Non-Registered Private Funds with Underlying Assets Having Characteristics of a Bond, Mortgage Loan or Other Fixed Income Instrument

Include: Fixed income instruments that are not corporate or governmental unit obligations (Schedule D) or secured by real property (Schedule B).

Any investments deemed by the reporting entity to possess the underlying characteristics of a bond or other fixed income instrument that has been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 0799999 and 0899999.

Any investments deemed by the reporting entity to possess the underlying characteristics of a bond or other fixed income investment that has not been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 0999999, 1099999, 1199999, 1299999, 1399999 and 1499999.

Joint Ventures, Partnership or Limited Liability Company Interests with Underlying Assets Having the Characteristics:

Fixed Income Instruments

Include: Leveraged Buy-out Fund.

A fund investing in the “Z” strip of Collateralized Mortgage Obligations.

Any investments deemed by the reporting entity to possess the underlying characteristics of fixed income instruments that has been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 1599999 and 1699999.

Any investments deemed by the reporting entity to possess the underlying characteristics of fixed income instruments that has not been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 1799999 and 1899999.

Common Stocks

Include: Venture Capital Funds.

Real Estate

Include: Real estate development interest. Reporting should be consistent with the detailed property analysis appropriate for the corresponding risk-based capital factor for this investment category. If the requisite details are not available for reporting, report under “Other” subcategory.

Mortgage Loans

Include: Mortgage obligations. Reporting should be consistent with the detailed property analysis appropriate for the corresponding risk-based capital factor for this investment category. If the requisite details are not available for reporting, report under "Other" subcategory.

Other

Include: Limited partnership interests in oil and gas production.

Forest product partnerships.

Investments within the Joint Venture and Partnership Interests category that do not qualify for inclusion in the "Fixed Income Instruments," "Common Stocks," "Real Estate" or "Mortgage Loans" subcategories.

Reporting should be consistent with the corresponding risk-based capital factor for this investment category (i.e., Other Long-Term Assets).

Residual Tranches or Interests with Underlying Assets Having Characteristics of:

Investment in Residual Tranches or Interests should be assigned to the subcategory with the highest underlying asset concentration. There shouldn't be any bifurcation of the underlying assets among the subcategories.

Include: Residual tranches or interests captures securitization tranches and beneficial interests as well as other structures captured in scope of *SSAP No. 43R – Loan-Backed and Structured Securities*, that reflect loss layers without any contractual payments, whether interest or principal, or both. Payments to holders of these investments occur after contractual interest and principal payments have been made to other tranches or interests and are based on the remaining available funds. See SSAP No. 43R for accounting guidance.

Fixed Income Instruments

Include: Investments with underlying collateral which, if held individually, would be reported on *Schedule D – Part 1 – Long-Term Bonds*

Common Stocks

Include: Investments with underlying collateral which, if held individually, would be reported on *Schedule D – Part 2 – Section 2 – Common Stocks*

Preferred Stocks

Include: Investments with underlying collateral which, if held individually, would be reported on *Schedule D – Part 2 – Section 1 – Preferred Stocks*

Real Estate

Include: Investments with underlying collateral which, if held individually, would be reported on *Schedule A – Real Estate Owned*

Mortgage Loans

Include: Investments with underlying collateral which, if held individually, would be reported on *Schedule B – Mortgage Loans*

Other

Include: Items that do not qualify for inclusion in the above subcategories.

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):

- Bond Project: Under the principle-based bond definition project, revisions are proposed to combine the non-registered provide funds within the reporting category for joint ventures, partnerships and limited liability companies as those items would also be in scope of SSAP No. 48. With that change the category of "fixed income instruments" would be retained.

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 recommend that the Working Group include this item on their maintenance agenda as a SAP clarification / potential blanks reporting change and expose this agenda item with a request for industry and regulator feedback to further define and provide examples for the investments captured as non-registered private funds, joint ventures, partnerships or limited liability companies, or residual interests and reported based on the underlying characteristics of assets. Specifically, comments are requested on what should be captured as investments with underlying asset characteristics of:

- Fixed-Income Instruments
- Common Stocks
- Real Estate
- Mortgage Loans
- Other

As detailed in the current A/S instructions, descriptions are included for non-registered private funds, joint ventures, partnerships, and limited liability companies, whereas references to the SSAP the underlying assets would be captured in are included for residual interests.

This agenda item is only intended to improve the annual statement instructions and examples for the allocation of investments based on the above underlying characteristics of assets. If needed, and preferred by the Working Group, this agenda item could be expanded to propose new reporting lines (structural changes) to Schedule BA. As noted within 'Activity to Date,' revisions are currently being considered to combine and rearrange broad reporting lines under the bond project. Those revisions currently do not expand on the instructions for reporting based on underlying characteristics of assets. The proposed revisions from the Statutory Accounting Principles (E) Working Group will be used to sponsor a blanks annual statement instruction change. The revisions within this agenda item will not result in actual statutory accounting revisions.

Staff Review Completed by: Julie Gann - NAIC Staff, May 2023

Status:
On August 13, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification and exposed this agenda item to further define for consistency purposes the investments captured as non-registered private funds, joint ventures, partnerships or limited liability companies, or residual interests and reported based on the underlying characteristics of assets.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/8-13-23 Summer National Meeting/Exposures/23-16 - Schedule BA Categories.docx

Statutory Accounting Principles (E) Working Group
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Issue: Short-Term Investments

Check (applicable entity):

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

Description of Issue: This agenda item has been developed to review the guidance in *SSAP No. 2R—Cash, Cash Equivalents, Drafts, and Short-Term investments* and establish principal concepts for the types of investments that should be permitted for reporting as either cash equivalents or short-term investments. This agenda item is in response to noted situations in which certain types of investments, particularly collateral loans or other Schedule BA items, are being designed specifically to meet the parameters for short-term reporting. Although revisions were previously incorporated to prevent the "rolling" of short-term items, information has been shared that some reporting entities are now effectively ending short-term collateral loan investments, only to reissue those collateral loans from other lenders in the same group (same ultimately owners) so that they can continue to qualify as short-term for reporting on Schedule DA. The effect is a continuously reporting short-term collateral loan investments in a way so that the investment in appearance is not considered 'substantially similar' to the investment previously held, although in effect the borrower is the same holding company group. This approach permits the company to report these investments as "Other Short-Term Investments" on Schedule DA, rather than in the designated reporting line for collateral loans. This allows companies to reduce the appearance of the collateral loans, not provide the detail that would be required for the loan is reported on Schedule BA, and potentially result in non-compliance with the SSAP No. 21 admittance requirements due to the Schedule DA reporting. Under SSAP No. 2R, paragraph 16, short-term investments are to be accounted for in the same manner as similar long-term investments. However, paragraph 17 indicates that short-term investments are admitted to the extent that they conform to the requirements of SSAP No. 2R. Although the intent of paragraph 16 is to require the same valuation and admittance requirements for short-term that exist for long-term, some reporting entities may be valuing collateral loans similar to the requirements of SSAP No. 21 but may interpret the guidance to indicate that the collateral requirements for admittance in SSAP No. 21 are not required if the investment has a short-term maturity.

In evaluating the current situation, the prior situations in which short-term investments were being continuously rolled, as well as the SSAP No. 2R guidance, it has been questioned why collateral loans and mortgage loans are included in the SSAP No. 2R guidance as named examples and whether Schedule BA investments should be permitted to be reported as wither cash equivalents (on Schedule E2) or short-term investments (on Schedule DA). For these investments, the main benefit of reporting as short-term (or cash equivalent) is the reduced RBC charge and/or potential exclusions from state investment limitations. Although NAIC designations are not required to be reported for cash equivalent or short-term investments, such designations are not required for collateral loans, mortgage loans or any Schedule BA investment. As such, excluding those items from Schedule DA will not impose a requirement for any reporting entity to obtain an NAIC designation. Considering this assessment, this agenda item proposes the exclusion of additional investment types from being reported as cash equivalents or short-term investments regardless of the maturity date of the investment at the date of acquisition.

Effectively, this agenda item and the prior revisions to exclude certain investments from SSAP No. 2R discussed as part of the bond project, will eliminate investments (except money market mutual funds and cash pooling dynamics) from being reported as cash equivalents or short-term investments unless they would qualify under *SSAP No. 26R—Bonds* as an issuer credit obligation. Such investments will then only qualify as a cash equivalent or short-term investment if they have a maturity date within 3-months (cash equivalents) or 12-months (short-term) from the date of acquisition or meet the specifics requirements for money market mutual funds or cash pooling arrangements. NAIC staff believes this scope is appropriate as investments that qualify as issuer credit obligations tend to reflect the more "traditional" investments, for which a short duration holding timeframe will most often have limited valuation swings caused from interest rate risk as well as other unknowns. Furthermore, as investments captured as issuer credit obligations in SSAP No. 26R are permitted as admitted assets without other qualifications (such as collateral or audit requirements), the ability to report as cash equivalent or short-term will not cause confusion on the applicability of such requirements in determining whether the investment should qualify as an admitted asset because it qualifies to be in scope of SSAP No. 2R.

This agenda item proposes to retain the guidance in SSAP No. 2R that prevents cash equivalent or short-term reporting for related party investments if the reporting entity does not reasonably expect to terminate the investment, the original maturity time as passed, and if the reporting entity reacquired a substantially similar investment. Investments with those characteristics will be required to be reported as long-term assets. With the limitation of eligible assets to issuer credit obligations in scope of SSAP No. 26R, NAIC staff anticipates the need for the guidance to be reduced but it could still be applicable.

The agenda item also proposes to retain the clarification that certificates of deposit do not qualify as cash equivalents or short-term deposits. This is because certificates of deposit that are less than 12 months in duration are classified as cash. Certificates of deposits that go beyond 12 months are reported as long-term bonds on Schedule D.

Existing Authoritative Literature:

- **SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments**

Cash Equivalents

6. Cash equivalents are short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash, and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Only investments with original maturities[1] of three months or less can qualify under this definition, with the exception of money market mutual funds, as detailed in paragraph 8, and cash pooling, as detailed in paragraph 9. Regardless of maturity date, derivative instruments shall not be reported as cash equivalents and shall be reported as derivatives on Schedule DB. Securities with terms that are reset at predefined dates (e.g., an auction-rate security that has a long-term maturity and an interest rate that is regularly reset through a Dutch auction) or have other features an investor may believe results in a different term than the related contractual maturity shall be accounted for based on the contractual maturity at the date of acquisition, except where other specific rules within the statutory accounting framework currently exist.

7. Regardless of maturity date, related party or affiliated investments that would be in scope of *SSAP No. 26R—Bonds, SSAP No. 43R—Loan-Backed and Structured Securities,* or that would be reported as "Other Invested Assets" shall be reported as long-term investments if any of the following conditions apply,[2] unless the reporting entity has re-underwritten the investment, maintained appropriate re-underwriting documentation, and each participating party had the ability to independently review the terms and can terminate the transaction prior to renewal.

a. The reporting entity does not reasonably expect the investment to terminate on the maturity date. This provision includes investments that are expected to be renewed (or rolled) with a maturity date that ends subsequent to the initial 90-day timeframe.

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[1] Original maturity means original maturity to the entity holding the investment. For example, both a three-month U.S. Treasury bill and a three-year Treasury note purchased three months from maturity qualify as cash equivalents. However, a Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months.

[2] Cash equivalents subject to the provisions of paragraph 7 are not permitted to be subsequently reported as short-term investments, even if the updated/reacquired maturity date is within one year. These investments shall be reported as long-term investments. To avoid changes in reporting schedules, reporting entities are permitted to report securities as long-term investments at initial acquisition, regardless of the initial maturity date.

b. The investment was previously reported as a cash equivalent investment and the initial maturity timeframe has passed. If an investment is reported as a cash equivalent and it is unexpectedly renewed/rolled, the reporting entity is not permitted to continue to report the held security as a cash equivalent, regardless of the updated maturity date, and shall report the security as a long-term investment. An investment is only permitted to be reported as a cash equivalent for one quarter reporting period. Meaning, if an investment was reported as a cash equivalent in the first quarter, it is not permitted to be reported as a cash equivalent in the second quarter.

c. The reporting entity reacquired the investment (or a substantially similar investment) within one year after the original security matured or was terminated. These reacquired securities shall be reported as long-term investments. (These securities are also not permitted to be reported as short-term investments, regardless of the maturity date of the reacquired investment.)

8. Money market mutual funds registered under the Investment Company Act of 1940 and regulated under rule 2a-7 of the Act shall be accounted for and reported as cash equivalents for statutory accounting. Investments in money market mutual funds shall be valued at fair value or net asset value (NAV) as a practical expedient. For reporting entities required to maintain an asset valuation reserve (AVR), the accounting for unrealized capital gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. For reporting entities not required to maintain an AVR, unrealized capital gains and losses shall be recorded as a direct credit or charge to surplus. Sales/reinvestments in money market mutual funds are excluded from the wash sale disclosure in SSAP No. 103R.

9. Cash pooling is a technique utilized by some companies under common control by which several entities' cash accounts are aggregated for numerous purposes, including liquidity management, optimizing interest or investment returns and reducing investment or banking transaction fees. Cash pools can have numerous functions and structures; however, only those that have obtained domiciliary regulator approval and meet the following requirements are in scope of this statement.

a. Members or participants in the pool are limited to affiliated entities as defined in *SSAP No. 25—Affiliates and Other Related Parties*.

b. Investments held by the pool are limited to non-affiliated entities investments (non-affiliated to the insurance reporting entity).

c. The pool must permit each participant to withdraw, at any time, cash up to the amount it has contributed to the pool. Each participant must own an undivided interest in the underlying assets of the pool in proportion to the aggregate amount of cash contributed. All affiliates' interests in the pool shall be of the same class, with equal rights, preferences, and privileges. All membership interests shall be fully paid and non-assessable and shall have no preemptive, conversion or exchange rights. The liability of a participant's debts and obligations of the pool shall be limited to the amount of its contributions and no participant shall be obligated to contribute money to the pool for any reason other than to participate in the pool's investments. Additionally, participants shall not cover the debits or credits of another participant (commonly referred to as notional cash pooling).

d. A reporting entity shall receive monthly reports from the pool manager, which identifies the participant's investment (share) in the cash pool and the dollar value of its share of cash, cash equivalents and short-term investments. The reporting entity shall report their total balances in the cash pool on Schedule E – Part 2, utilizing the line number as specified in the annual statement instructions. The reporting entity shall independently if the investments would have qualified as cash, cash equivalents or short-term investments had the entity independently acquired the investments. To the extent the pool holds investments that do not meet the definition of cash, cash equivalents, short-term investments, the pool does not qualify within scope of this statement.

e. Valuation of assets in the pool shall remain consistent with the valuations required by reported asset type as stipulated in this statement.

Short-Term Investments

14. Short-term investments are investments that do not qualify as cash equivalents with remaining maturities (or repurchase dates under reverse repurchase agreements) of one year or less at the time of acquisition. Short-term investments can include, but are not limited to bonds, commercial paper, reverse repurchase agreements, and collateral and mortgage loans which meet the noted criteria. Short-term investments shall not include investments specifically classified as cash equivalents as defined in this statement, certificates of deposit, or derivatives. Regardless of maturity date, derivative instruments shall not be reported as short-term investments and shall be reported as derivatives on Schedule DB.

15. Regardless of maturity date, related party or affiliated investments in scope of *SSAP No. 26R—Bonds, SSAP No. 43R—Loan-Backed and Structured Securities,* or that would be reported as "Other Invested Assets" shall be reported as long-term investments if any of the following conditions apply,[3, 4] unless the reporting entity has re-underwritten the investment, maintained appropriate re-underwriting documentation, and each participating party had the ability to independently review the terms and can terminate the transaction prior to renewal.

a. The reporting entity does not reasonably expect the investment to terminate on the maturity date. This provision includes investments that are expected to be renewed (or rolled) with a maturity date that ends subsequent to the initial "less than one year" timeframe.

b. The investment was previously reported as a short-term investment and the initial maturity timeframe has passed. If an investment is reported as a short-term investment and it is unexpectedly renewed/rolled, the reporting entity is not permitted to continue to report the held security as a short-term investment (or as a cash equivalent) regardless of the updated maturity date and shall report the security as a long-term investment. An investment is only permitted to be reported as a short-term investment for one annual reporting period. Meaning, if an investment was reported as a short-term investment as of December 31, 2018, it is not permitted to be reported as short-term investment as of December 31, 2019.

c. The reporting entity reacquired the investment (or a substantially similar investment) within one year after the original security matured or was terminated. These reacquired securities shall be reported as long-term investments. (These securities are also not permitted to be reported as cash equivalent investments regardless of the maturity date of the reacquired investment.)

16. All short-term investments shall be accounted for in the same manner as similar long-term investments.

17. Short-term investments meet the definition of assets as defined in SSAP No. 4 and are admitted assets to the extent they conform to the requirements of this statement.

- **Proposed Revisions under the Bond Project – Potential Adoption 2023 Summer National Meeting**

(These revisions are shaded to separate them from what is proposed as new edits under this agenda item.)

Cash Equivalents

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[3] Reverse repurchase transactions are excluded from these provisions if admitted in accordance with collateral requirements pursuant *to SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.*

[4] Short-term investments subject to the provisions of paragraph 15 are not permitted to be subsequently reported as cash equivalents, even if the updated/reacquired maturity date is within 90 days. These investments shall be reported as long-term investments. To avoid changes in reporting schedules, reporting entities are permitted to report securities as long-term investments at initial acquisition, regardless of the initial maturity date.

6. Cash equivalents are short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash, and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Only investments with original maturities[5] of three months or less can qualify under this definition, with the exception of money market mutual funds, as detailed in paragraph 8, and cash pooling, as detailed in paragraph 9. Regardless of maturity date~~, d~~Derivative instruments in scope of SSAP No. 86 or SSAP No. 108~~shall not be reported as cash equivalents and shall be reported as derivatives on Schedule DB~~.

a. Working capital finance investments in scope of SSAP No. 105R.

~~a.~~b. Securities with terms that are reset at predefined dates (e.g., an auction-rate security that has a long-term maturity and an interest rate that is regularly reset through a Dutch auction) or have other features an investor may believe results in a different term than the related contractual maturity shall be accounted for based on the contractual maturity at the date of acquisition, except where other specific rules within the statutory accounting framework currently exist.

Short-Term Investments

14. Short-term investments are investments that do not qualify as cash equivalents with remaining maturities (or repurchase dates under reverse repurchase agreements) of one year or less at the time of acquisition. Short-term investments can include, but are not limited to bonds, commercial paper, reverse repurchase agreements, and collateral and mortgage loans which meet the noted criteria. Short-term investments shall not include investments specifically classified as cash equivalents as defined in this statement, certificates of deposit, or derivatives. Regardless of maturity date, the following investments are not permitted to be reported as cash equivalents and shall be reported on the investment schedule that corresponds to the SSAP for which the investment is applicable:

a. Asset-backed securities captured in scope of SSAP No. 43R.

b. All debt securities that do not qualify as bonds, which are in scope of SSAP No. 21R.

c. ~~d~~Derivative instruments in scope of SSAP No. 86 or SSAP No. 108~~shall not be reported as short-term investments and shall be reported as derivatives on Schedule DB~~.

d. Working capital finance investments in scope of SSAP No. 105R.

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 2019-21: Principles-Based Bond Definition, proposes revisions to revise the definition of a bond, and establishes guidance separating between investments captured in *SSAP No. 26—Bonds* as issuer credit obligations for reporting on Schedule D-1-1 and investments captured in *SSAP No. 43R—Asset-Backed Securities* for reporting on Schedule D-1-2. With the requirements to assess ABS in determining whether they qualify for Schedule D-1-2 reporting as a "bond", revisions have been proposed to exclude ABS, as well as debt securities that do not qualify as bonds captured in SSAP No. 21R, from reporting on Schedule DA as cash equivalents or short-term investments. (These revisions are above with an anticipated adoption at the 2023 Summer National Meeting with a planned effective date of January 1, 2025.)

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

[5] Original maturity means original maturity to the entity holding the investment. For example, both a three-month U.S. Treasury bill and a three-year Treasury note purchased three months from maturity qualify as cash equivalents. However, a Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months.

Recommendation:
NAIC staff recommend that the Working Group include this item on their maintenance agenda as a new SAP concept and expose this agenda item with proposed revisions to further restrict the investments that are permitted for cash equivalent or short-term investment reporting. These revisions are proposed to ensure that certain investment types are captured on designated Schedule BA reporting lines and to eliminate the potential to design investments to specifically qualify for short-term reporting and perhaps mask the extent of investments held or to obtain favorable reporting such as with reduced RBC, exceptions for state investment limits, admittance requirements etc., (NAIC staff notes that NAIC designations are not required for cash equivalents or short-term investments, however, the investments proposed to be excluded from cash equivalents and short-term reporting in this agenda item are not required to obtain NAIC designations.)

With the adoption consideration of the bond definition, including the edits to exclude ABS and debt securities that do not qualify as bonds from SSAP No. 2R at the 2023 Summer National Meeting, this agenda item proposes edits after reflection of the bond project changes. To be consistent with the effective date of the bond project, this agenda item proposes an effective date of Jan. 1, 2025. Additionally, subsequent blanks reporting changes will be considered to modify the cash equivalent and short-term reporting lines accordingly.

Cash Equivalents

6. Cash equivalents are short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash, and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Only investments with original maturities[6] of three months or less can qualify under this definition, with the exception of money market mutual funds, as detailed in paragraph 8, and cash pooling, as detailed in paragraph 9. Certificates of deposit with a maturity of less than 12 months at the time of acquisition are reported as cash pursuant to paragraph 5. Regardless of maturity date, the following investments are not permitted to be reported as cash equivalents and shall be reported on the investment schedule that corresponds to the SSAP for which the investment is applicable:

a. Asset-backed securities captured in scope of SSAP No. 43R.

b. All investments that are reported on Schedule BA, including but not limited to:

i. All debt securities that do not qualify as bonds ~~which are~~ in scope of SSAP No. 21R.

ii. Collateral / Non-Collateral loans captured in scope of SSAP No. 21R.

iii. Working capital finance investments in scope of SSAP No. 105R.

~~i.~~iv. Surplus notes in scope of SSAP No. 41R

c. Mortgage loans captured in scope of SSAP No. 37.

~~b.~~d. Derivative instruments in scope of SSAP No. 86 or SSAP No. 108.

~~c.a. Working capital finance investments in scope of SSAP No. 105R.~~

~~d.~~e. Securities with terms that are reset at predefined dates (e.g., an auction-rate security that has a long-term maturity and an interest rate that is regularly reset through a Dutch auction) or have other features an investor may believe results in a different term than the related contractual maturity

[6] Original maturity means original maturity to the entity holding the investment. For example, both a three-month U.S. Treasury bill and a three-year Treasury note purchased three months from maturity qualify as cash equivalents. However, a Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months.

shall be accounted for based on the contractual maturity at the date of acquisition, except where other specific rules within the statutory accounting framework currently exist.

Short-Term Investments

14. Short-term investments are investments that do not qualify as cash equivalents, but that are still considered highly liquid as they have ~~with~~ remaining maturities (or repurchase dates under reverse repurchase agreements) of one year or less at the time of acquisition. ~~Short-term investments can include, but are not limited to bonds, commercial paper, reverse repurchase agreements, and collateral and mortgage loans which meet the noted criteria. Short-term investments shall not include investments specifically classified as cash equivalents as defined in this statement, certificates of deposit, or derivatives.~~ Certificates of deposit with a maturity of less than 12 months at the time of acquisition are reported as cash pursuant to paragraph 5. Regardless of maturity date, the following investments are not permitted to be reported as ~~cash equivalents~~ short-term investments and shall be reported on the investment schedule that corresponds to the SSAP for which the investment is applicable:

a. Asset-backed securities captured in scope of SSAP No. 43R.

b. All investments that are reported on Schedule BA, including but not limited to:

i. All debt securities that do not qualify as bonds in scope of SSAP No. 21R.

ii. Collateral / Non-Collateral loans captured in scope of SSAP No. 20R or 21R.

iii. Working capital finance investments in scope of SSAP No. 105R.

iv. Surplus notes in scope of SSAP No. 41R

~~b. All debt securities that do not qualify as bonds which are in scope of SSAP No. 21R.~~

c. Mortgage loans captured in scope of SSAP No. 37.

~~c.~~d. Derivative instruments in scope of SSAP No. 86 or SSAP No. 108.

~~d. Working capital finance investments in scope of SSAP No. 105R.~~

Staff Review Completed by: Julie Gann - NAIC Staff, July 2023

Status:
On August 13, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a new SAP concept, and exposed revisions to further restrict the investments that are permitted for cash equivalent or short-term investment reporting. To correspond with the bond project, this agenda item proposes an effective date of Jan. 1, 2025. Additionally, subsequent blanks reporting changes will be considered to modify the cash equivalent and short-term reporting lines accordingly.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/8-13-23 Summer National Meeting/Exposures/23-17 - Short-Term Investments.docx

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

Issue: Actuarial Guideline 51 and Appendix A-010 Interaction

Check (applicable entity):

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

Description of Issue:
In 2017, the National Association of Insurance Commissioners (NAIC) adopted Actuarial Guideline 51, *The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves* (AG 51). Subsequent to the adoption of AG 51, American Academy of Actuaries, Health Practice Council, Financial Reporting and Solvency Committee have observed some diversity in practice across issuers of long-term care insurance with regard to how the new guidance in AG 51, and specifically Section 4.C thereof, interacts with existing guidance on accident & health (A&H) insurance reserve adequacy, as found in paragraph 24 of Statement *of Statutory Accounting Principles (SSAP) No. 54R—Individual and Group Accident and Health Contracts*, and paragraph 26 of Appendix A-010, *Minimum Reserve Standards for Individual and Group Accident and Health Insurance Contracts.*

As an illustration of the observed diversity in practice, consider the following illustrative, simplified example:

1. Company XYZ has three lines of business: long-term care insurance, Medicare Supplement (Med Sup) insurance, and whole life insurance.

2. Cash flow testing performed for the long-term care block in isolation, in accordance with AG 51, shows deficiencies in all tested scenarios.

3. Cash flow testing performed for the entity as a whole, including both the life and A&H business combined, shows significant sufficiencies at the entity level in all tested scenarios.

4. A gross premium valuation performed on the long-term care reserves, in isolation, indicates that those reserves are deficient by $250 million.

5. A gross premium valuation performed on the Medicare Supplement reserves, in isolation, indicates that those reserves contain $150 million of sufficiency.

Given these facts, does Company XYZ need to strengthen its accident and health reserves in order to comply with the requirements of the NAIC *Accounting Practices & Procedures Manual*?

Depending on how one views the intended interaction between AG 51 and Appendix A-010, in this illustrative example one could conclude either that Company XYZ's reserves are adequate, or that they are deficient by $100 million.

Argument that the reserves are adequate:

- Section 4.C of AG 51 sets out conditions for "determining whether additional reserves are necessary" for a block of long-term care insurance.

- In particular, Section 4.C.1 of AG 51 says that "a reserve deficiency in the LTC block may be aggregated with sufficiencies in the company's other blocks of business for the purposes of developing an actuarial opinion, if cash-flow testing is used for both the LTC business and for all significant blocks of non-LTC business within a company."

- In light of point 3 above, this implies that Company XYZ does not need to establish any additional reserves for its long-term care block. In effect, here Company XYZ gets to use sufficiencies that exist in its life reserves to avoid needing to strengthen its LTC reserves.

- There had been an exposure draft of AG 51 in February 2017 that contained the following language: "Requirements for standalone analysis for a health insurance major block of contracts, per *Model Regulation #010*, still apply even if aggregation of cash-flow testing results occurs." However, this language was deleted from the version of AG 51 that was adopted later in 2017.

Argument that the reserves are deficient by $100 million:

- Combining points 4 and 5 above, a gross premium valuation performed on Company XYZ's A&H business in total shows a net deficiency of $100 million ($250 million LTC deficiency, offset by $150 million Medicare Supplement sufficiency).

- Paragraph 26 of Appendix A-010 reads, in part, "…a gross premium valuation is to be performed whenever a significant doubt exists as to reserve adequacy with respect to any major block of contracts, or with respect to the insurer's health business as a whole. In the event inadequacy is found to exist, immediate loss recognition shall be made and the reserves restored to adequacy."

- Nothing in AG 51 explicitly amends the requirement from Appendix A-010 that an entity's A&H reserves, in total, need to be adequate; nor is AG 51 explicitly referenced within the Valuation Manual Section VM-25, "Health Insurance Reserves Minimum Reserve Requirements," as a source of guidance on minimum reserve requirements.

- Thus, Company XYZ's health reserves, taken as a whole, must at a minimum exceed the reserves produced by a gross premium valuation, regardless of AG 51. This would imply that Company XYZ needs to strengthen its LTC reserves by $100 million, bringing the total deficiency in the gross premium valuation of its A&H reserves to zero.

Existing Authoritative Literature:

Excerpts from *SSAP No. 54R— Individual and Group Accident and Health Contracts* (bolding added):

11. Statutory policy reserves shall be established for all unmatured contractual obligations of the reporting entity arising out of the provisions of the contract. Where separate benefits are included in a contract, a reserve for each benefit shall be established as required in Appendix A-820. **A prospective gross premium valuation is the ultimate test of reserve adequacy as of a given valuation date.** Statutory reserves meet the definition of liabilities as defined in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*. The actuarial methodologies referred to in paragraph 12 meet the criteria required for reasonable estimates in SSAP No. 5R.

12. **The reserving methodologies and assumptions used in calculating individual and group accident and health reserves shall meet the provisions of Appendices A-010, A-641, A-820, A-822 (as applicable), the *Valuation Manual* and the actuarial guidelines found in Appendix C of this Manual (as applicable).** Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.

Reserve Adequacy

24. As discussed in Appendix A-010, a prospective gross premium valuation is the ultimate test of the adequacy of a reporting entity's accident and health reserves as of a given valuation date and shall be determined on the basis of unearned premium reserves, contract reserves, additional reserves, claim reserves (including claim liabilities), and miscellaneous reserves combined; however, each component shall be computed separately.

Excerpts from Appendix A-010, *Minimum Reserve Standards for Individual and Group Accident and Health Insurance Contracts* (bolding added)**:**

23. These standards apply to all individual and group health and accident and sickness insurance coverages, including single premium credit disability insurance. All other credit insurance is not subject to Appendix A-010.

24. When an insurer determines that adequacy of its health insurance reserves requires reserves in excess of the minimum standards specified herein, such increased reserves shall be held and shall be considered the minimum reserves for that insurer.

25. With respect to any block of contracts, or with respect to an insurer's health business as a whole**, a prospective gross premium valuation is the ultimate test of reserve adequacy as of a given valuation date.** Such a gross premium valuation will take into account, for contract in force, in a claims status, or in a continuation of benefits status on the valuation date, the present value as of the valuation date of all expected benefits unpaid, all expected expenses unpaid, and all unearned or expected premiums, adjusted for future premium increases reasonably expected to be put into effect.

26. Such a gross premium valuation is to be performed whenever a significant doubt exists as to reserve adequacy with respect to any major block of contracts, or with respect to the insurer's health business as a whole. In the event inadequacy is found to exist, immediate loss recognition shall be made and the reserves restored to adequacy. Adequate reserves (inclusive of claim, premium and contract reserves, if any) shall be held with respect to all contracts, regardless of whether contract reserves are required for such contracts under these standards.

40. This statement incorporates the requirements of Appendices **A-010,** A-225, A-641, A-820, A-822 (as applicable), the *Valuation Manual,* the Actuarial Standards Board *Actuarial Standards of Practice* and **the actuarial guidelines found in Appendix C** of this manual (as applicable).

Excerpts from NAIC Valuation Manual, Section VM-25:

VM-25: HEALTH INSURANCE RESERVES MINIMUM RESERVE REQUIREMENTS A. Purpose 1. Reserve requirements for individual A&H insurance policies issued on and after the Valuation Manual operative date and reserve requirements for group A&H insurance certificates issued on and after the Valuation Manual operative date are applicable requirements found in the AP&P Manual; Appendix A, which includes A-10; and applicable requirements found in the AP&P Manual Appendix C, which includes Actuarial Guideline XXVIII—Statutory Claim Reserves for Group Long-Term Disability Contracts With a Survivor Income Benefit Provision (AG 28); Actuarial Guideline XLIV—Group Term Life Waiver of Premium Disabled Life Reserves (AG 44); Actuarial Guideline XLVII—The Application of Company Experience in the Calculation of Claim Reserves Under the 2012 Group Long-Term Disability Valuation Table (AG 47); and Actuarial Guideline L—2013 Individual Disability Income Valuation Table (AG 50).

Excerpts from *Actuarial Guideline 51 - The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves (AG 51)*

"Background. The *Health Insurance Reserves Model Regulation (#010)* and the *NAIC Valuation Manual (VM-25)* contain requirements for the calculation of long-term care insurance (LTC) reserves. Regulators have observed a lack of uniform practice in the implementation of tests of reserve adequacy and reasonableness of LTC reserves. The reserve adequacy testing required by Model #10 and VM-25 does not provide regulators comfort as to the reserve adequacy of companies with material blocks of LTC business. As such, regulators must rely upon asset adequacy analysis required by the *NAIC Valuation Manual* (*VM-30*) to evaluate the solvency position of companies with sizable blocks of LTC business. This Guideline is intended to provide uniform guidance and clarification of requirements for the appropriate support of certain assumptions for the asset adequacy testing applied to a company's LTC block of contracts. In particular, this Guideline….

> Asset adequacy analysis specific to all inforce LTC business, and without consideration of results for other block of business within the company, must be performed for valuations associated with the December 31, 2017, and subsequent annual statutory financial statements. The analysis shall comply with applicable Actuarial Standards of Practice, including standards regarding identification of key risks. Material assumptions associated with the LTC business shall be determined using moderately adverse deviations in actuarial assumptions.

4.B When determining whether additional reserves are necessary:

1. A reserve deficiency in the LTC block may be aggregated with sufficiencies in the company's other blocks of business for the purposes of developing an actuarial opinion, if cash-flow testing is used for both the LTC business and for all significant blocks of non-LTC business within a company. If a reserve deficiency in the LTC block is not offset with sufficiencies in the company's other blocks of business, then additional reserves shall be established as required by section 2.C.2. of *VM-30*.

2. If cash-flow testing is not used for testing of the LTC business, then a reserve deficiency revealed from another method, e.g., a gross premium valuation, utilized for purposes of asset adequacy analysis of the LTC block under this Guideline shall not be offset with sufficiencies in the company's other blocks of business. The additional reserves under this Guideline shall be established based only upon the adequacy of the reserves in the LTC block.

First Page of Exhibit C

The NAIC Life Actuarial (A) Task Force and the Health Actuarial (B) Task Force, formerly known as the Life and Health Actuarial Task Force, have been asked on many occasions to assist a particular state insurance department in interpreting a statute dealing with an actuarial topic relative to an unusual policy form or situation not contemplated at the time of original drafting of a particular statute. The Life Actuarial (A) Task Force and the Health Actuarial (B) Task Force, in developing an interpretation or guideline, must often consider the intent of the statute, the reasons for initially adopting the statute and the current situation. The Life Actuarial (A) Task Force and the Health Actuarial (B) Task Force feel that for those situations which are sufficiently common to all states, that the publishing of actuarial guidelines on these topics would be beneficial to the regulatory officials in each state and would promote uniformity in regulation which is beneficial to everyone. To this end, the Life Actuarial (A) Task Force and the Health Actuarial (B) Task Force have developed certain actuarial guidelines and will continue to do so as the need arises. **The guidelines are not intended to be viewed as statutory revisions but merely a guide to be used in applying a statute to a specific circumstance.**

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):

Actuarial Guideline 51 was adopted by the Health Insurance and Managed Care (B) Committee in June 2017 and subsequently incorporated into Appendix C of the NAIC *Accounting Practices & Procedures Manual*.

As noted above, the February 2017 exposure draft of what was then called Actuarial Guideline LTC contained different language than the version adopted later that year as AG 51. The following are excerpts from the February 2017 exposure draft of AG LTC, with emphasis added. The bolded italicized language below does not exist, either verbatim or in modified form, within the adopted version of AG 51:

"Background The *Health Insurance Reserves Model Regulation (#010)* and the *NAIC Valuation Manual (VM-25)* contain requirements for the calculation of long-term care insurance (LTC) reserves. Regulators have observed a lack of uniform practice in the implementation of tests of reserve adequacy and reasonableness of LTC reserves. ***For instance, the Model Regulation states, "a gross premium valuation is to be performed whenever a significant doubt exists as to reserve adequacy with respect to any major block of contracts"; however, other wording in the Model Regulation creates confusion for some on whether the test of adequacy is required at the major block of contract level. In the absence of uniform guidance, insurers may not be determining adequacy of LTC reserves in a uniform manner.*** As such, this Guideline provides uniform guidance and limits to certain assumptions for the asset adequacy testing applied to an insurer's major LTC block of contracts. …"

3.C "When determining whether additional reserves are necessary:

1. In the case where cash-flow testing is used for both LTC business and for the companywide analysis.
   a. A deficiency in the LTC segment may be offset by a projected and justified overall cash-flow testing sufficiency in non-LTC segments. The LTC-related assumptions in the companywide cash-flow testing shall be the same as with the standalone LTC cash-flow testing.
   b. To the extent projected LTC reserve sufficiency is not offset through aggregation, reserves for LTC business shall be increased by any additional reserves required to eliminate the projected reserve insufficiency.
   c. ***Requirements for standalone analysis for a health insurance major block of contracts, per Model Regulation #010, still apply even if aggregation of cash-flow testing results occurs."***

2. "In cases where cash-flow testing is not used for LTC business, reserves for LTC business shall be increased by any additional reserves required by the standalone LTC business asset adequacy analysis to eliminate a reserve insufficiency."

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

To our knowledge the Working Group has not previously been made aware that a diversity of practice has developed, subsequent to the adoption of AG 51, regarding how AG 51 interacts with Appendix A-010.

In May 2022, the actuarial consulting firm Milliman released its seventh triennial survey on long-term care valuation practices.[1] Figure 2 of that report presents information about the approach companies use for aggregating statutory reserve adequacy testing results. The three options shown were "LTC line of business," selected by 8 out of the 20 respondents; "health or life business lines combined," selected by 2 out of the 20; and "company level," selected by 10 out of the 20. Figure 1 of that report presents information about the types of reserve adequacy testing that is performed.

The three options shown were:

1. "GPV only" ("Gross Premium Valuation only") selected by 3 out of the 20 respondents;
2. "Cash flow testing and GPV," selected by 4 out of the 20; and
3. "Cash flow testing only," selected by 13 out of the 20.

Taking these two pieces of data together, it would appear that many of the 20 companies participating in this Milliman survey believe that performing cash flow testing at the legal entity level is enough to satisfy reserve adequacy considerations in light of AG 51, and that there is not a separate requirement for the legal entity's accident and health reserves to be adequate in aggregate under a gross premium valuation.

Recommended Conclusion or Future Action on Issue:

The committee recommends that the Working Group issue an interpretation to clarify the intended interaction between AG 51 and Appendix A-010, along the lines of one of the following two statements below, depending on which statement reflects the NAIC's underlying intent:

Statement A: " With respect to an entity having a block of LTC insurance subject to Actuarial Guideline 51, even if Section 4.C of Actuarial Guideline 51 implies that the entity does not need to establish additional reserves for the LTC block, it nevertheless remains true that the entity's accident & health reserves in total must be adequate under a gross premium valuation in accordance with paragraph 26 of Appendix A-010."

Statement B: "With respect to an entity having a block of LTC insurance subject to Actuarial Guideline 51, if Section 4.C of Actuarial Guideline 51 implies that the entity does not need to establish additional reserves for the LTC block, then the reserves for the LTC block are deemed to be adequate for purposes of applying the requirements of paragraph 26 of Appendix A-010 if no other A&H blocks are deficient."

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1 https://us.milliman.com/-/media/milliman/pdfs/2022-articles/5-24-22_2021_report_on_survey_of_ltci_valuation.ash

Recommending Party:

American Academy of Actuaries, Health Practice Council
David Hutchins, MAAA, FSA, Chairperson, Financial Reporting and Solvency Committee
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Matthew Williams, Senior Policy Analyst, Health 202-223-8196;
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February 23, 2023

Staff Review Completed by:
Robin Marcotte, July 2023

Staff Recommendation:
This agenda item addresses the February 23 request from the Financial Reporting and Solvency Committee of the Health Practice Council of the American Academy of Actuaries, to the Long-Term Care Actuarial (B) Working Group and to the Statutory Accounting Principles (E) Working Group which requested clarifications regarding some observed diversity in practice across issuers of long-term care insurance with regard to how the guidance in *Actuarial Guideline LI: The application of Asset Adequacy Testing to Long Term Care Insurance Reserves* (AG 51), specifically Section 4.C, on determining when additional reserves may be necessary, interacts with existing guidance on accident and health insurance reserve adequacy, in *SSAP No. 54R—Individual and Group Accident and Health Contracts*, paragraphs 12 and 24 and Appendix A-010*, Minimum Reserve Standards for Individual and Group Accident and Health Insurance Contracts,* paragraph 26. The fundamental question is regarding whether gross premium valuation only, cash flow testing only or both cash flow testing and gross premium valuation are required.

NAIC staff recommend that the Working Group include this item on their maintenance agenda as a SAP clarification and expose clarifying revisions and an illustration to SSAP No. 54R to clarify that gross premium valuation (under A-010) and cash flow testing (under AG 51) are both required if indicated. In addition, the Long-Term Care Actuarial (B) Working Group and the Valuation Analysis (E) Working Group should receive formal notice of the exposure.

The recommendation is based on the following key points:

1. SSAP No. 54R, paragraph 12 references both Appendix A-010 and the Actuarial Guidelines in Appendix C. SSAP No. 54R, paragraph 24 explicitly notes the A-010 requirements for a prospective gross premium valuation as the ultimate test for reserve adequacy.

2. Appendix A-010 is based on a widely adopted NAIC model law 10 *Minimum Reserve Standards for Individual and Group Accident and Health Insurance Contracts*. Appendix A-010 and Model 10 require that that an entity's A&H reserves, in total, need to be adequate. The front of Appendix C notes that the Actuarial Guidelines "The guidelines are not intended to be viewed as statutory revisions but merely a guide to be used in applying a statute to a specific circumstance."

3. The adoption of the AG -51 did not change the provisions of the Model Law 10 or Appendix A-010. The provisions of the model law and Appendix A-010 both require health insurance reserves to be sufficient from a gross premium valuation standpoint on their own.

   a. Paragraph 26 of Appendix A-010 reads, in part, "…a gross premium valuation is to be performed whenever a significant doubt exists as to reserve adequacy with respect to any major block of contracts, or with respect to the insurer's health business as a whole. In the event inadequacy is found to exist, immediate loss recognition shall be made and the reserves restored to adequacy."

   b. Nothing in AG 51 explicitly amends the requirement from Appendix A-010 that an entity's A&H reserves, in total, need to be adequate. (Note that amending the Model #10 would require going through the NAIC model law procedures, therefore, until such a process is undertaken.)

   c. AG 51is not explicitly referenced within the *Valuation Manual* Section VM- 25, "Health Insurance Reserves Minimum Reserve Requirements," as a source of guidance on minimum reserve requirements.

4. AG 51 Section 4.C. provides an additional long term care reserves adequacy cash flow test which allows aggregation. The AG 51 cash flow testing is in addition to the requirements of A-010, it does not replace the gross premium valuation requirements of A-010.

Therefore, in response to the example, in the initial illustration, additional reserves are indicated under A-010 and SSAP No. 54R. (Statement A is the correct response for the Illustration on page 1.) In the example provided, a gross premium valuation performed on Company XYZ's A&H business in total shows a net deficiency of $100 million ($250 million LTC deficiency, offset by $150 million Medicare Supplement sufficiency).Therefore, the answer is that the company would need to post an additional $100 million such that the Long-Term Care and Medicare Supplement reserves are sufficient, from a gross premium valuation standpoint, in total.

Proposed revisions to SSAP No. 54R

12. The reserving methodologies and assumptions used in calculating individual and group accident and health reserves shall meet the provisions of Appendices A-010, A-641, A-820, A-822 (as applicable), the *Valuation Manual* and the actuarial guidelines found in Appendix C of this Manual (as applicable). Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.

Reserve Adequacy

24. As discussed in Appendix A-010, a prospective gross premium valuation is the ultimate test of the adequacy of a reporting entity's accident and health reserves as of a given valuation date and shall be determined on the basis of unearned premium reserves, contract reserves, additional reserves, claim reserves (including claim liabilities), and miscellaneous reserves combined; however, each component shall be computed separately. Pursuant to Appendix A-010, paragraph 26 an entity's accident and health reserves in total must be adequate under a gross premium valuation. The requirements of ***Actuarial Guideline 51 - The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves (AG 51)*** provide a test which indicates whether reserves in addition to the requirements of A-010 are indicated. AG 51 does not change the base requirements of A-010. (See Long Term Care Illustration in Exhibit A)

New Exhibit to SSAP No. 54R

Long-term Care Illustration on Interaction between SSAP No. 54R, and A-010 and AG 51

This illustration is to address the interaction in long term care reserving requirements noted in this statement, Appendix A-010, *Minimum Reserve Standards for Individual and Group Accident and Health Insurance Contracts* and *Actuarial Guideline 51 - The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves (AG 51).* At a high level, A-010 is from Model #10 of the same name which provides the minimum requirements. AG 51 is an actuarial guideline which provides a test for whether additional reserves are indicated. AG 51 does not change the base requirements of A-010.

Consider the following illustrative, simplified example:

1. Company XYZ has three lines of business: long-term care insurance, Medicare Supplement (Med Sup) insurance, and whole life insurance.

2. Cash flow testing performed for the long-term care block in isolation, in accordance with Actuarial Guideline 51 (AG 51), shows deficiencies in all tested scenarios.

3. Cash flow testing performed for the entity as a whole, including both the life and A&H business combined, shows significant sufficiency at the entity level in all tested scenarios.

4. A gross premium valuation performed on the long-term care reserves, in isolation, indicates that those reserves are deficient by $250 million.

5. A gross premium valuation performed on the Medicare Supplement reserves, in isolation, indicates that those reserves contain $150 million of sufficiency.

Given these facts, does Company XYZ need to strengthen its accident and health reserves in order to comply with the requirements of the NAIC *Accounting Practices & Procedures Manual*?

Response: Yes, Company XYZ needs to strengthen its accident and health reserves by $100 million. This number is determined by the following:

	Millions
Long term care GPV, reserves are deficient by	($250) million.
Medicare Supplement GPV reserves sufficiency of	$150 million.
Accident and health GPV reserve net deficiency of	**$100 million**

Appendix A-010 paragraph 26 and SSAP No. 54R, paragraph 24 both require gross premium valuation.

Actuarial Guideline 51 is a test for additional reserves. That is, passing AG 51 does not relieve the reporting entity of the requirement of SSAP No. 54R and A-010 to have adequate accident and health reserves indicated by gross premium valuation.

Status:

On August 13, 2023, 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. 54R to clarify that gross premium valuation (under Appendix A-010) and cash flow testing (under AG 51) are both required, if indicated. In addition, the Working Group directed staff to provide formal notice of the exposure to the Long-Term Care Actuarial (B)

Working Group and the Valuation Analysis (E) Working Group.

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2023/8-13-23 summer national meeting/exposures/23-22 academy ag51__appendix_a-010.docx

Statutory Accounting Principles (E) Working Group
Fall National Meeting
Comment Letters Received

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September 29, 2023

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
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RE: Interested Parties Comments on Items Exposed for Comment with Comments due September 29

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the following items that were exposed for comment during the NAIC National Meeting in Seattle by the Statutory Accounting Working Group (the Working Group).

Ref # 2019-21: Principles-Based Bond Definition

The Working Group exposed revisions to SSAP No. 21R for debt securities that do not qualify as bonds, including the accounting for residual tranches, as well as an Issue Paper to detail historical discussions on the bond project. Interested parties have no comments on the Issue Paper.

Interested parties met with NAIC Staff to discuss SSAP No. 21R issues, other than the accounting for residual tranches, and agreed there are issues that need clarification and/or consistency between SSAP No. 21R, SSAP No. 26R, SSAP 43R, and the recently adopted language on the definition of residual tranches in SSAP No. 48.

As these are nuanced and interrelated changes still subject to the best approach in achieving clarification and/or consistency, it was agreed it was most efficient to work through the changes collaboratively especially given the significant agreement on the end results that are trying to be achieved. As part of this collaboration, interested parties would also like to discuss with NAIC staff and regulators the concept of audit requirements for residual tranches. The remainder of interested parties' comments relate to the proposed accounting for residual tranches.

In response to the residual accounting proposal forwarded by regulators, interested parties understand concerns about accreting investments above this initial cost, but also believe there may be a more reasonable accounting method for these investments versus the proposed cost recovery method.

Residual Tranche Accounting Alternatives (Paragraph 31)

Interested parties noted that the example provided by regulators showed a risky asset accreting high yields for multiple periods even if no cash is received, which is concerning from the point of view of accounting conservatism. While this example may raise alarms to regulators, it may not be representative of residual tranche investments in the industry currently. Many residual tranche investments generate positive cash flows period after period, by design and in practice. Additionally, since the risk of residual tranches is already being addressed through risk-based-capital regulation, we hope that accounting may be formulated to be reasonable on its own, without attempting to address risk through a second channel.

Interested parties initially proposed the effective yield method of accounting, which regulators rejected, noting in some cases it could lead to income generation which was deemed to be aggressive or premature. Regulators then proposed cost recovery method of accounting, which interested parties believe is too punitive in cases where healthy cash generating assets would be written down to zero before recognizing any income.

We hope that a third alternative can be reached which incorporates these two principles:

- Assets cannot be accreted above original (or subsequent) consideration paid; and
- Assets may use a systematic approach to record investment income to the extent cash is received.

In industry discussions it became clear that variety and complexity exists which impacts this topic including:

- Underlying collateral assets span from loans to mortgages to real estate to equity to lease backed assets, each case which may suggest a different expected earnings and cash flow pattern.
- Certain servicers clearly delineate the amount of principal vs. interest cash flows generated by the collateral that are allocated to each tranche of investment. Interested parties are currently reaching out to investment advisors to understand whether some servicers do not provide this same level of granularity.
- Certain investments accounted for currently under the equity method, may prospectively be classified as residuals. Currently under the equity method, distributions are allocated between return of capital and return on capital.

Interested parties have been discussing several alternatives, two of which are described below: servicer reports and capital statements and an effective yield method with a cap. Both alternatives will also use a lower of adjusted cost or fair value concept and appropriate treatment for other than temporary impairments (OTTI). Interested parties would like the opportunity to discuss these alternatives with the Working Group to determine whether one or both of these approaches may be considered a reasonable alternative to the cost recovery method.

Servicer Reports or Capital and Distribution Statements

Servicer reports generally attribute every cash distribution into cash receipts from the interest payment on the collateral versus principal paydowns on the collateral. These cash distributions are allocated to each tranche of investment (including the residual) based upon a priority of payments schedule formalized in the operative documents for the respective securitization. Similarly, capital and distribution statements schedule out the return on capital and the return of capital. Insurers applying the equity method are accustomed to the appropriate timing to record a distribution as a dividend on the income statement under the equity method of accounting.

One alternative is to guide companies to refer to servicer reports or capital and distribution statements to recognize income equal to the portion of the residual interest's cash disbursements generated from interest receipts on the collateral pool. This method is simple, reliable and supportable.

Effective Yield Method with a Cap

Another alternative which could be applied is an effective yield method with a cap on income, such that income could only be recognized to the extent that there is a receipt of cash. As part of this alternative, the carry value of this asset may not be accreted above the cost of consideration paid. A detailed example of how this method would compare to effective yield method and cost recovery method has been drafted, noting that this third alternative would generally – if not always – result in a period-over-period carry value which is lower than the effective yield method and higher than the cost recovery method, meaning it represents a middle road, as expected. For this proposal, initial draft language has been presented for discussion as well.

We would like to offer the following principles for discussion, with the intent of replacing paragraph 31 in its entirety. Should this concept be acceptable to regulators, interested parties could also suggest actual SSAP language to accomplish what is described below.

Each period the book adjusted carrying value and interest income would be determined in the following manner:

1. At the beginning of the period, calculate the book yield as the discount rate that equates the then current best estimate of cash flows projections to the cost basis of the asset.
2. The maximum amount of interest income will be the product of the book yield and beginning of period book adjusted carrying value.
3. If cash distributed to the asset is less than the maximum amount of interest income:
    - Interest income equals total amount of cash distributions.
    - Book adjusted carrying value of the asset is not decreased.

4. If cash distributed to the asset is greater than the maximum amount of interest income:
   - ➢ Interest income equals the maximum amount calculated above.
   - ➢ Book adjusted carrying value is decreased by the amount of cash distributions in excess of the maximum amount of interest income.

Both a servicer report/capital and distribution statement method and an effective yield method with a cap would ensure that the carrying value is not accreted above cost and would allow for income recognition which is supported by cash receipts.

Comment on OTTI (Paragraphs 30 and 32)

It appears that the most recent draft of residual tranche guidance was adjusted to depart from standard lower of cost or market (LOCOM) accounting to automatically record any decrease of fair value below adjusted cost to be an other-than-temporary impairment, rather than capturing temporary reductions as unrealized losses. Interested parties generally would expect that LOCOM and OTTI processes would remain consistent for this asset class as it would be applied to other asset classes. We believe the following language, currently in SSAP 43R paragraph 26.c., should be moved to this standard:

> "For residual tranches or interests captured in scope of this statement, all reporting entities shall report the item on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value. Changes in reported value from the prior period shall be recorded as unrealized gains or losses. For reporting entities that maintain an AVR, the accounting for unrealized gains and losses shall be in accordance with SSAP No. 7-Asset Valuation Reserve and Interest Maintenance Reserve."

Additionally, the language from SSAP No. 48 paragraphs 18 and 19 addresses the impairment process of an equity method investment and SSAP No. 43R, paragraphs 34 and 36, addresses the impairment process of a residual interest in a beneficial interest.

As noted, many alternatives are being discussed by interested parties. We have shared examples of our latest thinking above in order to continue a productive discussion with regulators on this important topic. We look forward to continuing to engage with regulators and stand ready to answer any questions you may have on this topic.

Ref #2022-12: Review of INT 03-02*: Modification to an Existing Intercompany Pooling Arrangement*

The Working Group re-exposed the intent to nullify INT 03-02 and directed NAIC staff to work with industry regarding some of their comments and examples to be submitted by industry.

In response to the Working Group's request for examples of a modification to an existing intercompany pooling arrangement, interested parties identified the two most common modifications to intercompany pooling arrangements:

- the combination of two intercompany pooling arrangements following the acquisition by an insurance group of another insurance company (or group of companies), and
- the removal of an insurance subsidiary from an intercompany pooling arrangement in preparation for the sale of the subsidiary (discontinued line of business)

These two types of modifications may involve the movement of a significant amount of assets and liabilities to re-balance the capital and surplus of the insurance subsidiaries involved to manage the impact to a targeted RBC for the members of the intercompany pooling arrangement. A less common modification is the re-capitalization of the members of the pooling arrangement to adjust for changes in investment strategy over time. Because this latter type of transaction usually involves the movement of cash, not assets and liabilities, we are not including an example as the effects are fairly straight forward.

For purposes of the Example 1 below, please see the attached Organization Chart – Pre-Acquisition.

Example 1 is the combination of two intercompany pools following the acquisition of a group of companies:

- Insurance Group (Holdco) A acquires Insurance Group (Holdco) B.
- Insurance Group A and Insurance Group B have the following intercompany pools:

Intercompany Pool A:	Pool participation percentage:
Entity A1	70%
Entity A2	26%
Entity A3	4%

Intercompany Pool B:	Pool participation percentage:
Entity B1	60%
Entity B2	22%
Entity B3	18%

Upon completion of the acquisition, the acquired companies are owned by a common holding company for this example (please see attached Organizational Chart Post Acquisition – Example 1).

- Intercompany Pool A modifies its pooling arrangement, brings Intercompany Pool B into Intercompany Pool A and resets the pool participation percentages retroactive to January 1 of the current year as follows:

Intercompany Pool A:	Pool participation percentage:
Entity A1	40%
Entity A2	20%
Entity A3	3%

Entity B1	22%
Entity B2	8%
Entity B3	7%

- In this example, each entity's pool participation percentage have been reset in order to balance future capital needs, with consideration of risk-based capital and other financial measures (e.g., IRIS ratios).

- As a result of the pooling modification, the three former Intercompany Pool B entities must transfer net assets to each of the Intercompany Pool A entities. For purposes of this example, entity B1 transfers bonds totaling $9,000,000 to entity A1 in order to support the $9,000,000 of reserves[1] transferred to entity A1.

Scenario 1:

- If bonds with a market value of $9,000,000 and an amortized cost of $8,000,000 are transferred from entity B1 to entity A1 at market value, entity B1 may or may not have to defer its gain resulting from the transfer. This will depend on whether entity A1 and entity B1 have a common insurance entity parent. For example, if entity B1 is under entity A1's ownership chain or vice-versa as shown in the attached Organizational Chart Post Acquisition – Example 1, the gain will be deferred; otherwise, the gain will be realized. In the example provided, B1 would realize the gain on the transfers of assets to A1 as the two entities are not owned by the same insurer. However, if A3 transferred assets to A1, the gain in this instance would be deferred.

- More importantly, because insurers generally hold most bond investments to maturity, the cash flows from the contractual payments over the term of the bonds will be aligned with the bonds' amortized cost, not the market value at a point in time. Because entity B1 transferred bonds with an amortized cost of $1,000,000 less than that needed to support the reserves transferred (at book value) to entity A1, entity A1 will have received a deficient amount of assets (future cashflows) as part of the modification of the intercompany pooling arrangement. This will result because entity A1 will realize cash flows closer to the $8,000,000 amortized cost of the bonds rather than the market value at the time of the pooling modification of $9,000,000.

- In addition, if entity B1 has recorded a gain in surplus as a result of the transfer of the bonds as part of the intercompany pooling modification transaction, entity B1 must treat the intercompany pooling as retroactive reinsurance pursuant to paragraph 36d of SSAP No. 62R as provided in the example.

[1] The reserves transferred would typically include loss and loss adjustment expenses and other underwriting expense reserves, net of any premiums receivable subject to the pooling arrangement.

Scenario 2:

- If bonds with a market value of $9,000,000 and an amortized cost of $10,000,000 are transferred from entity B1 to entity A1 at market value, entity A1 will have received excess assets of $1,000,000 above the reserves transferred (at book value) to entity A1, as entity A1 will realize cash flows from the $10,000,000 amortized cost of the bonds rather than the market value at the time of the pooling modification of $9,000,000. Therefore, if entity B1 is required to transfer the assets at fair value, it has essentially sent a dividend of $1,000,000 to entity A1.

Example 2 is the removal of an insurance subsidiary from an intercompany pooling arrangement in preparation for the sale of the subsidiary (discontinued line of business). For this example, please see attached Organizational Chart – Example 2:

- Entity A6 is removed from the Intercompany Pool comprised of 6 insurance subsidiaries under Holdco A (as the insurance group is discontinuing A6's lines of business and selling the entity A6).

- The intercompany pooling arrangement is modified and the pooling percentages are reset such that entity A1 absorbs A6's pooling participation (retroactive to January 1 of the current year).

- Prior to the modification, the intercompany pooling percentages are:

Intercompany Pool participant:	Pool participation percentage:
Entity A1	37%
Entity A2	14%
Entity A3	2%
Entity A4	28%
Entity A5	10%
Entity A6	9%

- After the modification, the intercompany pooling percentages are:

Intercompany Pool participant:	Pool participation percentage:
Entity A1	46%
Entity A2	14%
Entity A3	2%
Entity A4	28%
Entity A5	10%

- As a result of the pooling modification, entity A6 must transfer net assets to entity A1. For purposes of this example, entity A6 transfers bonds totaling $27,000,000 to entity A1 in order to support the reserves[2] transferred to entity A1 for the business retained by the intercompany pool.

Scenario 1:

- If bonds with a market value of $27,000,000 and an amortized cost of $26,000,000 are transferred from entity A6 to entity A1 at market value, the implications of such a transfer are the same as in Example 1. Entity A6 may or may not have to defer its gain resulting from the transfer. This will depend on whether or not entity A1 and entity A6 have a common insurance entity parent (the attached Example 2 assumes that the entities do not have a common insurance entity parent). For example, if entity was a subsidiary of entity A1, the gain will be deferred; otherwise, the gain will be realized. In the example provided, A6 would realize the gain on the transfers of assets to A1 as the two entities are not owned by the same insurer. However, if A3 transferred assets to A1, the gain in this instance would be deferred.

- Because entity A6 transferred bonds with an amortized cost of $1,000,000 less than that needed to support the reserves transferred (at book value) to entity A1, entity A1 will have received a deficient amount of assets (future cash flows) as part of the modification of the intercompany pooling arrangement. This will result because entity A1 will realize cash flows closer to the $26,000,000 amortized cost of the bonds rather than the market value of $27,000,000 at the time of the pooling modification.

- In addition, if entity A6 has recorded a gain in surplus as a result of the transfer of the bonds as part of the intercompany pooling modification transaction, entity A6 must treat the intercompany pooling as retroactive reinsurance pursuant to SSAP No. 62R.

Scenario 2:

- If bonds with a market value of $27,000,000 and an amortized cost of $28,000,000 are transferred from entity A6 to entity A1 at market value, entity A1 will have received excess assets of $1,000,000 above the reserves transferred (at book value) to entity A1, as entity A1 will realize cash flows from the $28,000,000 amortized cost of the bonds rather than the market value of $27,000,000 at the time of the pooling modification. Therefore, if entity A6 is required to transfer the assets at fair value, it has essentially sent a dividend of $1,000,000 to entity A1.

Ref #2022-14: New Market Tax Credits

The Working Group exposed additional revisions made to SSAP No. 93 and SSAP No. 94R. Additionally, the Working Group directed NAIC staff to work with interested parties to draft revisions to the annual statement instructions and reporting updates.

[2] The reserves transferred would typically include loss and loss adjustment expenses and other underwriting expense reserves, net of any premiums receivable subject to the pooling arrangement.

Revisions to SSAP No. 93 – *Low-Income Housing Tax Credit Property Investments* and SSAP No. 94R – *Transferable and non-transferable State Tax Credits* and updates were made in response to comments received from interested parties.

Interested parties appreciate the opportunity to comment on the substantive revisions exposed by the Working Group for SSAP No. 93 – *Low Income Housing Tax Credit Property Investments* and SSAP No. 94 - *Transferable and Non-Transferable State Tax Credits* under item Ref #2022-14 *New Markets Tax Credits* (the Exposure). As stated in our prior comment letter on this topic, interested parties agree with having uniformity in accounting and reporting for equity and debt investments for which the return is earned primarily through tax credits. Interested parties agree that the proportional amortization method is an appropriate method to use for any type of investment (debt or equity) where the return is primarily earned through tax credits. However, we have concerns regarding the proposed adoption and scope provisions of the Exposure along with concerns that certain aspects of the Exposure could be misinterpreted which are outlined in the comments below:

SSAP No. 93 Admissibility Requirements for Ownership Interests in Tax Credit Investments
Paragraph 18 requires reporting entities to annually assess the future utilization of the unallocated tax credits associated with an entity's ownership interest in a tax credit investment project to determine if the investment can be admitted. Interested parties agree with the requirements of this paragraph to the extent that a tax credit investment meets **both** of the following criteria:

1) a reporting entity is not permitted to sell its ownership interest in a tax credit investment project to a 3rd party, and
2) the tax credits generated by the investment are not transferrable post allocation by the tax credit investment project.

If both of these criteria are met, a reporting entity's ownership interest in a tax credit investment can only be converted into allocated tax credits for use by the reporting entity and therefore, evaluation for admittance based on a reporting entity's ability to utilize the tax credits is appropriate.

Interested parties do not believe that the admissibility criteria within paragraph 18 should apply to ownership interests in tax credit investments that are unrestricted for sale (regardless of the type of tax credits that it generates and allocates) **or** for ownership interests in tax credit investments that are restricted but generate transferrable tax credits. Ownership interests in these types of tax credit investments represent investments that can be directly liquidated to satisfy policyholder obligations either through sale of the reporting entity's ownership interest in the investment (i.e., the future rights to receive tax credits that have not yet been generated and allocated by the tax credit investment) *or* sale of the transferrable tax credit post allocation. Therefore, we believe that these types of tax credit investments represent admitted assets and are fundamentally different from nonsaleable ownership interests in tax credit investments that only allocate non-transferrable tax credits.

Interested parties acknowledge that paragraphs 18(a) and 18(b) appear to provide an exception to the admissibility requirements in paragraph 18 for these types of investments:

> *18(a). Tax credit investments which allocate tax credits which are certificated or transferable in accordance with permitted IRS or state tax provisions may admit up to the lesser of the proportional amortized cost, or fair value of the tax credits. If the fair market value is not determinable, then the reporting entity may only admit the amount calculated in paragraph 18.*
>
> *18(b). Tax credit investments which allocate tax credits eligible for direct payment may admit up to the lesser of the proportional amortized cost, or the estimated proceeds.*

With respect to paragraph 18(a), interested parties disagree with the concept that if the fair value of a tax credit investment is not determinable, a reporting entity must apply the admissibility criteria within paragraph 18 because this conflicts with the impairment requirements in paragraph 25 of SSAP No. 93R, which provides guidance to ensure that a reporting entity's ownership interest in a tax credit investment would never exceed its fair value. We believe paragraph 25 of SSAP No. 93R appropriately addresses admissibility for these scenarios and therefore the language in paragraph 18(a) should be removed from the Exposure. Further, paragraph 25 requires a reporting entity to test its investment in tax credit projects for impairment annually and permits a reporting entity to estimate fair value as the present value of the future tax credits and other tax benefits that are expected to be generated by the tax credit investment discounted at a risk-free rate of return. Interested parties believe that this method provides a reasonable approximation of the fair value of a reporting entity's ownership interest in a tax credit investment, as it is based on assumptions that would be used by market participants when determining the purchase price of a similar investment (i.e., fair value is directly tied to the tax credits/benefits expected to be generated by the investment). As these types of tax credit investments are unrestricted for sale, we believe these ownership interests should be considered admitted assets and that admissibility is appropriately captured by the impairment testing requirements of paragraph 25. In addition, interest parties believe paragraph 25 also addresses admissibility for ownership interests in tax credit investments that may be restricted for sale if they allocate transferrable tax credits. This is because of the direct link between a tax credit investment's fair value and the value of the tax credits it allocates. Accordingly, in these circumstances because the tax credit allocated by the investment can ultimately be sold to a 3rd party, the impairment testing requirements of paragraph 25 also appropriately address admissibility considerations related to the tax credit investment.

With respect to paragraph 18(b), interested parties believe the meaning of "estimated proceeds" has the same meaning as fair value and represents the price that would be received by the reporting entity for its ownership interest in a tax credit investment in an orderly transaction between market participants and that wording should therefore be stricken from paragraph 18. We believe that ownership interests in tax credit investments that allocate tax credits eligible for direct payment (i.e., non-transferrable tax credits) are no different from those that allocate transferrable assets because a reporting entity can sell its ownership interest in the tax credit investment (i.e., the rights to receive tax credits that have not yet been generated and allocated by the tax credit investment). Similarly, we believe that admissibility of these tax credit investments is appropriately addressed by the impairment requirements of paragraph 25 because the fair value of a reporting entity's ownership interest in these tax credit investments is directly tied to the future tax credits and other tax benefits that are expected to be generated by the tax credit investment project.

Given these considerations, interest parties suggest the following revisions to paragraph 18; note that the proposed revisions below do not contemplate changes that may arise from the other comments discussed in this letter:

Reporting entities are required to annually assess the future utilization of the investment's current portion of unallocated tax credits against the estimated tax liabilities for both the tax year in which the tax credits can be initially utilized as well as any applicable carryback periods for a reporting entity's ownership interest in tax credit investments that meet both of the following criteria:

a. *the ownership interest in the tax credit investment is legally restricted for sale, and*
b. *the tax credits allocated to the reporting entity by the tax credit investment are not transferrable post allocation.*

~~Based on this assessment,~~ For tax credit investments that meet both of these criteria, ……………………………..

.... *~~As an exception to the admittance assessment detailed above, if the tax credit investment allocates tax credits with the following features the reporting entity may perform a secondary assessment to determine if additional amounts of the tax credit investment may be admitted~~:*

~~a. *Tax credit investments which allocate tax credits which are certificated or transferable in accordance with permitted IRS or state tax provisions may admit up to the lesser of the proportional amortized cost, or fair value of the tax credits. If the fair market value is not determinable, then the reporting entity may only admit the amount calculated in paragraph 18.*~~
~~b. *Tax credit investments which allocate tax credits eligible for direct payment may admit up to the lesser of the proportional amortized cost, or the estimated proceeds.*~~

SSAP No. 93 Paragraph 18 Clarifications
Interested parties also suggest clarification of key terms in paragraph 18. Based on previous dialog with the Working Group, we propose the following definitions:

1) "unallocated tax credits" - the portion of tax credits expected to be earned and allocated to the reporting entity through the investment structure.
2) "current portion" - the credits allocated within one year of the reporting period.

In addition, to avoid misinterpretation we propose that instead of assessing if the unallocated tax credits will be used over the life of the investment, that the assessment should occur over the life of the tax credit. This language aligns with the next sentence, which references if the unallocated tax credits will exceed what can be utilized under IRS or state tax provisions, the reporting entity must non-admit a portion of the investments. IRS and state tax authorities generally provide that if tax credits allocated or generated in the current year cannot be used to offset the current tax liability, they are carried forward for a specified number of years.

> "...if the reporting entity does not expect to substantially utilize the current portion of unallocated investment tax credits, the reporting entity shall perform an expanded assessment to determine the extent that it will be able to utilize all of the investment's unallocated tax credits over the life of the tax credit ~~the life of the invest ment~~. If assessment projections identify that the investment's unallocated tax credits will exceed what can be utilized under IRS or state tax provisions (current and carryforward periods ~~other applicable tax periods~~), the reporting entity shall nonadmit investments as necessary so that investments in scope of this statement (in aggregate) are only admitted to the extent tax credits are expected to be utilized within carryforward periods. Additionally, if the assessment indicates that the next three years of investment tax credits cannot be substantially utilized within the carryforward periods then the entire investment shall be nonadmitted."

Paragraph 18 disallows reporting entities from assuming that future operations will increase as support for the utilization of tax credits. However, interested parties assume that tax planning strategies are required when assessing the utilization of unallocated tax credits, similar to the valuation allowance requirements under SSAP No. 101. Explicitly providing this requirement prevents misinterpretation and avoids unintended fluctuations in surplus in the year credits are allocated and assessed under the guidelines in SSAP No. 101.

Retrospective Versus Prospective Adoption
Interested parties believe that applying the requirements under the revised standards upon transition should be done on a prospective basis so that no adjustments to surplus are recorded at the date of adoption. Under the prospective method, companies will analyze which of their investments meet the criteria under each standard. For SSAP No. 93 investments, the carrying book value at the date of adoption will become the starting balance, which will be used to determine future amortization under the proportional amortization method based on future tax credits and other tax benefits to be earned. Under SSAP No. 94, the requirement to record the credits at their face value should be applied to future purchases only. Otherwise, we would have to adjust the book value of those credits upon adoption due to the change in accounting for SSAP No. 94 purchased tax credits that requires recording these credits at face value rather than actual cost.

Adoption Date
Due to the level of work required to review investments for which tax credits are received to determine if they meet the criteria under SSAP No. 93, we believe that having an effective date of 1/1/25 would be more reasonable. In addition, we understand that changes to Schedule BA along with review by the NAIC's Capital Adequacy Working Group will need to take place to report the new investments in the appropriate section of the schedule. Since this will require

additional time as well, 1/1/25 seems reasonable. Although the FASB ASU has an adoption date of 1/1/2024 for many insurers, many other insurers do not apply US GAAP and/or meet the requirements to adopt the ASU after 1/1/2024. Additionally, the accounting requirements for the new FASB ASU are different than those under the Exposure and thus, additional time to adopt the Exposure is warranted.

For SSAP No. 94 tax credits, since the adoption of this standard requires minimal changes to the annual statement as these are reported as other-than-invested assets and not as investments, an effective date of 1/1/25 with early adoption allowed will be beneficial for industry. Early adoption will allow insurers that purchase federal tax credits to apply the proposed accounting under SSAP No. 94. Otherwise, there may be questions of admissibility for new instruments purchased, since today's SSAP No. 94 only addresses state tax credits.

SSAP No. 94 Scope
There have been some questions about whether there is enough clarity about the types of tax credits that fall within SSAP No. 93 versus SSAP. No. 94. Interested parties' understanding is that SSAP No. 93 relates to debt and equity investments where the return on the investment is predominantly from tax credits and other tax benefits whereas SSAP No. 94 addresses tax credit "vouchers" that are purchased outright from any party, which are not considered investments (but instead represent receivables). To that end, we want to suggest the following edits to the SSAP No. 94 scope:

> "This statement establishes statutory accounting principles for state and federal tax credits that are purchased1 by the reporting entity without being ~~an~~ bond or equity investor in the entity from which the tax credit were purchased."

Ref #2023-14: ***SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve***

The Working Group moved this agenda item to the active listing, categorized as a new SAP concept and exposed this agenda item with the overall concept for a long-term project to capture accounting guidance for AVR and IMR in SSAP No. 7. Although revisions may be considered and adopted to allow focus on specific discussion aspects, ultimately, the movement of the accounting guidance to SSAP No. 7, and any revisions from the annual statement instructions when incorporating SAP guidance, is proposed to be captured as a new SAP concept with a corresponding issue paper to detail the revisions. The agenda item identifies discussion topics to be included in this project.

Interested parties support the comments made by the ACLI in its comment letter.

Schedule Ref #2023-16: Schedule BA Reporting Categories

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification and exposed this agenda item to further define for consistency purposes the investments captured as non-registered private funds, joint ventures, partnerships or limited liability companies, or residual interests and reported based on the underlying characteristics of assets. This item contains revisions to further define, for consistency purposes, investments captured as non-registered private funds, joint ventures, partnerships or limited liability companies, or residual interests and reported based on the underlying characteristics of assets.

Interested parties recommend several edits to further clarify and define the investments that should be categorized as non-registered private funds, joint ventures, partnerships or limited liability companies or residual interests, based on the characteristics of the underlying assets.

Please see the related attachment with marked edits.

We do not recommend any changes to the language describing Non-Registered Private Funds, but we would like to comment on what is included in that section in response to the Working Group's request: in addition to private funds which have been filed with the SVO and private funds which have not been filed with the SVO, there are certain fixed income instruments not included on schedule D or schedule B, consistent with the Annual Statement Instructions for that schedule.

Ref #2023-17: Short-term Investments

The Working Group moved this agenda item to the active listing, categorized as a new SAP concept, and exposed revisions to further restrict the investments that are permitted for cash equivalent or short-term investment reporting. To correspond with the bond project, this agenda item proposes an effective date of Jan. 1, 2025. Additionally, subsequent blanks reporting changes will be considered to modify the cash equivalent and short-term reporting lines accordingly. This item contains revisions to further restrict the investments that are permitted to be included in cash or shorter-term investment reporting.

Interested parties have no comments on this item.

Ref #2023-18: ***Proposed Revisions to SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets***

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification and exposed revisions to adopt, with modification, *ASU 2016-19, Technical Corrections and Improvements* for statutory accounting in SSAP Nos. 5R, 92, 102, and 103R as illustrated in the proposal. The proposed revisions adopt with modification certain aspects of *ASU 2016-19: Technical Corrections and Improvements*. The revisions also include amending SSAP No. 92 – *Postretirement Benefits Other Than Pensions* guidance on insurance contracts to use the same terminology as that used in SSAP No. 102 – *Pensions*.

Interested parties have no comments on this item.

Ref #2023-19: ASU 2018-09, Codification Improvements

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification and exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2018-09 Codification Improvements* as not applicable for statutory accounting.

Interested parties agree with the recommendation in this agenda item.

Ref #2023-20: ASU 2020-10, Codification Improvements

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification and exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2020-10, Codification Improvements* as not applicable for statutory accounting.

Interested parties agree with the recommendation in this agenda item.

Ref #2023-21: Removal of Transition Guidance from SSAP No. 92 and SSAP No. 102

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 92 and SSAP No. 102 to remove the transition guidance that was no longer applicable as the ten-year effective period for that transition has ended.

Interested parties agree with the recommendation in this agenda item.

Ref #2023-22: Actuarial Guideline 51 and Appendix A-010 Interaction

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 54R to clarify that gross premium valuation (under Appendix A-010) and cash flow testing (under AG 51) are both required, if indicated. In addition, the Working Group directed staff to provide formal notice of the exposure to the Long-Term Care Actuarial (B) Working Group and the Valuation Analysis (E) Working Group.

Interested parties have no comments on this item.

* * * *

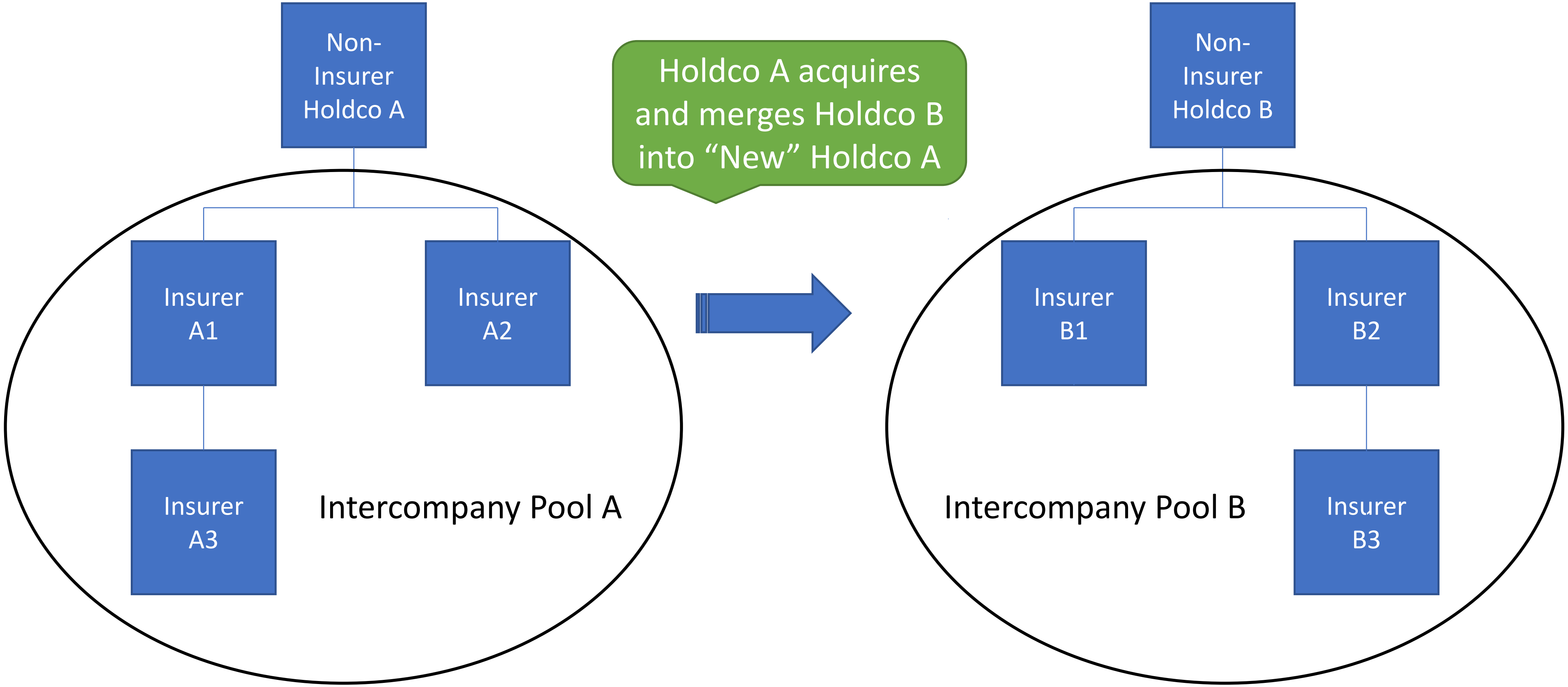
Please feel free to contact either one of us with any questions you may have.

Sincerely,

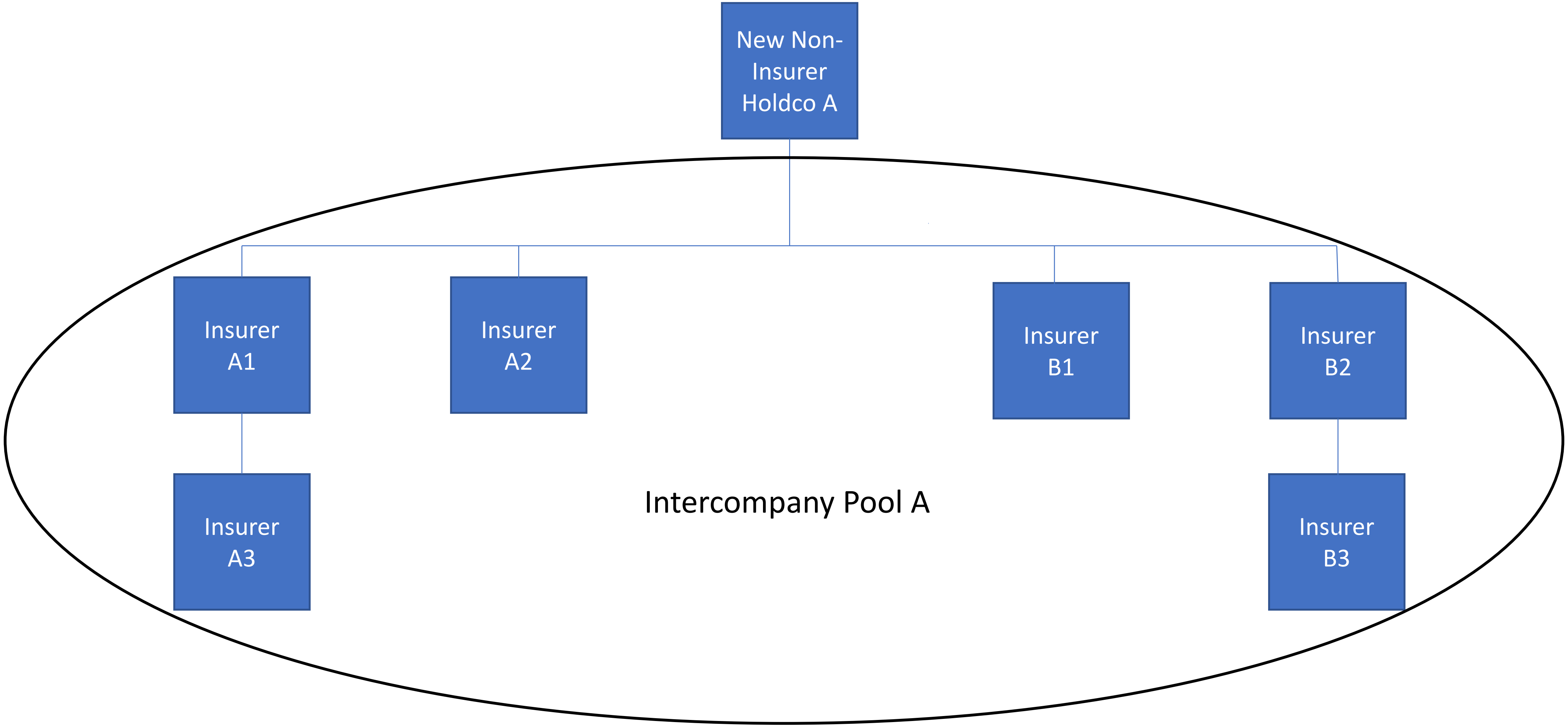
D. Keith Bell Rose Albrizio

cc: Interested parties
NAIC staff

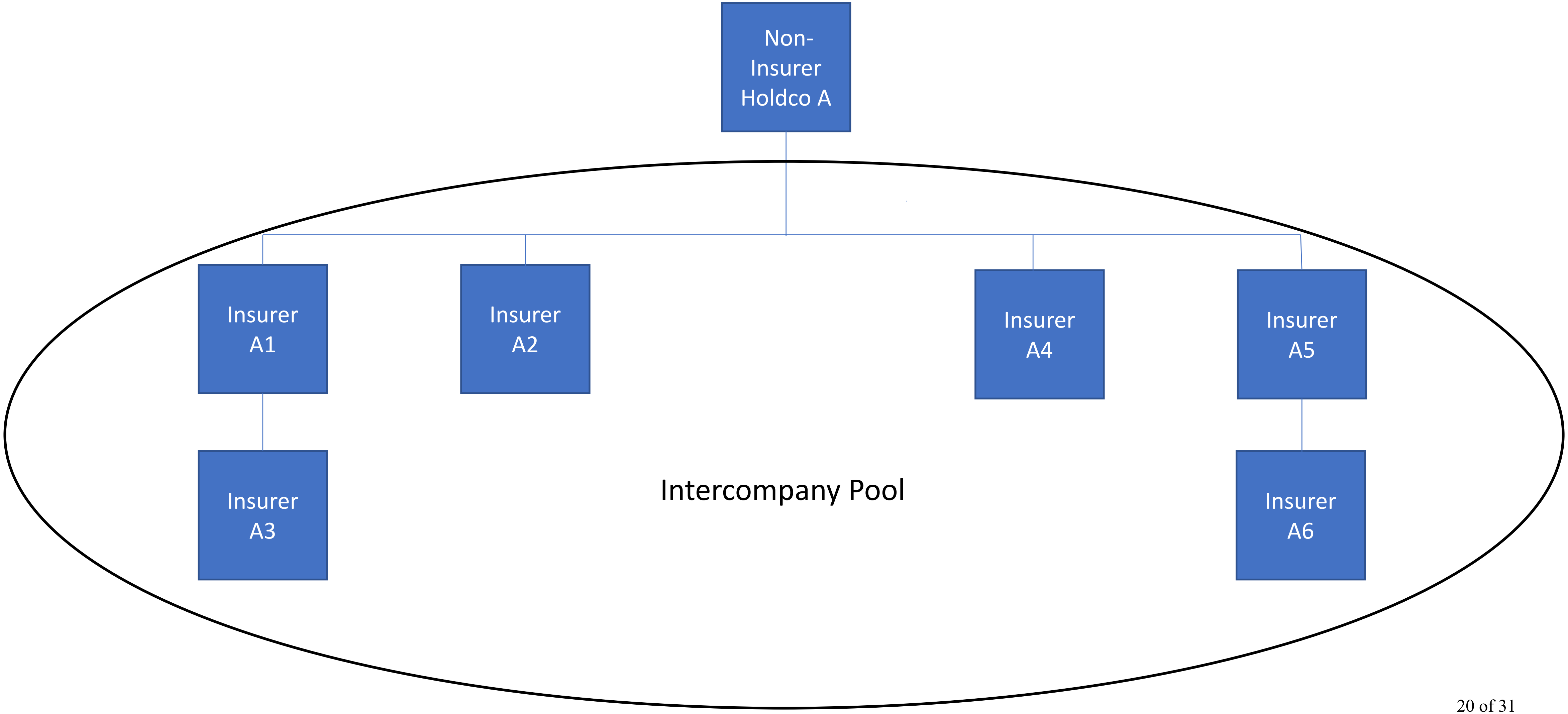
Organizational Chart Pre-Acquisition – Example 1



Organizational Chart Post Acquisition – Example 1



Organizational Chart – Example 2



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

Issue: Schedule BA Reporting Categories

Check (applicable entity):

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

Description of Issue: This agenda item has been developed to incorporate more detailed definitions for the annual statement reporting categories of *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* (SSAP No. 48) and residual interests on Schedule BA: Other Long-Term Invested Assets. These investments are reported on designated lines divided by the reporting entity's classification as to the underlying asset characteristics:

- Bonds / Fixed-Income Instruments*
- Common Stocks
- Real Estate
- Mortgage Loans
- Other

** Bonds / fixed-income instruments reported in scope of SSAP No. 48 as non-registered private funds, joint ventures, partnerships, or limited liability companies is divided between investments that have an NAIC designation assigned by the SVO and those that do not have an NAIC designation assigned by the SVO.*

The recent residual discussions have further identified that variations exist across industry on the types of investments that should be captured within each category. It has also been noted that the Annual Statement Instructions are limited with guidance and examples for determining reporting classification.

This agenda item has been drafted to propose revisions to the reporting category descriptions in the Annual Statement Instructions to improve consistency in reporting for both ease of industry classifications and for regulator assessment of the type and volume of investment types. The proposed revisions from the Statutory Accounting Principles (E) Working Group will be used to sponsor a blanks annual statement instruction change. The revisions within this agenda item will not result in statutory accounting revisions.

Existing Authoritative Literature:

- **A/S Instructions – Life, Accident and Health / Fraternal Companies**

Reporting Categories on Schedule BA:

Non-Registered Private Funds with Underlying Assets Having Characteristics of:
Bonds
NAIC Designation Assigned by the Securities Valuation Office (SVO)
Unaffiliated....................0799999
Affiliated....................0899999
NAIC Designation Not Assigned by the Securities Valuation Office (SVO)
Unaffiliated....................0999999
Affiliated....................1099999
Mortgage Loans
Unaffiliated....................1199999

Affiliated 1299999

Other Fixed Income Instruments

Unaffiliated..1399999
Affiliated 1499999

Joint Venture, Partnership or Limited Liability Company Interests with Underlying Assets Having the Characteristics of:

Fixed Income Instruments

NAIC Designation Assigned by the Securities Valuation Office (SVO)

Unaffiliated..1599999
Affiliated 1699999

NAIC Designation Not Assigned by the Securities Valuation Office (SVO)

Unaffiliated..1799999
Affiliated 1899999

Common Stocks

Unaffiliated..1999999
Affiliated 2099999

Real Estate

Unaffiliated..2199999
Affiliated 2299999

Mortgage Loans

Unaffiliated..2399999
Affiliated 2499999

Other

Unaffiliated..2599999
Affiliated 2699999

Residual Tranches or Interests with Underlying Assets Having Characteristics of:

Fixed Income Instruments

Unaffiliated..4699999
Affiliated 4799999

Common Stock

Unaffiliated..4899999
Affiliated 4999999

Preferred Stock

Unaffiliated..5099999
Affiliated 5199999

Real Estate

Unaffiliated..5299999
Affiliated 5399999

Mortgage Loans

Unaffiliated..5499999
Affiliated 5599999

Other

Unaffiliated..5699999
Affiliated 5799999

Schedule BA Classification Instructions / Guidance:

<u>Non-Registered Private Funds with Underlying Assets Having Characteristics of a Bond, Mortgage Loan or Other Fixed Income Instrument</u>

Include: Fixed income instruments that are not corporate or governmental unit obligations (Schedule D) or secured by real property (Schedule B).

Any investments deemed by the reporting entity to possess the underlying characteristics of a bond or other fixed income instrument that has been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 0799999 and 0899999.

Any investments deemed by the reporting entity to possess the underlying characteristics of a bond or other fixed income investment that has not been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 0999999, 1099999, 1199999, 1299999, 1399999 and 1499999.

<u>Joint Ventures, Partnership or Limited Liability Company Interests with Underlying Assets Having the Characteristics:</u>

<u>Fixed Income Instruments</u>

Include: Investments with underlying collateral which include contractual principal and/or interest payments, excluding mortgage loans.

Any investments deemed by the reporting entity to possess the underlying characteristics of fixed income instruments that has been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 1599999 and 1699999.

Any investments deemed by the reporting entity to possess the underlying characteristics of fixed income instruments that has not been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 1799999 and 1899999.

<u>Common Stocks</u>

Include: Venture Capital Funds or other underlying equity investments.

<u>Real Estate</u>

Include: Real estate development interest. Reporting should be consistent with the detailed property analysis appropriate for the corresponding risk-based capital factor for this investment category. If the requisite details are not available for reporting, report under “Other” subcategory.

<u>Mortgage Loans</u>

Include: Mortgage obligations. Reporting should be consistent with the detailed property analysis appropriate for the corresponding risk-based capital factor for this investment category. If the requisite details are not available for reporting, report under “Other” subcategory.

<u>Other</u>

Include: Limited partnership interests in oil and gas production.

Forest product partnerships.

Investments within the Joint Venture and Partnership Interests category that do not qualify for inclusion in the "Fixed Income Instruments," "Common Stocks," "Real Estate" or "Mortgage Loans" subcategories.

Residual Tranches or Interests with Underlying Assets Having Characteristics of:

Investment in Residual Tranches or Interests should be assigned to the subcategory with the highest underlying asset concentration. There shouldn't be any bifurcation of the underlying assets among the subcategories.

Include: Residual tranches or interests from securitization tranches and beneficial interests as well as other structures captured in scope of *SSAP No. 43R – Loan-Backed and Structured Securities* Investments in joint ventures, partnerships and limited liability companies captured in scope of *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* that represent residual interests or that predominantly hold residual interests.

This category shall also include residual interests or residual security tranches within investment structures that are not captured in scope of SSAP No. 43R or SSAP No. 48 but that reflect, in substance, residual interests or residual security tranches.

Fixed Income Instruments

Include: Investments with underlying collateral which include contractual principal and/or interest payments, excluding mortgage loans.

Common Stocks

Include: Investments with underlying collateral which are securities that represent a subordinate equity ownership.

Preferred Stocks

Include: Investments with underlying collateral which is a security that represents ownership of a corporation and gives the holder a claim prior to the claim of common stockholders on earnings and also generally on assets in the event of liquidation.

Real Estate

Include: Investments with underlying collateral which is defined as directly-owned real estate properties and single real estate property investments that are directly and wholly-owned through a limited liability company.

Mortgage Loans

Include: Investments with underlying collateral which is secured by a mortgage on real estate.

Other

Include: Items that do not qualify for inclusion in the above subcategories.

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):

- Bond Project: Under the principle-based bond definition project, revisions are proposed to combine the non-registered provide funds within the reporting category for joint ventures, partnerships and limited liability companies as those items would also be in scope of SSAP No. 48. With that change the category of "fixed income instruments" would be retained.

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 recommend that the Working Group include this item on their maintenance agenda as a SAP clarification / potential blanks reporting change and expose this agenda item with a request for industry and regulator feedback to further define and provide examples for the investments captured as non-registered private funds, joint ventures, partnerships or limited liability companies, or residual interests and reported based on the underlying characteristics of assets. Specifically, comments are requested on what should be captured as investments with underlying asset characteristics of:

- Fixed-Income Instruments
- Common Stocks
- Real Estate
- Mortgage Loans
- Other

As detailed in the current A/S instructions, descriptions are included for non-registered private funds, joint ventures, partnerships, and limited liability companies, whereas references to the SSAP the underlying assets would be captured in are included for residual interests.

This agenda item is only intended to improve the annual statement instructions and examples for the allocation of investments based on the above underlying characteristics of assets. If needed, and preferred by the Working Group, this agenda item could be expanded to propose new reporting lines (structural changes) to Schedule BA. As noted within 'Activity to Date,' revisions are currently being considered to combine and rearrange broad reporting lines under the bond project. Those revisions currently do not expand on the instructions for reporting based on underlying characteristics of assets. The proposed revisions from the Statutory Accounting Principles (E) Working Group will be used to sponsor a blanks annual statement instruction change. The revisions within this agenda item will not result in actual statutory accounting revisions.

Staff Review Completed by: Julie Gann - NAIC Staff, May 2023

Status:
On August 13, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification and exposed this agenda item to further define for consistency purposes the investments captured as non-registered private funds, joint ventures, partnerships or limited liability companies, or residual interests and reported based on the underlying characteristics of assets.

Mike Monahan
Senior Director, Accounting Policy
202-624-2324 t
mikemonahan@acli.com

September 29, 2023

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Dear Mr. Bruggeman:

Re: Exposure Ref #2023-14 – SSAP No. 7 Asset Valuation Reserve and Interest Maintenance Reserve

The American Council of Life Insurers (ACLI) appreciates the continued thoughtful and timely attention the Statutory Accounting Principles Working Group is dedicating to this important topic.

ACLI is very appreciative and supportive of the IMR Technical Working Group. ACLI stands ready to continue working with the NAIC to ensure the most appropriate long-term treatment of the IMR can be applied and a company's surplus and financial strength are properly reflected, all while not disincentivizing the prudent management practices that are in the best interest of all.

We are supportive of efforts to capture guidance for the IMR and AVR in SSAP No. 7. We further appreciate NAIC staff's efforts to create an initial list of topics to be addressed, noting that the interconnectedness and complexity of the IMR and AVR will result in robust, detailed discussions at the Technical Working Group.

If you have any questions regarding this letter, please do not hesitate to contact us.

Sincerely,

Mike Monahan
Senior Director, Accounting Policy

MMonahan

ACLI
Financial Security for Life

Mike Monahan
Senior Director, Accounting Policy
202-624-2324 t
mikemonahan@acli.com

October 18, 2023

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Dear Mr. Bruggeman:

Re: Exposure Ref #2023-15 – IMR / AVR Specific Allocation

The American Council of Life Insurers (ACLI) appreciates the opportunity to comment on the above referenced exposure. The ACLI believes the exposure can essentially be separated into three components, all of which NAIC staff believes will result in a more correct allocation of gain/losses to IMR. Specifically, 1) where a mortgage loan has been sold at a loss while subject to a valuation allowance, 2) where an acute credit event occurred with the security sold at a loss prior to the event being reflected in CRP ratings or on the SVO feed, and 3) the current notch rule potentially allows inappropriate credit losses going to IMR. ACLI is supportive of ensuring the appropriate treatment of interest and credit related gains and losses and committed to working with NAIC to address regulator concerns.

Mortgage Loans Sold at a Loss While Subject to A Valuation Allowance

ACLI is supportive of the proposed IMR changes related to mortgage loans.

An Acute Credit Event Occurred But Is Not Yet Reflected in CRP Ratings/SVO Feed

ACLI appreciates the NAIC's concern that the current notching criteria for an IMR eligible gain/loss does not pick up situations where there is an acute credit event (e.g., wild fires and lawsuits related to PG&E or Silicon Valley Bank) and where an insurance company may want to exit security holdings at a loss, but where the acute credit even is not yet reflected in a CRP downgrade and/or the SVO feed.

Most insurance companies subject to IMR utilize the SVO feed for both risk-based capital purposes and IMR, and have an automated process to utilize the SVO feed where applicable (i.e., not all securities are included in the SVO feed at time or purchase and/or sale and therefore insurance companies have procedures to take the second lowest available CRP rating, or internal rating if CRP ratings do not exist at the time, that subsequently get automated).

While ACLI is supportive of what the NAIC is trying to achieve, the ACLI has struggled to think of a way to operationalize it. The concept of a "reasonable period of time" presents the following challenges:

- The concept itself is ambiguous, and even in a principles-based rule is difficult to operationalize,
- What is a reasonable period of time for a sale in January could be the remaining 11 months of the year, albeit with inter-quarter adjustments, but in December could need to be much shorter,
- Each sale in December, which could be a substantial number, would require insurance companies to keep their books open and potentially rerun and revise all internal and external reporting through their annual statement filing date.
- CRP ratings and/or the SVO feed could be delayed beyond even that period, requiring inter-year changes.
- Certain companies utilize CRP ratings directly, instead of the SVO feed, to more appropriately capture the second lowest CRP rating where the SVO feed does not appropriately capture.

Rather than support the "reasonable period of time" concept, ACLI proposes an alternative which it believes better captures the NAIC's goals.

Include realized capital gains(losses) on:

Debt securities (excluding loan-backed and structured securities) and preferred stocks whose National Association of Insurance Commissioners (NAIC)/Securities Valuation Office designation at the end of the holding period is ~~NOT~~ different from its NAIC designation at the beginning of the holding period by one or less ~~more than one~~ NAIC designations. However, if the security sold also includes the following, it should not be included:

- Between the purchase and sale date there was an acute credit event (a known event that significantly impacts the price of the security), that was not yet reflected in CRP ratings and/or the SVO feed at the time of sale, where the resulting gain/loss from the sale was predominantly credit related.

The ACLI looks forward to working with the NAIC to more appropriately tailor this concept if needed, to achieve the NAIC objectives, and so it can be adopted so as to be effective as early as January 1, 2024, which may be the earliest it can be operationalized.

The Current Notch Rule Allows Inappropriate Credit Losses Going to IMR

Embedded within the proposed changes in this exposure is the concept of changing the term NAIC Designation to NAIC Designation Category, as can be understood by the chart below. Essentially, this drastically changes the granularity by utilizing the 20 NAIC Designation Categories versus the 6 NAIC Designations.

NAIC Designation	NAIC Designation Category
1	1A
	1B
	1C
	1D
	1E
	1F
	1G
2	2A
	2B
	2C
3	3A
	3B
	3C
4	4A
	4B
	4C
5	5A
	5B
	5C
6	6

The ACLI suspects this change was intended to more precisely allocate gains/losses to IMR and AVR. The ACLI notes several challenges with this approach.

Most importantly, such an approach may result in unintended consequences that could be concerning to regulators. This can best be illustrated with the following.

	1A	1B	1C	1D	1E	1F	1G	2A	2B	2C	3A	3B	3C	4A	4B	4C	5A	5B	5C
1A	0	-1	8	10	20	32	47	71	85	127	205	221	250	316	372	465	644	777	1367
1B		0	9	10	20	32	48	72	86	128	206	221	251	317	373	465	644	778	1367
1C			0	2	12	24	39	63	77	119	197	212	242	308	364	457	636	769	1359
1D				0	10	22	37	61	76	117	195	211	240	306	362	455	634	767	1357
1E					0	12	27	51	66	107	185	201	230	296	352	445	624	757	1347
1F						0	15	39	54	95	173	189	218	284	340	433	612	745	1335
1G							0	24	38	80	158	173	203	269	325	417	596	730	1320
2A								0	14	56	134	150	179	245	301	394	573	706	1296
2B									0	42	120	135	165	231	287	379	558	692	1281
2C										0	78	94	123	189	245	338	517	650	1240
3A											0	15	45	111	167	259	438	572	1162
3B												0	29	96	151	244	423	556	1146
3C													0	66	122	215	394	527	1117
4A														0	56	148	327	461	1051
4B															0	93	272	405	995
4C																0	179	312	902
5A																	0	133	723
5B																		0	590
5C																			0

Source: Average spreads by index rating of the Bloomberg US Corporate Investment Grade Index and U.S. High Yield - 1% Issuer Cap Index over 5 years (10/1/2018 through 9/19/2023); Aladdin

If a security was sold, going from a 1A (vertical axis) to a 1C (horizontal axis), the credit related component of its yield would increase approximately 8 basis points. In a sale where the risk-free rate also went up 3% or 300 basis points, the interest related component of the gain/loss would be approximately 37.5x (300/8) the credit related component. The proposal still results in imprecision for IMR eligibility, and may be especially troubling in a declining interest rate environment as gains would not go to IMR (the scenario that was most troubling to regulators when IMR was developed)

In summary, in a falling interest rate environment, gains may overstate a company's surplus or could be distributed (showing the same financial strength when the company now has a lower yielding portfolio). In a rising interest rate environment, losses would show decreased financial strength, when in fact a company would have a higher yielding portfolio. It is important to understand that the portion of any gain/loss attributable to interest and/or credit is essentially linked to three variables 1) credit spreads as articulated in the above table, which fluctuate over time 2) the change in risk-free rate, which also fluctuates over time and 3) where the security exists in the credit spectrum (e.g., represented by either the CRP rating, NAIC Designation, or NAIC Designation Category, where the spread change is not linear as one proceeds from higher ratings to lower ratings).

ACLI believes it is very important to carefully consider:

- Should the existing one-notch NAIC Designation rule be retained?
- Should it be several NAIC sub-categories?
- Should it be different for Investment Grade and Below Investment Grade Securities?

- Should gain losses be bifurcated between interest and credit related components?
- If so, is there a simple way to calculate the bifurcated gains and losses to ensure consistency between companies and so that it can be automated?

Lastly, even if the exposed approach was deemed appropriate, there are additional significant operational issues:

- The SVO feeds are the primary source of data for calculating such IMR related gains/losses but the 20 NAIC categories are not included prior to the implementation of the new factors for risk-based capital.
- It would be impractical for insurance companies to retroactively apply this given their automated processes.
- Most companies do not have all CRP feeds to determine the second lowest CRP ratings.

ACLI strongly encourages any action beyond its alternative acute credit event proposal be addressed as part of the long-term project.

If you have any questions regarding this letter, please do not hesitate to contact us.

Sincerely,

Mike Monahan
Senior Director, Accounting Policy