Date: 3/22/22

2022 Spring National Meeting
Kansas City, Missouri

STATUTORY ACCOUNTING PRINCIPLES (E) WORKING GROUP
Monday, April 4, 2022
9:45 a.m. – 12:00 p.m.
2501C—Convention Center—Level 2

OVERVIEW AGENDA

HEARING AGENDA

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Date: 3/22/22

2022 Spring National Meeting
Kansas City, Missouri

STATUTORY ACCOUNTING PRINCIPLES (E) WORKING GROUP
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2501C—Convention Center—Level 2

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MEETING AGENDA

5. SAPWG Meeting – Maintenance Agenda – Pending List—Dale Bruggeman (OH)
   • Ref #2022-01: Conceptual Framework – Updates
   • Ref #2022-02: SSAP No. 48 – Alternative Valuation of Minority Ownership Interests
   • Ref #2022-03: Premium Adjustments Allocated to Jurisdictions
   • Ref #2022-04: ASU 2021-10, Government Assistance
   • Ref #2022-05: ASU 2021-09, Leases, Discount Rates for Lessees
   • Ref #2022-06: ASU 2021-07, Compensation – Stock Compensation
   • Ref #2022-07: ASU 2021-08, Business Combinations
   • Ref #2022-08: INT 22-01T: Freddie Mac When-Issued K-Deal (WI Trust) Certificates

6. SAPWG Meeting – Any Other Matters Brought Before the Working Group—Dale Bruggeman (OH)
   • Review of U.S. GAAP Exposures
   • Working Group referral to CASTF - Update

➢ Comment Deadline for Ref #2022-03 & #2022-08 – Friday, May 6
➢ Comment Deadline for all other items – Friday, June 3

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2022/4- spring nm/04 2022 overview agenda.docx
Hearing Agenda

Statutory Accounting Principles (E) Working Group

Hearing Agenda

April 4, 2022

9:45 a.m. – Noon (Central)

ROLL CALL

Dale Bruggeman, Chair  Ohio  Judy Weaver  Michigan
Carrie Mears, Co-Vice Chair  Iowa  Doug Bartlett  New Hampshire
Sheila Travis  Alabama  Bob Kasinow  New York
Kim Hudson  California  Kimberly Rankin/Melissa Greiner  Pennsylvania
William Arfanis/Michael Estabrook  Connecticut  Jamie Walker  Texas
Rylynn Brown  Delaware  Doug Stolte/David Smith  Virginia
Eric Moser  Illinois  Amy Malm/ Elena Vetrina  Wisconsin
Stewart Guerin/Melissa Gibson  Louisiana

NAIC Support Staff: Julie Gann, Robin Marcotte, Jim Pinegar, Jake Stultz, Jason Farr

Note: This meeting will be recorded for subsequent use.

REVIEW AND ADOPTION OF MINUTES

1. Fall National Meeting (Attachment 1)
2. January 27, 2022 (Attachment 2)
3. March 2, 2022 (Attachment 3)

The Statutory Accounting Principles (E) Working Group met in regulator-to-regulator sessions on February 28 and March 31, 2022. These regulator sessions were 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. The discussion during the Feb. 28 session previewed the March 2 agenda item regarding the bond project. The discussion during the March 31 session previewed the Spring National Meeting agendas and discussed other items with NAIC staff pursuant to the NAIC open meeting policy.

REVIEW AND ADOPTION of NON-CONTESTED POSITIONS

The Working Group may individually discuss the following items, or may consider adoption in a single motion:

1. Ref #2021-24: Cryptocurrency General Interrogatory
2. Ref #2021-28: ASU 2021-03, Intangibles – Goodwill and Other
3. Ref #2021-29: ASU 2021-05, Variable Lease Payments
4. Ref #2021-30: ASU 2021-06, Amendments to SEC Paragraphs

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<tr>
<td>2021-24 Blanks (Jake)</td>
<td>Cryptocurrency General Interrogatory</td>
<td>4 - Agenda Item</td>
<td>No Comments</td>
<td>IP – 13</td>
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Summary:
On December 11, the Working Group exposed this agenda item to propose a new general interrogatory within the annual reporting blanks, specific to the use or acceptance of cryptocurrencies. Examples of inquiries within the interrogatory include the identification regarding 1) if cryptocurrencies are held by an insurance reporting entity (and if so, which reporting schedules are the cryptocurrencies reported), and 2) if cryptocurrencies are accepted for the payment of premiums. While this agenda item did not propose statutory revisions, it was requested by regulators after the Working Group’s May 2021 adoption of INT 21-01: Accounting for Cryptocurrencies, which established that directly held cryptocurrencies do not meet the definition of an admitted asset for statutory accounting.

Interested Parties’ Comments:
Interested parties have no comment on this item.

Recommended Action:
NAIC staff recommends that the Working Group adopt this agenda item, noting that there are no actual statutory revisions. Rather, adoption will express support for the corresponding Blanks (E) Working Group exposure (2022-01BWG), which includes the new cryptocurrency general interrogatory within the statutory financial statements.

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<tbody>
<tr>
<td>2021-28</td>
<td>ASU 2021-03, Intangibles Goodwill and Other</td>
<td>5 - Agenda Item</td>
<td>No Comment</td>
<td>IP – 16</td>
</tr>
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Summary:
On December 11, the Working Group exposed revisions to SSAP No. 68—Business Combinations and Goodwill to reject ASU 2021-03, Intangibles – Goodwill and Other (Topic 350) – Accounting Alternative for Evaluating Triggering Events for statutory accounting. ASU 2021-03 provides private companies and not-for-profit entities with an optional accounting alternative for the performance of a goodwill impairment triggering evaluation so that goodwill impairment is only assessed at the end of a reporting period. The allowance provided in this ASU is contrary to INT 06-07: Definition of Phrase “Other Than Temporary,” which requires that an impairment be assessed when an impairment indicator is present. Thus, it does not permit the delay of an impairment assessment until a reporting period, nor does it permit assessment differentiation based on entity type (public vs. private or a not-for-profit entity).

Interested Parties’ Comments:
Interested parties have no comment on this item.

Recommended Action:
NAIC staff recommends that the Working Group adopt the exposed SAP clarifications to SSAP No. 68—Business Combinations and Goodwill to reject ASU 2021-03, Intangibles – Goodwill and Other (Topic 350) – Accounting Alternative for Evaluating Triggering Events for statutory accounting.
Summary:
On December 11, the Working Group exposed revisions to SSAP No. 22R—Leases to reject ASU 2021-05, Leases (Topic 842), Lessors—Certain Leases with Variable Lease Payments for statutory accounting. ASU 2021-05 applies to lessors with lease contracts that: 1) have variable lease payments that do not depend on a reference index or rate, and/or 2) would have resulted in the lessor being required to recognize a day one selling loss (at lease commencement) if those leases were classified as sales-type or direct financing. The changes to Topic 842 will require a lessor to classify a lease with variable lease payments that do not depend on an index or a rate as an operating lease at lease commencement if classifying the lease as a sales-type lease or a direct financing lease would result in the recognition of a selling loss. However, as SSAP No. 22R requires nearly all leases to be treated as operating leases for statutory accounting, adoption of this guidance would be redundant and unnecessary.

Interested Parties’ Comments:
Interested parties have no comment on this item.

Recommended Action:
NAIC staff recommends that the Working Group adopt the exposed SAP clarifications to SSAP No. 22R—Leases to reject ASU 2021-05, Leases (Topic 842), Lessors—Certain Leases with Variable Lease Payments for statutory accounting.

Summary:
On December 11, the Working Group exposed revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject 2021-06, Presentation of Financial Statements (Topic 205), Financial Services—Depository and Lending (Topic 942), and Financial Services—Investment Companies (Topic 946), Amendments to SEC Paragraphs Pursuant to SEC Final Rule Releases No. 33-10786, Amendments to Financial Disclosures about Acquired and Disposed Businesses, and No. 33-10835, Update of Statistical Disclosures for Bank and Savings and Loan Registrants as not applicable to statutory accounting. The amendments in ASU 2021-06 are only applicable for SEC reporting and thus are not relevant for statutory accounting purposes.

Interested Parties’ Comments:
Interested parties have no comment on this item.
Recommended Action:
NAIC staff recommends that the Working Group adopt the SAP clarification revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2021-06 as not applicable to statutory accounting.

REVIEW of COMMENTS on EXPOSED ITEMS – EXPECTING MINIMAL DISCUSSION

The following items received comments during the exposure period that are open for discussion.

1. Ref #2021-23: SSAP No. 43R – Financial Modeling – Updated Guidance
2. Ref #2021-26EP: Editorial Updates (Substantive vs. Nonsubstantive)
3. Ref #2021-27: ASU 2021-04, Issuer’s Accounting for Certain Modifications

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<td>8 - Agenda Item</td>
<td>In Agreement (minor edit proposed)</td>
<td>IP – 12</td>
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Summary:
On Oct. 20, 2021, the Valuation of Securities (E) Task Force (VOSTF) adopted updated financial modeling guidance for residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS), to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual). In response, on December 11, the Working Group exposed two alternatives of SAP clarifications to the summarized financial modeling guidance reflected in SSAP No. 43R—Loan-backed and Structured Securities.

Option #1 proposed to retain summarized financial modeling guidance in SSAP No. 43R, which is proposed to be updated for this and any subsequent modeling modifications when subsequently adopted by the VOSTF.

Option #2 proposed to remove the financial modeling guidance from SSAP No. 43R and refer users to the P&P manual – the source governing document for the financial modeling and related designation process.

Recognizing that both options have varying advantages and disadvantages, the Working Group elected to expose both alternatives for consideration.

Interested Parties’ Comments:
Interested parties support option one as presented in the exposure. While there are advantages and disadvantages to each option, option 1 provides meaningful holistic view of how these securities are treated in one spot, and without reference to the P&P manual, which we believe will be useful for financial and annual statement preparers. Interested parties note the following grammatical error in paragraph 27 a – third sentence (tracked changed suggestion):

“For a modeled non-legacy security, meaning one which closed after December 31, 2012, the NAIC designation and NAIC designation category assigned by the NAIC Securities Valuation Office must be used.”

Recommended Action:
NAIC staff recognize that both options presented have varying advantages and disadvantages, and with the comments from interested parties, have no concern with proceeding with Option 1 and the continued
approach to reflect the summarized guidance in SSAP No. 43R. Accordingly, NAIC staff recommend the Working Group adopt the exposed SAP clarifications, as illustrated below, (to include the minor grammatical correction proposed by interested parties) to SSAP No. 43R—Loan-backed and Structured Securities.

**Designation Guidance**

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

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

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

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

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

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

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<td>9 - Agenda Item</td>
<td>Comments Received</td>
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**Summary:**
In response to a Aug. 14 referral from the Financial Condition (E) Committee, on December 11, the Working Group exposed SAP clarifying edits to 1) the Preamble, 2) Volume I and II’s Table of Contents (How to use the Manual) and the Summary of Changes, and 3) Appendix F regarding the terminology references of “substantive” and “nonsubstantive,” which have historically been used to describe statutory accounting revisions being considered by the Working Group to the AP&P Manual. This agenda item is the second of two agenda items related to the term and phraseology changes of substantive and nonsubstantive. The agenda item, 2021-14: SAP Terminology, which was adopted by the Working Group in Dec. 2021, addressed terminology/phraseology changes in the NAIC Policy Statement on Maintenance of Statutory Accounting Principles (Appendix F). This current editorial agenda item 2021-26EP identifies all remaining uses of the terms in the AP&P manual for change consideration.

NAIC staff note that this current editorial agenda item did not amend the terms or phraseology used in previous adopted SSAPs, issue papers, or other historical documents. Accordingly, the new use of the terms/phrases “new SSAP” or “new SAP concept” (for items previously referred to as substantive revisions) and “SAP clarifications” (for items previously referred to as nonsubstantive revisions) will be used on a going forward basis for all items discussed or issued after Jan. 1, 2022.

**Interested Parties’ Comments:**
Interested parties agree that the distinction between substantive (proposed to change to “development of new SSAPs or New SAP Concepts in an Existing SSAPs”) and non-substantive (proposed to change to “Development of SAP Clarifications”) can be confusing and that there would be more clarity in the development process if the distinction were eliminated.

Instead, we recommend that all new standards be handled similarly but that the effective date for each new standard be determined by evaluating the complexity of implementation (e.g., the extent that systems or process changes are required) and the availability of data to insurers to implement the new standard. This determination would be made as guidance is completed and with feedback from industry as to the time needed to adopt proposed reporting and/or disclosure.

**Recommended Action:**
NAIC staff recommends that the Working Group adopt the exposed editorial revisions to 1) the Preamble, 2) Volume I and II’s Table of Contents (How to use the Manual) and the Summary of Changes, and 3) Appendix F. This action completes the implementation of the Working Group’s adoption SAP clarifications detailed in agenda item, 2021-14: SAP Terminology.

The combination of the prior agenda item and this editorial item and meets the intent of the Financial Condition (E) Committee referral to clarify the terms “substantive” and “nonsubstantive” to prevent future misrepresentations or assessment by others. That referral specifically noted that the Committee was not proposing that the Working Group...
reassess the classification criteria, and the suggestion from the interested parties’ comment letter goes beyond Committee’s requested intent. (For clarification purposes, the revisions to the Policy Statement reflecting this new terminology was adopted by the Working Group during the Fall National Meeting. This current agenda item only enacts editorial updates to reflect the previously adopted terminology changes. If these editorial revisions are not adopted, there would be a disconnect between the Policy Statement and the terminology reflected in other Manual sections.)

Although it is recommended that the Working Group proceed with adopting the revised terms consistent with the Financial Condition (E) Committee referral, if industry continues to support consideration of a revised process, an alternative approach could be sponsored in a separate agenda item. NAIC staff recognizes that under the current approach nonsubstantive revisions are generally effective upon adoption, but the current process permits the Working Group to establish effective dates that factor in various assessments. The Working Group often considers industry comments when determining an effective date, even if the change is considered a SAP clarification (previously referred to as a nonsubstantive change).

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<td>10 - Agenda Item</td>
<td>No Comments (minor proposed modification)</td>
<td>IP – 16</td>
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**Summary:**
On December 11, the Working Group exposed revisions to SSAP No. 72—Surplus and Quasi-Reorganizations to reject Accounting Standard Update (ASU) 2021-04, Earnings Per Share (Topic 260), Debt—Modifications and Extinguishments (Subtopic 470-50), Compensation—Stock Compensation (Topic 718), and Derivatives and Hedging—Contracts in Entity’s Own Equity (Subtopic 815-40)—Issuer’s Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options for statutory accounting. ASU 2021-04 directs that if the modification/exchange of a share-based payment is related to a debt instrument or line-of-credit, the differences in fair value before and after the modification may be capitalized in accordance with U.S. GAAP debt issuance guidance – a concept disallowed per SSAP No. 15—Debt and Holding Company Obligations.

However, ASU 2021-04 also directs that when a freestanding equity-classified written call option is modified, or exchanged, and the instrument remains classified as equity after the modification/exchange, the differences in fair value before and after the modification is to be accounted for as an adjustment to equity. While the agenda item proposes to reject ASU 2021-04, it did propose to incorporate certain guidance regarding accounting for the changes in fair value in exchanges of free-standing equity-classified written call options into SSAP No. 72.

**Interested Parties’ Comments:**
Interested parties have no comment on the approach taken in the exposed revisions but recommend that the revisions be expanded to provide more detail to clarify what guidance from GAAP is adopted and what is not (similar to the description generally provided in an SSAP).

**Recommended Action:**
NAIC staff recommends that the Working Group adopt the exposed SAP clarifications to SSAP No. 72—Surplus and Quasi-Reorganizations to reject ASU 2021-04 for statutory accounting while incorporating guidance that modifications of terms, conditions or exchanges of free-standing equity-classified written call options shall be treated as an exchange. Additionally, NAIC staff have added additional language, as was
suggested by the interested parties, to clarify what guidance is being adopted from this ASU (highlighted in gray below).

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

**REVIEW of COMMENTS on EXPOSED ITEMS**

The following items received comments during the exposure period that are open for discussion.

1. Ref #2019-21: SSAP No. 43R - Proposed Bond Definition (Reporting Options)
2. Ref #2021-20: Effective Derivatives – ASU 2017-12
3. Ref #2021-21: Related Party Reporting
4. Ref #2021-22: Schedule D-6-1, Supplemental Reporting
5. Ref #2021-25: Leasehold Improvements After Lease Termination

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<td>11 - Agenda Item</td>
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<td>SSAP No. 26R &amp; 43R (Julie)</td>
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**Summary:**
During the 2021 Fall National Meeting, the Working Group exposed two elements related to the principles-based bond definition.

1. Definition and Issue Paper - The first item pertained to the change of terminology from a “sufficient credit enhancement” to a “substantive credit enhancement.” As detailed in the interested parties’ comment letter, the interested parties were supportive of those refinements. On March 2, 2022, the Working Group exposed an updated version of the principles-based bond proposal and a draft issue paper in which the change in terminology was reflected and discussed. **The comment deadline for those exposed documents is May 6, 2022.**

2. Reporting - The second item exposed during the Fall National Meeting was a discussion document on reporting options. As detailed within that exposure, NAIC staff anticipates significant reporting changes to provide more granularity of investments on Schedule D-1: Long-Term Bonds as a result of the bond project. Potential changes were exposed with a request for comments. The 2022 Spring National Meeting hearing will receive the comments from interested parties in response to this reporting options exposure.
Interested Parties’ Comments:
Interested parties also offer the following comments on the various possible reporting options for Schedule D-1.

1. Reporting Lines:
   With the principles-based bond definition, it is recommended that more granular reporting lines be established to capture investments in scope of SSAP No. 26R and SSAP No. 43R. From preliminary assessments, the current general categories are not used for analytical assessments / reports except for U.S. Govt – Full Faith and Credit. As such, this document proposes to replace the current general categories with the inclusion of more useful reporting lines based on the type of investment.

   Exposure Request Detail provided on pages 2-5:
   1. Information is requested on the potential removal of the general categories and whether the elimination would impact any tools or analyses currently performed.
      - Interested parties have no concerns currently with the proposed removal of the general categories.
   2. Information is requested on the proposed reporting lines and whether additional categories would be beneficial. (Note – The proposal suggests dedicated reporting lines for certain securities that are now identified by codes. Comments on this approach are requested.)
      - Interested parties note that one of the challenges with the current Schedule D reporting categories and/or columns is ambiguity which leads to inconsistent reporting among companies. Interested parties recommends working together to ensure the instructions are clear and unambiguous to help prevent this problem with the new reporting schedules. This will benefit both companies and regulators.
      - Interested parties would like a better understanding of the unaffiliated/affiliated split of certain rows in the proposal; for example, are the rows not labelled with ‘Affiliated’ implied to be ‘Unaffiliated’? Or are the affiliated rows a subset of the former? Have you considered an alternative such as removing the lines identifying ‘Affiliated’ investments and utilizing a column to identify them instead? Blanks interested parties are suggesting that an Affiliated or Related Party indicator be utilized in a column for the investment schedules in the Blanks exposure 2021-22BWG (Related Party Reporting).
      - Since investments in GNMA are RBC exempt, we recommend that additional lines be added to the ABS section to accommodate these for ease of identification (e.g., US Government Residential Mortgage-Backed Securities; US Government Commercial Mortgage-Backed Securities).
      - Consider adding a new category in Issuer Credit Obligation for investments in Surplus Notes/Surplus Debentures which are currently reported on Schedule BA.

2. New Sub-Schedule D-1:
   The bond project is currently proposing a new sub-schedule that details bond investments that have certain characteristics (e.g., ABS backed by financial assets that are not self-liquidating and ABS backed by cash-generating non-financial assets not captured within the practical expedient.)

   Exposure Request:
   1. Information is requested on how investments shall be categorized on this schedule.
• Interested parties believe that the proposed ‘sub-schedule’ for Schedule D – Part 1 could be confusing, and the proposed data could be readily incorporated into electronic-only columns for the respective categories in the ‘Other Asset-Backed Securities’ section.

• Clear instructions for each category under Other ABS will be extremely beneficial.

2. Information is requested on additional information / columns desired for these structures. Initial ideas that have been proposed include:
   a. Balloon payment as % of principal at acquisition
   b. Current loan-to-value
   c. PIK – Information on whether payment of interest is deferrable
   d. Amount of PIK interest to date
   e. Expected payoff date determined at acquisition
   f. Expected payoff date as of the financial statement date.

• Currently, interested parties would support the proposed data elements for the ‘Other Asset-Backed Securities’ categories being reported in columns instead of in a ‘sub-schedule.’ As changes to SSAP No. 26R and SSAP No. 43R are finalized for this project and further evaluation of these investments is done, modifications to the list may be warranted.

• Interested Parties note that some of this data (e.g., Expected payoff date determined at acquisition) may not be readily available upon transition because it assumes a forward-looking analysis at a point in time that has already occurred (potentially decades in the past). Would a practical expedient be needed upon adoption to populate these types of fields?

3. Schedule D-1 Information:

As noted, with the change in reporting lines, it has been proposed a review of the columns and instructions also be considered. The following code columns have been potentially identified.

• Column 3 – Code Column
• Column 5 – Bond Characteristics
• Column 26 – Collateral Type
• Column 34 – Capital Structure Code

Exposure Request – Detail provided on page 6:

1. Information is requested on whether other columns / reporting instructions should be clarified as part of the bond proposal project.

• Interested parties are requesting additional time to address possible changes to the definitions of the columns indicated in the proposal. As rows are being changed, it could have a direct impact on what might be included in the columns as to minimize data redundancy.

2. Comments are welcome on the additional investment elements should be captured and/or whether certain elements are no longer beneficial to be captured. Potential elements related to asset-backed securities include:
   a. Market Validation – This will be a code to identify situations where none of the issuance is owned by unrelated parties.

• Currently, interested parties don’t have an issue with adding this field and we believe the answer could be either yes or no.
However, interested parties are not sure if the intent is to have the same meaning as the following – *This will be a code to identify situations where all of the issuance is owned by related parties.* If so, interested parties recommends removing the double negatives to be less confusing. If not, interested parties may not fully appreciate what is trying to be captured.

b. Participation in residual tranche (Y/N)

Interested parties aren’t sure how to respond to this question. Should the insurer respond Yes if it currently owns a residual tranche of the same securitization (e.g., residual issued from the same vehicle that issued the bond it invested in) or if they have ever owned a participation in the residual tranche?

**Recommended Action:**
NAIC staff greatly appreciates the initial feedback from industry with regards to the reporting options discussion document. For this 2022 Spring National Meeting, it is recommended that the Working Group direct NAIC Staff to proceed with developing a more robust illustration of the proposed reporting proposal with a goal to expose at the Working Group’s May conference call. In developing the document for exposure, NAIC staff should continue to work with interested parties, particularly in developing category descriptions and in understanding the provided comments.

NAIC staff highlights that certain aspects from the interested parties’ comments may not be initially supported by regulators. As such, unless the Working Group was to direct otherwise, NAIC staff recommends proceeding with drafting an exposure document that reflects the following. Subsequent consideration can continue to occur if a different approach should be considered.

1. **Surplus Notes** – Surplus notes are reported on dedicated reporting lines on Schedule BA and can be reported with or without a CRP rating. (The NAIC SVO does not review and provide NAIC designations on Surplus Notes.) The measurement method for a surplus note is determined from **SSAP No. 41R — Surplus Notes** and is impacted based on whether surplus note is rated by a CRP with an equivalent NAIC 1 or 2 designation. As detailed in SSAP No. 41R, surplus notes have characteristics of debt and equity, and payments from insurers on issued surplus notes are under the strict control of the issuer’s domiciliary commissioner. Surplus notes are required to be subordinate to policyholders, claimant and beneficiary claims, and all other classes of creditors other than other surplus note holders. Payment of interest and principal on surplus notes can only occur with approval by the issuing insurer’s domiciliary state commissioner. Due to the specific nature of surplus notes, the reporting on Schedule BA was a deliberate decision and goes back prior to the Codification of statutory accounting principles. (For example, in the original *Issue Paper No. 41—Surplus Notes*, adopted in 1998, there is reference to prior guidance that indicates surplus notes being captured on Schedule BA as an other invested asset.) In addition to moving an asset that is akin to an equity item, as there is no assurance that interest or principal payments would occur, if moved to Schedule D-1, it would seemingly require all surplus notes to obtain CRP designations to determine measurement and applicable RBC charges. As such, NAIC staff does not recommend proposing edits as part of the bond proposal project to move surplus notes to Schedule D-1.

2. **Sub-Schedule D-1** – Based on initial discussion with regulators involved in the bond proposal project, and the intent to separately identify specific ABS that qualify as bonds (namely, those backed by financial assets that do not self-liquidate (e.g., equity backed) and those that have exceed the practical expedient for determining meaningful cash flows), NAIC staff recommends proceeding with developing guidance for a sub-schedule D-1. NAIC staff believes that the presentation of the schedules will help address potential confusion from the theoretical concept. NAIC staff highlights that expanding the electronic-only columns to identify key characteristics of
these investments would not provide the transparency that is desired for these investments as part of the bond project.

3. Affiliate Reporting Lines – The definition of an affiliate is captured in the Model, SSAP No. 25 and SSAP No. 97. Although the definition is consistently referenced, it seems that there is inconsistency in practice and differing interpretations on the reporting of investments with entities that qualify as affiliates, and whether these investments shall always be captured within the affiliated reporting line. Pursuant to comments from interested parties, actual credit exposure should be present to report an investment on the affiliate reporting line. However, the regulator viewpoint is that all affiliated transactions shall be reported to the regulator pursuant to SSAP No. 25 and the Insurance Holding Company System Model #440 and its related Regulation 450 with Reporting Forms and Instructions (#450), (which includes Form D filings). By reporting all investments acquired from affiliates on the affiliated reporting line, the regulator has necessary information regarding these investments and the affiliate interactions.

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**Summary:**
During the 2021 Fall National Meeting, the Working Group exposed an agenda item that summarized key changes detailed in Accounting Standard Update (ASU) 2017-12: Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities to reduce complexity and align hedge accounting with risk management activities. In addition to summarizing key U.S. GAAP changes, the agenda item identified various elements to consider as a result of the different accounting approaches between U.S. GAAP and SAP. Despite these variations, the agenda item noted that the determination of an effective hedge should be consistent between U.S. GAAP and SAP. With the exposure of the agenda item, NAIC staff was directed to work with industry and regulators in assessing and developing revisions to facilitate effective hedge assessments between SAP and U.S. GAAP. This agenda item noted that the revisions will likely result in changes from the original intent of SSAP No. 86, therefore would be considered a change in SAP concepts and should be accompanied by the development of an issue paper.

Since the exposure of the agenda item, NAIC staff has met twice with key industry reps focusing on derivatives. These meetings have focused on education of excluded components pertaining to foreign currency hedge transactions, focusing on forward spot rates and cross-currency basis spreads. These meetings have provided detail on the reporting differences between U.S. GAAP and SAP, and the impact of reporting the excluded component at fair value under SAP, even though the derivative transaction qualifies as an effective hedge.

**Interested Parties’ Comments:**
ASU 2017-12 provided targeted improvements to the existing GAAP hedge accounting framework that helps reduce some of the cost and complexity of applying hedge accounting and allows for additional hedging strategies that better align with an entity's risk management practices. Substantive changes that weren’t initially adopted in SSAP No. 86 are addressing cross-currency basis spread as an excluded component, partial-term hedging for fair value hedges, ability to use the benchmark interest rate component of contractual cash flows to calculate the change in fair value of the hedged item in fair value hedges, last-of-layer/portfolio layer method for fair value hedges, and hedges of interest rate risk when the hedged item can be settled before scheduled maturity. Additionally, we are proposing clarifications to existing SSAP No. 86 for the accounting of forward points as an excluded component for currency forwards. Please refer to the attached appendix for proposed mark-ups to SSAP86 for these changes.
Summary of changes proposed to SSAP No. 86:

1. **Clarifications for the accounting of forward points as an excluded component for FX forwards** – Currently there is implicit inconsistency between paragraph 40 and Exhibit C for forward points as excluded components; this results in accounting that doesn’t align with companies’ risk management strategies. Application of the guidance in Paragraph 40 for a FX forward in an effective hedge relationship with an excluded component results in an impact to Surplus that is the same as if hedge accounting had not been applied. We propose resolving this matter by explicitly allowing the guidance in Exhibit C to be applied regardless of whether a component of the derivative is excluded from the assessment of effectiveness. When forward points are an excluded component from the assessment of hedge effectiveness, the forward points would be amortized into income. This would allow for the execution of FX forward effective hedge relationships, which interested parties would consider sound risk management strategies, to receive an accounting treatment that is more favorable relative to hedge accounting not being applied.

2. **Adding cross-currency basis spread as an excluded component** – We propose adding cross-currency basis spread as an excluded component. Doing so better aligns hedge accounting with companies’ risk management strategies, aligns the accounting for FX swaps where the cross-currency basis spread is an excluded component with the proposed accounting for FX forwards where forward points are an excluded component, and brings consistency between U.S. GAAP and Statutory accounting. Changes in the fair value of cross-currency basis spread have historically resulted in a less effective hedge or ineffective hedge because there is no corresponding offset in the hedged item. Excluding the cross-currency basis spread from the assessment of hedge effectiveness is beneficial for fair value hedges of foreign-denominated assets and liabilities. When the value of the cross-currency basis spread is excluded from the assessment of effectiveness, based on proposed changes to Paragraph 40 and Exhibit C, the excluded component would be held at amortized cost. With FX forwards, forward points as excluded components need to be amortized to be recognized in income. For FX swaps, the value of the cross-currency basis spread is embedded in the coupon payments of the swap, so the value is recorded in income each period through the typical swap accrual process.

3. **Adding ability to designate partial-term for fair value hedges** – We propose adding partial-term hedging for fair value hedges because it better aligns hedge accounting with companies’ risk management strategies for managing interest rate risk and brings consistency between U.S. GAAP and Statutory accounting. Currently SSAP No. 86 requires that the full contractual cash flows of the entire hedged item must be used to calculate the change in the hedged item’s fair value attributed to the benchmark interest rate. With partial term an entity may designate only certain consecutive interest payments of a financial instrument as the hedged item and assume that the principal payment occurs at the end of the hedge term. Partial-term hedging allows entities to calculate the change in the fair value of the hedged item using an assumed term that begins when the first hedged cash flow begins to accrue and ends when the last hedged cash flow is due and payable. When using full contractual cash flows to calculate the change in the hedged item's fair value attributed to changes in the benchmark rate, it can be difficult to achieve a highly effective hedge because the hedging instrument and the hedged item would react differently to changes in interest rates since the principal repayment occurs on different dates.

4. **Adding alternative to use the benchmark interest rate component of contractual cash flows to calculate the change in the fair value of the hedged item in fair value hedges** – We propose adding an alternative to use the benchmark interest rate component of contractual cash flows to calculate the change in the fair value of the hedged item in fair value hedges because it better aligns hedge accounting with companies’ risk management strategies for managing interest rate risk and brings consistency between U.S. GAAP and statutory accounting. Currently SSAP No. 86 requires that the full contractual cash flows of the entire hedged item be used to calculate the change in the hedged item’s fair value attributed to the benchmark interest rate. Calculating the change in fair value using only the benchmark rate component
instead of the entire coupon may better reflect how an entity manages interest rate risk. In addition, it will provide a greater degree of offset between the changes in the fair values of the hedging instrument and the hedged item. Generally, the benchmark rate being hedged and the fixed rate on the hedging swap will match if the swap is “at-market” and executed at the inception of the hedging relationship.

5. **Adding last-of-layer/portfolio layer method for fair value hedges** — We propose adding last-of-layer/portfolio layer method for fair value hedges because it better aligns hedge accounting with companies’ risk management strategies for managing interest rate risk and brings consistency between U.S. GAAP and statutory accounting. Last-of-layer allows entities to designate as the hedged item the last dollar amount of a closed portfolio of prepayable financial assets, or one or more beneficial interests in a portfolio of prepayable financial instruments. When using this approach, it is assumed that as prepayments occur, they are first applied to the portion of the closed portfolio that are not part of the designated layer. At inception and on each assessment date, the entity would need to determine that the designated layer is expected to be outstanding until the end of the hedge. This approach simplifies the rigid nature of the similar asset test required for portfolio hedging for fair value hedges by allowing the ability to assess qualitatively instead of quantitatively by combining the partial-term fair value hedge election and the election to measure changes in the hedged item by using the benchmark rate component of the contractual coupon cash flows. This makes achieving hedge accounting for a portfolio of prepayable fixed rate assets easier. The similar asset test requirement for portfolio hedges often makes it difficult, if not impossible, for a group of disparate fixed-rate assets to qualify to be hedged on a portfolio basis. The FASB currently has tentative conclusions for updates to last-of-layer method, so we will need a scope limitation to maintain consistency with GAAP. For example, last-of-layer would only be applicable to closed portfolios of assets, and companies would be prohibited from designating closed portfolios of liabilities.

6. **Adding hedges of interest rate risk when the hedged item can be settled before scheduled maturity** — We propose adding the ability to elect to only consider how changes in the benchmark rate affects the decision to prepay the instrument when it assesses hedge effectiveness and measures the change in the hedged item’s value attributable to the hedged risk because it better aligns hedge accounting with companies’ risk management strategies and brings consistency between U.S. GAAP and statutory accounting. If an entity makes this election, it does not consider how other factors (e.g. credit risk) might affect the decision to prepay the financial instrument.

**Recommended Action:**

NAIC staff greatly appreciates the efforts of industry to provide details and walk-throughs of derivative transactions. Although industry provided proposed edits to SSAP No. 86 as part of their comment letter, after a review of SSAP No. 86, NAIC staff believes more-robust edits are warranted. This is predominantly due to existing guidance in Exhibit A and Exhibit B of SSAP No. 86 reflecting outdated, non-authoritative U.S. GAAP guidance. When FAS 133 was initially issued, it was accompanied by statements from the “Derivative Implementation Group” (DIGs). These DIGs were by FASB staff but were not official positions of the FASB. Since the issuance of FAS 133 (and the DIGs), the FASB adopted the Accounting Standards Codification (ASC), and it is considered the authoritative source of U.S. GAAP guidance. With the ASC development, the FASB incorporated FAS 133 – as well as various DIGs – as authoritative guidance. The ASC has been modified since original development (2009) through the issuance of ASUs, including ASU 2017-12. With the focus on this agenda item, particularly the intent to ensure consistency in hedge effectiveness determination between U.S. GAAP and SAP, NAIC staff recommends that SSAP No. 86 Exhibit A and Exhibit B be completely revised, and that there be additional revisions to SSAP No. 86 to clarify the accounting and reporting guidance of excluded components. (Ultimately, NAIC staff believes that if incorporating only limited edits that do not reflect the U.S. GAAP guidance, there will be questions and potential subsequent confusion on whether the guidance was intended to converge with U.S. GAAP as it pertains to hedge effectiveness.)
For this National Meeting, NAIC staff recommends the exposure of two documents, which are intended to reflect aspects of a future issue paper as follows:

1. **Assessment of Hedging Effectiveness**: This document proposes a new Exhibit A (which will replace both Exhibit A and Exhibit B of SSAP No. 86) that details the current U.S. GAAP guidance in determining hedge effectiveness (Attachment 12.1). As detailed within the document, although there are several elements from the ASC that are proposed to be pulled into the SSAP exhibit, this document proposes adoption with modification of the overall U.S. GAAP guidance for determining hedge effectiveness even though not all paragraphs are proposed to be captured within the SSAP No. 86 Exhibit A. This adoption is modified as it excludes the U.S. GAAP guidance for the accounting and reporting of the hedging instruments, including the excluded components of those instruments. This exclusion is required as statutory accounting has specific accounting and reporting guidance for hedging instruments that differs from U.S. GAAP.

2. **Measurement of Excluded Components**: This document proposes revised guidance in SSAP No. 86 to detail the measurement method required for the different types of excluded components (Attachment 12.2). As identified by industry, there are current inconsistencies in SSAP No. 86 for excluded components and these edits would eliminate those issues. NAIC staff believes that the proposed accounting and reporting within this document is consistent with the overall recommendations from industry for excluded components pertaining to foreign currency forward points as well as a cross-currency spread basis. However, although the overall measurement treatment from industry is reflected, the proposed edits in this document are more robust than what industry proposed. This is because the proposed revisions will address non-foreign currency excluded components and expands investment schedule reporting and disclosures.

NAIC staff recognizes that these two documents only focus on limited elements from the ASU 2017-12 (excluded components), and requests that the Working Group continue to direct NAIC staff to work with industry on other elements (such as partial term hedging and the last-of-layer (portfolio) method) in the interim. NAIC staff acknowledges that industry has proposed edits to SSAP No. 86 for those elements as well, but NAIC staff would like additional time to evaluate those items in accordance with the statutory accounting reporting of derivatives before recommending exposure of the industry-proposed edits for those topics to SSAP No. 86.

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**Summary:**
On December 11, the Working Group exposed SAP clarification revisions to SSAP No. 25—Affiliates and Other Related Parties and SSAP No. 43R—Loan-backed and Structured Securities to clarify related party / affiliate guidance as well as new reporting disclosures for investments acquired from a related party, regardless of whether the investment is captured on an “affiliate” reporting line. The agenda item had two broad goals which included:

1. Clarifying the reporting of affiliate transactions within existing reporting lines in the investment schedules. This clarification intends to be consistent with the definition of an “affiliate” pursuant to the Insurance Holding Company System Regulatory Act (Model #440), SSAP No. 25—Affiliates and Other Related Parties and SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities.
2. To incorporate new reporting requirements for investment transactions with related parties. Pursuant to recent discussions, regulators desire additional information on investment transactions involving related parties, regardless of whether the related party is “affiliated” pursuant to Model #440. To preserve the affiliate definition and reporting categories, these additional proposed reporting elements will be captured outside of the current affiliate reporting requirements.

The agenda item proposed that the identification of such items would occur through a reporting code in the year-end investment schedules and would apply in a variety of circumstances, which include:

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

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

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

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

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

Interested Parties’ Comments:
The Related Party Exposure has the following two main goals:

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

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

To accomplish these goals, the Related Party Exposure proposes to make changes to SSAP No 25 - Affiliates and Other Related Parties and SSAP No. 43R - Loan-backed and Structured Securities. We understand that one of the goals of the proposal is to identify investments that are originated, managed, sponsored or serviced (referred to as managed by affiliates for the remainder of this letter) by an affiliate or related party of the insurer. Interested parties agree that this information can be useful for the regulators, but we believe that it is critical to differentiate investments where there is direct credit exposure to an affiliate from those investments that are only managed by affiliates with no underlying credit exposure to the affiliate or related parties of the insurer. The affiliate reporting distinction is very important for a number of reasons, including but not limited to the following:
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a. **Rating Agencies** – Interested parties understand that the rating agencies may apply a higher risk factor to affiliated assets as there is a presumption that anything reported as affiliated has credit risk exposure to an SCA of the insurer.

b. **NAIC Designations** – Affiliated debt investments where there is credit exposure to an SCA of the insurer have to be filed with the SVO to obtain an NAIC designation. Affiliated equity investments in SCAs reported on Schedule D also require filing to confirm their reporting value on Schedule D. Debt investments in CLOs/CDOs that are managed by affiliates but that do not have any credit exposure to an affiliate are filing exempt because they are not deemed affiliated.

Our comments to the proposed changes to SSAP No. 25 and SSAP No. 43 are provided below:

1. **Removal of references to U.S. GAAP guidance from SSAP No. 25** - Interested parties agree with removing the U.S. GAAP reference to FASB Interpretation No. 35 as we agree that the statutory guidance uses a different threshold than US GAAP to determine if significant influence exists over an investee. In addition, the SSAP No. 25 guidance already includes a number of scenarios to rebut the presumption of control, which are similar to the examples provided in the GAAP guidance.

2. **The Working Group’s Proposed changes to SSAP No. 25 to add the following new paragraph:**

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

We understand from conversations with staff that this paragraph is meant to clarify the guidance in paragraph 7 of SSAP No. 25 and paragraph 6 of SSAP No. 97 - Investments in Subsidiary, Controlled and Affiliated Entities. That guidance requires that investments in limited partnerships and other similar entities (i.e. investment funds) that are managed by a general partner that is affiliated to the insurer and where the insurer owns more than 10% of the investment fund’s equity be reported as affiliated investments.

Interested parties understand that the current SSAP No. 25 and SSAP No. 97 guidance already require equity investments in limited partnerships and similar entities to be reported as affiliated if the insurer owns more than 10% of the equity of the limited partnership and the insurer is affiliated to the general partner or managing member for limited liability company structures. One thing to note is that even if the insurer is affiliated to the general partner, the insurer would usually not have any credit exposure to its affiliates in these structures as the underlying assets of the investment fund are usually held with unrelated parties. For this reason, interested parties note that there is a diversity in practice in the reporting of these investment funds on Schedule BA, with some insurers reporting these investments in the affiliated section of Schedule BA and others reporting these investments as unaffiliated. If the intent is to report these types of equity investments as affiliated when the presumption of control cannot be overcome, this will require some reporting changes by some insurers.

In regard to debt investments in investment funds or securitization vehicles managed by the insurer affiliates or related parties as well as mortgage loans managed by affiliates, we note that most insurers currently
report those investments as unaffiliated on Schedule D, Schedule BA and Schedule B if there is no underlying credit exposure to affiliates of the insurer. Interested parties would like to highlight again that just because the insurer is affiliated with the manager or servicer of an investment vehicle such as a securitization, if the underlying assets in the structure do not have affiliated credit exposure, the investment itself should not be reported as affiliated as that would not be accurate reporting. See further comments on the SSAP No. 43R proposed changes in item No. 4 below.

The new proposed paragraph also includes a look-through requirement of these investment funds to identify instances where the investment fund owns more than 10% of the common stock of its underlying investees. Interested parties have concerns with this look-through review. Doing a look-through of the underlying investments of investment funds managed by affiliates of the insurer could potentially create a very significant operational burden that may have little or no benefit. The reason why there is potentially little benefit to this is because if these investment funds have purchased an equity investment that represents more than 10% but less than 50% of the voting stock of one of their investees, this would almost never give control to the investment fund. For most entities capitalized with common stock (i.e. voting entities), the parties that control are the ones that own more than 50% of the voting shares. If the Working Group feels that this look-through is necessary, interested parties will need time to get this process implemented. Interested parties believe that the earliest this look-through requirement can be implemented is for year-end 2023 as time will be needed to set up a process with all affiliated funds so that the funds provide a listing of underlying equity investments in other entities along with the percentage ownership. In addition, we suggest some wording changes, as shown below in the underlined text to the new paragraph, to link the new paragraph back to the examples in paragraph 7 to incorporate the examples of when the presumption of control can be overcome:

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

Interested parties also ask for clarification regarding what the implications are of identifying an underlying investee of an investment fund as an affiliate. We believe that any other transactions carried out with the indirect affiliate need to be disclosed in the related party footnote, but we are unclear as to the impacts to Schedule Y and any other reporting schedules. The unit of account in this case would be the direct investment in the affiliated investment fund, not the underlying investments of the investment fund. It is not clear to us whether the indirect affiliates would also need to be reported on Schedule Y and/or any other reporting schedules.

3. **Proposed changes under paragraph 6 (a) of SSAP No. 43R regarding insurers’ investments in securitization vehicles where the underlying assets of the securitization predominantly relate to assets with credit exposure to affiliates/related parties of the insurer** – Interested parties agree that when the insurer has credit exposure to its SCAs, even if there are intermediaries as part of the transaction, such investment should be reported as affiliated in the investment schedules.
4. **Proposed changes to SSAP No. 43R to clarify that investments managed by affiliates are viewed as affiliated even if the underlying assets in the structure do not have any credit exposure to an affiliate** - Many insurers own asset management subsidiaries which manage securitization transactions. There is no question that the asset manager itself is an SCA of the insurer and such asset managers are reported on Schedule Y as affiliates of the insurer. However, when any debt tranches purchased from those securitization vehicles do not have any credit exposure to SCAs of the insurer, the debt tranches are not reported in the affiliated section of Schedule D even if the securitization vehicle is managed by an affiliate.

It is very important to interested parties that this distinction is understood for Schedule D bond investments. Schedule D bond investments should not be reported as affiliated if they do not have credit exposure to SCAs of the insurer.

We understand from conversations with NAIC staff that this clarification is not intended to change the reporting lines in which investments are currently reported. The expectation is that these investments will now have a new code that will identify these investments as being managed by a related party of the insurer but have no credit exposures to related parties.

Interested parties agree with adding new codes to differentiate investments that are simply managed by a related party (including SCAs) from those that in fact have credit exposure to a related party (including SCAs) of the insurer. See further comments to the proposed codes in item 5 below.

5. **Proposed annual statement changes to add a new electronic-only column to the investment schedules to identify investments involving related parties** – Interested Parties have no objection to the proposed new codes to specify the type of relationship with the manager/sponsor/servicer of an investment vehicle. However, we offer the following comments to provide better clarity as to the applicability of the codes:

a. Most if not all of an insurer’s general account investments are managed by an affiliated asset manager. The affiliated asset manager makes decisions as to when to buy and sell a specific investment, including reviewing the investment for potential credit losses. We do not believe that it is the intent of the proposal to flag all investments as affiliated only because an affiliated asset manager makes investment decisions over the investment. Insurers already report their relationship with affiliated asset managers in the related party footnote. We believe that the intent of this proposal is to identify investment vehicles that are managed by related parties (including SCAs) as well as investments with direct exposure to related parties (including SCAs) of the insurer. To that end, we believe the codes would predominantly apply to the following types of investments:

i. CLOs/CDOs or special purpose entities set up to create a securitization vehicle that are managed by related parties (including SCAs) of the insurer.

ii. Mutual funds/ETFs and other similar funds where the asset manager is a related party of the insurers (including SCAs of the insurer).

iii. Limited partnerships, limited liability companies or trusts set up as investment vehicles where the general partner or managing member is a related party of the insurer (including SCAs of the insurer).

iv. Debt and equity investments in affiliates where there is direct credit risk exposure to a related party (including SCAs of the insurer).

b. Codes 2, 3 and 4 of the Related Party Exposure refer to “securitizations and other similar investments” which may imply to some that the codes only apply to Schedule D assets since Schedule D is where debt investments in securitizations are reported. If the codes are expected to apply to all investment vehicles, perhaps the wording can be made clearer by saying “securitizations...”
and other investment vehicles such as mutual funds, limited partnerships and limited liability companies.”

**Recommended Action:**

NAIC staff appreciate the thorough comments received from the interested parties. For the Spring National Meeting, it is recommended that the Working Group expose the agenda item with the suggested revisions that were provided by interested parties. NAIC staff agree that these are minor overall and add value to the proposed guidance. Below are the proposed revisions that were suggested by interested parties, highlighted in grey below.

**SSAP No. 25, new paragraph 9:**

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

**Annual Statement Reporting Changes:**

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

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

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

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

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

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

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

5. The investment is identified as related party, but the role of the related party represents a different arrangement than the options provided in choices 1-4.
NAIC staff noted that the interested parties comment letter expressed concerns with changes to the affiliated and unaffiliated reporting lines in the investment schedules. NAIC staff want to reiterate that this agenda item does not intend to make any changes to what is reported as affiliated or unaffiliated, and we want to take this opportunity to again be clear that the changes proposed in this agenda item are not intended to change reporting lines and this is only intended to add a new column in the current reporting schedules to capture information on related party investments. The definition of an affiliate is captured in the Model, SSAP No. 25 and SSAP No. 97. Although the definition is consistently referenced, it seems that there is inconsistency in practice and differing interpretations on the reporting of investments with entities that qualify as affiliates, and whether these investments shall always be captured within the affiliated reporting line. Pursuant to comments from interested parties, actual credit exposure should be present to report an investment on the affiliate reporting line. However, the regulator viewpoint is that all affiliated transactions shall be reported to the regulator pursuant to SSAP No. 25 and the Insurance Holding Company System Model Regulatory Act (#440) and its related Regulation and with Reporting Forms and Instructions (#450), (which includes Form D filings). By reporting all investments acquired from affiliates on the affiliated reporting line, the regulator has necessary information regarding these investments and the affiliate interactions.

Interested parties also stated in their comment letter that “If the Working Group feels that this look-through is necessary, interested parties will need time to get this process implemented. Interested parties believe that the earliest this look-through requirement can be implemented is for year-end 2023 as time will be needed to set up a process with all affiliated funds so that the funds provide a listing of underlying equity investments in other entities along with the percentage ownership.” While NAIC staff are sympathetic to this request to push this disclosure to 2023, the broader issue with related party reporting is part of a larger initiative within the NAIC, and at this time we believe that this must be adopted for 2022 reporting.

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**Summary:**
On December 11, the Working Group exposed this agenda item for public comment and while it did not propose revisions to statutory accounting, it did result in a proposal being forwarded to the Blanks (E) Working Group to expand (in electronic only columns) reporting in Schedule D – Part 6 – Section 1: Valuation of Shares of Subsidiary, Controlled or Affiliated Entities (Schedule D-6-1). Schedule D-6-1 captures investments which are defined in SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities. The proposed expansion in reporting would capture items consistent with current requirements in SSAP No. 97 and include items such as prior year’s BACV, nonadmitted amount, sub-2 verified value, and VISION filing number. The addition of these items to the Schedule D-6-1 tables were proposed as they will assist regulators to 1) ensure Sub 1 and Sub 2 filings are being submitted by reporting entities, and 2) identify situations where the NAIC approved value varies significantly from the value reported on Schedule D-6-1.

**Interested Parties’ Comments:**
Interested parties have the following observations regarding this proposal:

- The nature of the NAIC valuation adjustments can be broad and include a range of possibilities. But in looking back to the reductions from the 2020 filings, there are notes for items such as: going concern, lack of audit, audit not provided in English, lack of a U.S. GAAP reconciliation, or other errors, etc. It appears
that the most prevalent, by far, is a reduction to match the equity reflected in the audit.

- The adjustment is not intended to match the approved amount, but to adjust subsequent valuations to reflect the current equity that factors in the noted adjustment / issue by NAIC staff from the filing submission. For example, if an insurer didn’t adjust for a surplus note, and staff adjusted their approved year end value to remove the surplus note, the insurer should make sure that a similar adjustment is reflected going forward when reporting the current equity amount.

- In addition, since this is gathering prior year information, we note that regulators will be able to easily identify significant swings in equity values for any particular SCA.

In summary, interested parties recommend that there be a formal process for communicating the adjustment to the state of domicile and a clearly articulated instruction for how the adjustment is to be reported to ensure that the adjustments are communicated to insurers by the state of domicile and that insurers clearly understand how the adjustments are to be reflected.

**Recommended Action:**
NAIC staff recommends that the Working Group adopt this agenda item, noting that there are no actual statutory revisions. Rather, adoption will express support for the corresponding Blanks (E) Working Group exposure (2022-02BWG), which includes the new electronic only columns in Schedule D-6-1.

In response to comments received from interested parties, NAIC staff refers filers to SSAP No. 97, paragraph 51 which states that if an insurance company has reported a value for the SCA investment on its financial statement blank that differs from the value approved by the NAIC, the insurer is required to adjust the reported value in its next quarterly financial statement blank, unless otherwise directed by the insurer’s state of domicile. Financial statement filers are generally required to submit Sub-2 filings by Aug. 31 (SSAP No. 97, paragraph 52) and most filers meet this deadline. For example, a filer may file a 2021 year-end Sub-2 filing on Aug. 31, 2022 – at which time NAIC staff review the submitted information. If a material adjustment is required (e.g., the filer did not reduce the value of the subsidiary for reciprocal ownership), then the filer should consider that adjustment in its valuation assessment during the preparation of its next quarterly financial statement. Depending on the timing of the review, in the example of a Aug. 31 filing, the substance of the adjustment could occur in either the 3rd or 4th quarter filing. However, the filer should consider the nature of the adjustments in the subsequent year Sub-2 filing. While this agenda item had multiple objectives, one goal was to help identify filers who have repeated, identical adjustments year-after-year.

If an adjustment is made, filers are notified in VISION regarding rationale for the change. Please note that VISION is also the location where filers can see the status of any filing (submitted, accepted, reviewed, etc.) and the location where the valuation reports can be printed.

In terms of communications of adjustments with the states of domicile, NAIC staff send monthly updates to the states, in a formalized reporting template, the status of all reviews completed for the month. The template includes identification of the insurance reporting entity, SCA, state of domicile, approved value, approved share value and notations (with explanation) of any differences in approved vs. submitted valuations. NAIC staff submit rationale for any changes, and frequently consult with the states in advance of approving valuations that differ from what is submitted by an insurer, especially in cases where an opinion is required on the materiality of exception items (as NAIC staff are not permitted to opine on materiality per SSAP No. 97, paragraph 50). After submitting the monthly reports to the states, NAIC staff often answer any questions (regarding valuation or other items) for insurance regulators.
Summary:
On December 11, the Working Group exposed SAP clarification revisions to SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements and SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities to address questions about the treatment of leasehold improvements in situations where a leased property is purchased by the lessee during the lease term. In these scenarios, it was identified that the reporting entity had acquired the property that was initially subject to a lease; and informed that regardless of the scenario, amortization of leasehold improvements is only permitted over the shorter of the estimated useful life of the improvement or the lease term (as defined in SSAP No. 22R—Leases). In a normal lease termination, one where the lessee does not acquire said property, any remaining leasehold improvements at the time of termination shall be immediately expensed. This agenda item was drafted to clarify this guidance to articulate that in any scenario in which a lease terminates early, that all remaining leasehold improvements shall be immediately expensed.

Interested Parties’ Comments:
Interested parties agree that, in most cases, unamortized lessee owned leasehold improvements should be immediately expensed if the lease is terminated. However, in the situation where the reporting entity purchases a property that it was previously leasing, the immediate expensing may not be appropriate in all circumstances.

SSAP No. 19, Furniture, Fixtures, Equipment and Leasehold Improvements, paragraph 4 defines leasehold improvements as (bolded for emphasis) “lessee expenditures that are permanently attached to an asset that a reporting entity is leasing under an operating lease.”

In defining this issue, NAIC Staff referred to paragraphs 18 and 31 of SSAP No. 40R, Real Estate Investments, which relate to the sale of real estate. Within the guidance of these paragraphs, it is emphasized by Staff that the sale of real estate includes property improvements or integral equipment, which are defined as any physical structure or equipment attached to the real estate that cannot be removed and used separately without incurring significant costs, such as an office building. Interested parties agree if a reporting entity sells real estate, the asset, including property improvements and integral equipment, should be derecognized and a gain or loss on the sale be realized. However, as noted above, this issue relates to when a reporting entity acquires, not sells, a property that it was leasing.

SSAP No. 40R paragraph 8 states (bolded for emphasis), “The cost of real estate represents the fair value of the consideration exchanged plus any costs incurred to place the real estate asset in usable condition, including but not limited to, brokerage fees, legal fees, demolition, clearing and grading, fees of architects and engineers, any additional expenditures made for equipment and fixtures that are made a permanent part of the structure…” Therefore, under SSAP No. 40R, leasehold improvements are admitted assets.

The proposed revisions to SSAP No. 19 and SSAP No. 73 both state (bolded for emphasis; italics to denote reference to the appropriate party acquiring the leased real estate):

The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the
reporting entity (lessee) lessor. If leased real estate is acquired, recognition of the real estate shall follow the provisions in SSAP No. 40R—Real Estate Investments.

It is noted in the Staff Recommendation that “[i]t is presumed that the purchase of a property from a third party would include the leasehold improvements as part of the full purchase price.” Under this presumption it is logical that the previously recognized leasehold improvements should be immediately expensed, otherwise, the reporting entity would be double counting the assets and related expense. In practice, however, interested parties generally believe this to be an unlikely scenario.

Lease agreements with purchase options can be complex and structured in a myriad of ways depending on how the reporting entity lessee negotiated with the lessor. There may be circumstances that the reporting entity negotiates a reduced price to acquire the real estate formerly leased to compensate for the permanent improvements it previously made. In other situations, the sales price is determined based on the then current fair or appraised value. In this situation, the lessee and lessor will engage a third-party appraiser to establish the sales price. Appraisers generally use the cost, sales comparison, or income approaches to establish the value. Generally, those approaches may not contemplate the specific lessee owned leasehold improvements unless those improvements generate material utility (e.g., expansion of the building itself, or in a ground lease, land improvements or a constructed building, etc.). Accordingly, the reporting entity would not be including in the cost of the acquired real estate any additional expenditures made for equipment and fixtures that are made a permanent part of the structure as required/allowed by SSAP No. 40R if the amendments to SSAP No. 19 and 73 require them to be written off at acquisition.

Additionally, interested parties believe it would generally be economically punitive to a reporting entity to provide consideration to purchase a leased asset to the landlord (seller) that includes significant costs that the reporting entity lessee already incurred for the leasehold improvements. Also, many States require material purchases of real estate (particularly for HMOs) to be approved by the Department of Insurance. Barring any unique circumstances, it is unlikely a regulator would approve a transaction that requires the reporting entity to pay additional amounts to a lessor for costs it already incurred.

Interested parties are also concerned with the additional complexity the exposure draft will add in applying SSAP No 22R versus ASC 842 for GAAP. As it stands today, there is already a cost basis difference between GAAP and SAP when purchasing the underlying leased asset. SSAP No 22R implies that any deferred rent liability upon termination of a lease would be adjusted off to the P&L (i.e., a gain). For GAAP under ASC 842, any remaining lease liability upon purchase of the leased asset is adjusted to the cost basis of the asset (i.e., effectively deferring the gain) along with the unamortized portion of the lessee owned leasehold improvements. Expensing unamortized leasehold improvements in all circumstances for terminated leases for SAP creates further cost basis differences that will artificially and significantly distort earnings and will be extremely difficult to operationalize.

It is also worth noting that for some interested parties, external auditors and regulators have audited these transactions and have been comfortable that duplication is not occurring.

Interested parties suggest that the following amendments be revised guidance of SSAP No. 19 and 73:

The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any events in which the lease is terminated in advance of the lease term. When leased real estate is purchased by the reporting entity lessee resulting in termination of the lease, any unamortized lessee owned leasehold improvements should be added to the cost basis of the acquired real estate and recognized in accordance with SSAP No. 40R—Real Estate Investments. Any unamortized leasehold improvements owned by the reporting entity lessee that have no future economic benefit upon purchase of the leased real estate asset or those included in the purchase price of the acquired real estate should be immediately expensed. This includes situations in which leased real estate is acquired by the reporting entity lessor. If leased real estate is acquired, recognition of the real estate shall follow the provisions in SSAP No. 40R—Real Estate Investments.
Recommended Action:
NAIC staff appreciate the thorough comments received from the interested parties. For the Spring National Meeting, it is recommended that the Working Group direct NAIC staff to work further with the interested parties in refining this updated guidance. Below are several issues that will need to be discussed.

- NAIC staff are concerned that the language suggested by interested parties would allow companies to essentially move leasehold improvement assets from being nonadmitted under SSAP Nos. 19 and 73 to be included in the building cost and ultimately reflected as admitted under SSAP No. 40R.

- NAIC staff note that not all lease agreements include provisions for a purchase option at the time that the lease is signed, and in these situations, we believe that the leasehold improvement assets should be expensed at the time of the purchase of the building, as almost all professional real estate companies would factor those leasehold improvements into the value of the building at the time of the purchase.

- For situations where the lease agreement includes purchase options that discuss leasehold improvements, NAIC staff agree that these must be considered as part of the purchase of an asset that was part of a prior lease. NAIC staff agree that there could be some limited situations where the intent is that the leasehold improvement asset would not be included in the purchase price of the building. In these limited situations, the correct accounting may be to add that amount to the cost of the building. However, in these cases, NAIC staff request consult with regulators as to if this exception as it may require verification with the reporting entity’s auditor for this accounting treatment for the leasehold improvements.

The comment letters are included in Attachment 16 (22 pages).

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met Dec. 11, 2021. The following Working Group members participated: Dale Bruggeman, Chair (OH); Carrie Mears and Kevin Clark, Co-Vice Chairs (IA); Kim Hudson and Susan Bernard (CA); William Arfanis, Kathy Belfi, and Kenneth Cotrone (CT); Rylynn Brown (DE); Kevin Fry (IL); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Melissa Greiner, Kimberly Rankin, and Matt Milford (PA); Jamie Walker (TX); Greg Chew (VA); and Amy Malm (WI).

1. **Adopted its Nov. 10, Oct. 25, Sept. 10, Aug. 26, July 20, and July 12 Minutes**

Ms. Malm made a motion, seconded by Mr. Chew, to adopt the Working Group’s Nov. 10 (Attachment One-A), Oct. 25 (Attachment One-B), Sept. 10 (Attachment One-C), Aug. 26 (Attachment One-D), July 20 (see NAIC Proceedings – Summer 2021, Accounting Practices and Procedures (E) Task Force, Attachment One-A), and July 12 (see NAIC Proceedings – Summer 2021, Accounting Practices and Procedures (E) Task Force, Attachment One-B) minutes. The motion passed unanimously.

The Working Group met Dec. 2, Aug. 10, and July 29 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. No actions were taken during these meetings. The discussion for the respective dates referenced above included review of the Fall National Meeting agenda, an update on the “SSAP No. 43R Project,” and a review of certain (company specific) financial information from 2020 year-end financial statements filed with the NAIC.

2. **Adopted Non-Contested Positions**

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

a. **Agenda Item 2019-24**

Mr. Bruggeman directed the Working Group to agenda item 2019-24: SSAP No. 71 – Levelized and Persistency Commissions – Issue Paper. Robin Marcotte (NAIC) stated that this issue paper documents the discussions that occurred during the development of the nonsubstantive revisions to Statement of Statutory Accounting Principles (SSAP) No. 71—Policy Acquisition Costs and Commissions, which are effective Dec. 31. She stated that the adoption of the nonsubstantive revisions to SSAP No. 71 has been through the entire committee adoption process; however, the issue paper was directed to document the discussions for historical retention purposes. In addition to the revisions to SSAP No. 71, the original agenda item also recommended a new annual statement general interrogatory to identify when a third-party has been utilized for the payment of commission expenses. This new general interrogatory was adopted by the Blanks (E) Working Group for annual 2021 reporting.

Ms. Belfi made a motion, seconded by Mr. Fry, to adopt Issue Paper No. 165—Levelized Commissions (Attachment One-F). The motion passed unanimously.

b. **Agenda Item 2021-11**

Mr. Bruggeman directed the Working Group to agenda item 2021-11: SSAP No. 43R – Credit Tenant Loans – Scope. Julie Gann (NAIC) stated that this agenda item was drafted as a result of the Valuation of Securities (E) Task Force’s adopted revisions to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual), which clarified that the definition of a credit tenant loan (CTL) is specific to mortgage loans in scope of SSAP No. 37—Mortgage Loans. She stated that the revisions clarify that the application of the structural assessment to identify CTLs is limited to direct mortgage loans and pertains to the potential reclassification of investments from Schedule B: Mortgage Loans to Schedule D-1: Long-Term Bonds for qualifying investments. In response to the P&P Manual revisions, this agenda item proposed three items: 1) to nullify Interpretation (INT) 20-10: Reporting Nonconforming CTLs as no longer applicable; 2) to dispose agenda item 2020-24: Accounting and Reporting of Credit Tenant Loans without statutory revisions; and 3) nonsubstantive revisions to SSAP No. 43R—Loan-Backed and Structured Securities to explicitly identified Securities Valuation Office (SVO)-identified CTLs in scope and delete references to examples of “other Loan-Backed and Structured Securities” in paragraph 27.b, as that paragraph is not a scope paragraph. Ms. Gann stated that INT 20-10 was proposed for formal nullification, with information on why the
INT is no longer relevant, even though the INT expired on Oct. 1. She stated that this documentation will provide the historical documentation on why the INT was not renewed or other statutory accounting revisions were not considered.

Mr. Fry made a motion, seconded by Mr. Clark, to: 1) nullify INT 20-10 as no longer applicable (Attachment One-G); 2) dispose agenda item 2020-24 without statutory revisions; and 3) adopt the exposed nonsubstantive revisions to SSAP No. 43R (Attachment One-H). The motion passed unanimously.

c. Agenda Item 2021-16

Mr. Bruggeman directed the Working Group to agenda item 2021-16: SSAP No. 30R – FHLB Disclosures – Blanks Referral. Jim Pinegar (NAIC) stated that this agenda item was to identify Federal Home Loan Bank (FHLB) borrowings that are captured in scope of SSAP No. 52—Deposit-Type Contracts and reported in Exhibit 7 – Deposit-Type Contracts. He stated that due to the varied reporting on Exhibit 7 based on differing policy forms, FHLB borrowings in Exhibit 7 were not readily identifiable to financial statement users. This agenda item did not propose statutory revisions but resulted in a proposal to the Blanks (E) Working Group to include a supplemental footnote for FHLB funding agreements in Exhibit 7.

Ms. Greiner made a motion, seconded by Mr. Bartlett, to adopt agenda item 2021-16 (Attachment One-I), noting no statutory revisions but support for the corresponding Blanks (E) Working Group proposal. The motion passed unanimously.

d. Agenda Item 2021-17

Mr. Bruggeman directed the Working Group to agenda item 2021-17: SSAP No. 32R – Permitted Valuation Methods. Mr. Pinegar stated that this agenda item removes a lingering reference indicating that historical cost is a permissible valuation method and introduces other minor consistency modifications to SSAP No. 32R—Preferred Stock.

Ms. Walker made a motion, seconded by Mr. Hudson, to adopt the exposed nonsubstantive revisions to SSAP No. 32R (Attachment One-J). The motion passed unanimously.

e. Agenda Item 2021-19EP


Ms. Weaver made a motion, seconded by Mr. Clark, to adopt the exposed nonsubstantive revisions to SSAP No. 16R and SSAP No. 43R (Attachment One-K). The motion passed unanimously.

3. Reviewed Comments on Exposed Items

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

a. Agenda Item 2021-18

Mr. Bruggeman directed the Working Group to agenda item 2021-18: VM-21 Scenario Consistency Update. Ms. Marcotte stated that this agenda item proposed edits to SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees to ensure consistency with VM-21, Requirements for Principle-Based Reserves for Variable Annuities. She stated that interested parties provided potential edits to the exposure, and the edits were shared with a few of the Life Actuarial (A) Task Force representatives, who suggested additional revisions. In an effort to have the updates in place for year-end 2021 reporting, a shortened exposure period of the combined edits was recommended so the Working Group could consider via e-vote potential adoption in January 2022.

Michael M. Monahan (American Council of Life Insurers—ACLI) stated that the ACLI supports a shortened exposure period and an e-vote for possible adoption by the Working Group.
Mr. Chew made a motion, seconded by Mr. Hudson, to expose agenda item 2021-18 until Jan. 14, 2022. The motion passed unanimously.

b. Agenda Item 2021-14

Mr. Bruggeman directed the Working Group to agenda item 2021-14: Policy Statement Terminology Change – Substantive and Nonsubstantive. Ms. Gann stated that this agenda item was drafted in response to a Financial Condition (E) Committee referral, which identified during the SSAP No. 71 discussions (Ref #2019-24: SSAP No. 71 – Levelized and Persistency Commission) that the statutory accounting terminology of “substantive” and “nonsubstantive” to describe statutory accounting revisions could be misunderstood by users that are not familiar with the specific definitions and application of those terms. She stated that those not familiar with the AP&P maintenance process may incorrectly reference a material financial impact as “substantive”; however, the use of the term in the AP&P Manual was to reflect the introduction of a new statutory accounting concept. She stated that the terms do not consider potential financial impact, and the introduction of a new statutory accounting principles (SAP) concept is a substantive change, regardless of any financial impact to a company, and SAP clarifications are nonsubstantive, even if a company previously misapplied the existing guidance and could have a financial impact from correcting past practice. She stated that this agenda item proposes revisions in the NAIC Policy Statement on Maintenance of Statutory Accounting Principles (Policy Statement) to replace the term “substantive” with “new SAP concept” and replace “nonsubstantive” with “SAP clarification.” She stated that interested parties suggested removal of the classifications completely with assessment as to the appropriate effective date and discussion process for every agenda item. She stated that this proposal went beyond the referral from the Committee to not revise the basis in determining the type of statutory revisions and only revise terminology. In addition, the Working Group can deviate from established processes to have more discussion, an issue paper, and an effective date for nonsubstantive (SAP clarification) changes, and it has utilized that ability in the past. Ms. Gann stated that if this concept is further desired by industry, a separate agenda item from interested parties could sponsor this change for further consideration.

Ms. Belfi made a motion, seconded by Ms. Malm, to adopt the exposed nonsubstantive revisions to the Policy Statement (Attachment One-L). The motion passed unanimously.

4. Considered Maintenance Agenda – Pending Listing – Exposures

Mr. Hudson made a motion, seconded by Mr. Bartlett, to move agenda items 2021-20 through 2021-31 to the active listing and expose all items for public comment. The motion passed unanimously.

Mr. Bruggeman stated that the public comment period for all agenda items (except 2021-18 and 2021-31) ends Feb. 18, 2022. The public comment period for agenda items 2021-18 and 2021-31 ends Jan. 14, 2022.

a. Agenda Item 2021-20

Mr. Bruggeman directed the Working Group to agenda item 2021-20: Effective Derivatives – ASU 2017-12. Ms. Gann stated that this agenda item was drafted to consider expanding guidance in SSAP No. 86—Derivatives for what qualifies as a highly effective hedging derivative. She stated that the intent is to mirror effective hedging determinations that the Financial Accounting Standards Board (FASB) permits within Accounting Standard Update (ASU) 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. While ASU 2017-12 was previously reviewed, the review was limited in scope and only adopted updates for hedging documentation, noting that a broader review would occur at a later date. Ms. Gann stated that both state insurance regulators and industry representatives requested further consideration of ASU 2017-12, particularly with regards to the permitted derivative arrangements that U.S. generally accepted accounting principles (GAAP) now allow to qualify as a highly effective hedge. She stated that in general, NAIC staff believe that if a hedging relationship is considered effective under U.S. GAAP, it should also be considered effective for statutory accounting. However, differences in the accounting between U.S. GAAP and statutory accounting need to be reviewed before those new effective hedging relationships are permitted to ensure the financial statement reporting and derivative impact is defined and understood. Ms. Gann stated that this agenda item will result in substantive revisions; however, the agenda item does not currently propose revisions but seeks public comment on several aspects in accordance with the current accounting and reporting provisions in SSAP No. 86. The agenda item details specifics, but she summarized a few items as follows:

- Partial Term Hedging – A provision that permits entities to enter into fair value hedges of interest rate risk for only a portion of the hedged financial instrument. Prior to ASU 2017-12, these arrangements were not generally successful

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in being identified as highly effective due to timing differences between the underlying hedged item’s principal payment and the maturity of the hedging instrument. However, for statutory accounting, this could cause an issue if the underlying item is a liability and the hedging transactions results in an adjustment to the “basis of the hedged item.” Such an adjustment could result in a financial statement presentation that reduces the hedged liability when the contractual obligation has not actually been reduced, affecting the assessment of debt in the financial statements.

- Last of Layer – A provision that permits hedging in a closed portfolio of prepayable financial assets so that the items not expected to be affected by prepayments, defaults, and other factors affecting the timing and amount of cash flows are the underlying hedged item. In addition to U.S. GAAP specifications on how the derivative adjustments are reflected in the portfolio and not individual items, the guidance has the potential for derivative bifurcation so that a derivative can continue to effectively hedge one layer if another layer is no longer effective. The bifurcation of derivatives is not currently permitted in statutory accounting, and if changes are incorporated to allow this approach, the reporting of both the effective and noneffective portions of the hedging instrument will need to be determined.

- Expansion of Excluded Components – A provision that permits the ability to exclude a component from the assessment of hedge effectiveness. This also involves the bifurcation of derivatives and how the excluded components shall be reported for statutory accounting.

Mr. Bruggeman stated that the concepts in the agenda item will need significant input from both industry and state insurance regulators, especially with the reporting of derivatives and the resulting impact in the balance sheet. In addition to exposure, there was no objection to the recommendation for NAIC staff to work directly with industry to discuss and develop potential resolutions during the exposure period.

b. Agenda Item 2021-21

Mr. Bruggeman directed the Working Group to agenda item 2021-21: Related Party Reporting. Ms. Gann stated that this agenda item has been drafted in response to recent discussions on the reporting and disclosure requirements for investments that involve related parties. This agenda item clarifies the reporting of affiliate transactions within existing reporting lines in the investment schedules. The clarification is intended to be consistent with the definition of an affiliate pursuant to the Insurance Holding Company System Regulatory Act (#440), SSAP No. 25—Affiliates and Other Related Parties, and SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities. Additionally, this agenda item incorporates new disclosures for investment transactions that involve related parties, regardless of whether the related party is classified as an affiliate. Ms. Gann stated that the agenda item proposes new reporting requirements so that direct investments, investments sponsored or originated by related parties, and investments with other related party involvement are specifically identified in the investment schedules using a new electronic column. She stated that the Blanks (E) Working Group is planning to expose a Blanks proposal to capture the new electronic columns for year-end 2022 reporting.

c. Agenda Item 2021-22

Mr. Bruggeman directed the Working Group to agenda item 2021-22: Schedule D-6-1, Supplemental Reporting. Mr. Pinegar stated that this agenda item proposes four additional data capture elements for Schedule D-6-1: Valuation of Shares of Subsidiary, Controlled or Affiliated Entities. He stated that SSAP No. 97 details several filing requirements, including a requirement for certain subsidiary, controlled, and affiliated entities (SCAs) to file information with the NAIC annually to support the values reported on Schedule D-6-1. If a reported value for a SCA investment materially differs from the value approved by the NAIC, the insurer is required to adjust the reported value in its next quarterly financial statement blank, unless otherwise directed by the insurer’s state of domicile. Mr. Pinegar stated that upon review of the 2019 SCA filings, approximately 17% of all valuation filings resulted in valuation decreases, and some entities have year-after-year valuation decreases. This proposal to add four additional electronic-only columns will assist state insurance regulators in identifying that valuation filings are being submitted when required and identifying situations where the NAIC-approved value varies significantly from values reported on Schedule D-6-1. Mr. Pinegar stated that the supplemental data to be captured is consistent with existing disclosure requirements, so the agenda item does not propose statutory revisions, but it will result in a concurrent proposal to the Blanks (E) Working Group to include the new electronic columns in Schedule D-6-1. Mr. Bruggeman stated that he views this agenda item, which is recommended for exposure, as a way for state insurance regulators to perform reviews and reconciliations of SCA valuations more efficiently.
d.  **Agenda Item 2021-23**

Mr. Bruggeman directed the Working Group to agenda item 2021-23: SSAP No. 43R – Financial Modeling Updated Guidance. Mr. Pinegar stated that this agenda item reflects updated NAIC designation/NAIC designation category guidance adopted on Oct. 20 by the Valuation of Securities (E) Task Force to the P&P Manual for residential mortgage backed securities (RMBS) and commercial mortgage backed securities (CMBS). He stated that while the P&P Manual governs the financial modeling process, when this guidance was first adopted, a summarized process was reflected in the AP&P Manual. However, as the financial modeling concept is no longer new and is governed by the Task Force, NAIC staff have proposed two alternatives for possible exposure. The first option will retain summarized financial modeling guidance in SSAP No. 43R, updated to reflect the changes by the Task Force. The second option will remove the financial modeling guidance from SSAP No. 43R and refer users to the source financial modeling guidance in the P&P Manual.

Mr. Bruggeman stated that his preference is to expose both options, seeking input as to which option is preferable to state insurance regulators and industry. Mr. Hudson stated that California supports exposing both options for public comment.

e.  **Agenda Item 2021-24**

Mr. Bruggeman directed the Working Group to agenda item 2021-24: Cryptocurrency General Interrogatory. Jake Stultz (NAIC) stated that in May, the Working Group adopted INT 21-01: Accounting for Cryptocurrencies, which clarified that directly held cryptocurrencies do not reflect cash and do not meet the definition of an admitted asset. He stated that while researching this topic, it was noted that some insurance companies held cryptocurrencies, but these were not always easy to identify in the statutory financial statements. At the request of state insurance regulators, this agenda item has been drafted to propose a new general interrogatory within the annual reporting blanks specific to the use or acceptance of cryptocurrencies. The general interrogatory will capture whether cryptocurrencies are held (and if held, identification of which schedules the cryptocurrencies are reported) and whether cryptocurrencies are accepted for the payment of premiums. Mr. Stultz stated that while the agenda item is recommended for exposure and does not propose statutory revisions, it will result in a proposal to the Blanks (E) Working Group to add this new general interrogatory to the annual statement for year-end 2022 reporting.

f.  **Agenda Item 2021-25**

Mr. Bruggeman directed the Working Group to agenda item 2021-25: Leasehold Improvement After Lease Termination. Mr. Stultz stated that in 2019, the Working Group adopted substantive revisions resulting in SSAP No. 22R—Leases. The updated guidance rejected financing lease treatment that was adopted in U.S. GAAP, but it incorporated language from Accounting Standards Codification (ASC) Topic 842, which kept SSAP No. 22R as consistent as possible with the primary concepts in the U.S. GAAP standard. This agenda item has been drafted to address questions about the treatment of leasehold improvements in situations where a leased property is purchased by the lessee during the lease term. It was noted that guidance for these situations was not addressed in SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements or SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities. This agenda item proposes nonsubstantive revisions to SSAP No. 19 and SSAP No. 73 to clarify that in any scenario in which a lease terminates early, all remaining leasehold improvements shall be immediately expensed. This would include scenarios where the lease naturally terminates or when the lessee purchases a property it is leasing.

g.  **Agenda Item 2021-26EP**

Mr. Bruggeman directed the Working Group to agenda item 2021-26EP: Editorial Updates (Substantive vs. Nonsubstantive). Mr. Pinegar stated that this agenda item is in response to the Working Group’s adoption of agenda item 2021-14, which modifies the use of the terminology of “substantive” and “nonsubstantive” in the Policy Statement. This agenda item reviews all remaining uses of those terms throughout the AP&P Manual and recommends changes where appropriate. Mr. Pinegar stated that changes are recommended in the preamble, table of contents, summary of changes, and the Policy Statement (Appendix F). He stated that in addition, a file has been posted to identify every use of the terms and includes the rationale of why some were not proposed for modification. As the intent is to use the new phraseology going forward, starting on or after Jan. 1, 2022, historical documents are not proposed for revision.

h.  **Agenda Item 2021-27**

Mr. Bruggeman directed the Working Group to agenda item 2021-27: ASU 2021-04, Issuer’s Accounting for Certain Modifications. Mr. Stultz stated that this agenda item reviews ASU 2021-04, Earnings Per Share (Topic 260), Debt—
Modifications and Extinguishments (Subtopic 470-50), Compensation—Stock Compensation (Topic 718), and Derivatives and Hedging—Contracts in Entity’s Own Equity (Subtopic 815-40): Issuer’s Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options. He stated that ASU 2021-04 directs that when a freestanding equity-classified written call option is modified or exchanged and the instrument remains classified as equity after the modification/exchange, the differences in fair value before and after the modification are to be accounted for as an adjustment to equity. However conversely, ASU 2021-04 directs that if the modification/exchange is related to a debt instrument or line-of-credit, the differences in fair value before and after the modification may be capitalized in accordance with U.S. GAAP debt issuance guidance, a concept disallowed per SSAP No. 15—Debt and Holding Company Obligations. Mr. Stultz stated that this agenda item proposes to reject ASU 2021-04 for statutory accounting; however, it also proposes nonsubstantive modifications to SSAP No. 72—Surplus and Quasi-Reorganizations, incorporating minor updates related to the accounting for changes in fair value involving the exchange of a free-standing equity-classified written call options.

i. Agenda Item 2021-28

Mr. Bruggeman directed the Working Group to agenda item 2021-28: ASU 2021-03, Intangibles – Goodwill and Other. Mr. Pinegar stated that this agenda item reviews ASU 2021-03, Intangibles – Goodwill and Other – Accounting Alternative for Evaluating Triggering Events. He stated that ASU 2021-03 provides private companies and not-for-profit entities with an optional accounting alternative for the performance of a goodwill impairment triggering evaluation. The amendments allow for the assessment of goodwill impairment only as of the end of a reporting period. Mr. Pinegar stated that statutory accounting’s authoritative guidance regarding impairment is documented in INT 06-07: Definition of Phrase “Other Than Temporary” and does not permit the delay of an impairment assessment until a reporting period. He stated that this agenda item proposes nonsubstantive revisions to SSAP No. 68—Business Combinations and Goodwill to reject ASU 2021-03 for statutory accounting.

j. Agenda Item 2021-29

Mr. Bruggeman directed the Working Group to agenda item 2021-29: ASU 2021-05 – Variable Lease Payments. Mr. Stultz stated that this agenda item reviews ASU 2021-05, Leases (Topic 842): Lessors—Certain Leases with Variable Lease Payments. He stated that ASU 2021-05 applies to lessors with lease contracts that have variable lease payments that do not depend on a reference index or rate and/or would have resulted in the lessor being required to recognize a day one selling loss (at lease commencement) if those leases were classified as sales-type or direct financing. He stated that SSAP No. 22R requires nearly all leases to be treated as operating leases, and adoption of this guidance would be redundant and unnecessary, so this agenda item proposes nonsubstantive revisions in SSAP No. 22R to reject ASU 2021-05.

k. Agenda Item 2021-30

Mr. Bruggeman directed the Working Group to agenda item 2021-30: ASU 2021-06 – Amendments to SEC Paragraphs. Mr. Stultz stated that this agenda item reviews ASU 2021-06, Presentation of Financial Statements (Topic 205), Financial Services—Depository and Lending (Topic 942), and Financial Services—Investment Companies (Topic 946), Amendments to SEC Paragraphs Pursuant to SEC Final Rule Releases No. 33-10786, Amendments to Financial Disclosures about Acquired and Disposed Businesses, and No. 33-10835, Update of Statistical Disclosures for Bank and Savings and Loan Registrants. He stated that ASU 2021-06 provides formatting and paragraph references applicable to only U.S. Securities and Exchange Commission (SEC) registrants. This agenda item proposes nonsubstantive revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2021-06 as not applicable to statutory accounting.

l. Agenda Item 2021-31

Mr. Bruggeman directed the Working Group to agenda item 2021-31: Life Reinsurance Disclosure Clarifications. Ms. Marcotte stated that this agenda item is to address questions received from members of the American Institute of Certified Public Accountants’ (AICPA) NAIC Task Force regarding the life reinsurance disclosures and the related audited notes that were first effective in December 2020. The disclosures were adopted in SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance from agenda item 2017-28: Reinsurance Risk Transfer for Short Duration Contracts. Ms. Marcotte stated that preparers and auditors have highlighted unclear elements in the disclosures and requested several clarifications, specifically whether the disclosures apply to ceding and assuming contracts, the format expected for the audited notes, and how broadly to interpret the scope of certain disclosures. The proposed nonsubstantive revisions to SSAP No. 61R narrow the scope and clarify what is required in the disclosures. In order to allow for a possible adoption for year-end 2021 reporting, a shortened exposure period of Jan. 14, 2022, was recommended.
Ms. Marcotte summarized the proposed revisions by paragraph:

- Paragraph 78 revision is to provide clarity that a supplemental table is not required if the answer is none or not applicable. The disclosure responses indicating that such features were identified could be either in the audited notes or the audited supplemental table.

- Paragraph 79 and 80 revisions provide clarity that the disclosure applies to ceding contracts.

- Paragraph 80 revisions are to narrow the scope of the risk limiting features disclosure, which is currently broadly written. The proposed revisions would not require disclosure of excess of loss and stop loss deductible and caps, which are not adjustable. She stated that such clauses are standard features in such contracts.

- Paragraph 82b revisions would remove the disclosure of non-proportional reinsurance that does not result in significant surplus relief, as the disclosure would only capture immaterial items.

- Paragraph 83 and 84 revisions pertain to U.S. GAAP to statutory accounting reporting differences of reinsurance contracts. The revisions clarify that if the entity is not a U.S. GAAP preparer or not included in upstream U.S. GAAP preparer financial statements, then the disclosure can be noted as not applicable. She stated that because of the Life and Health Reinsurance Agreements Model Regulation (#791), the life and health disclosure will capture more reinsurance contracts than the related property/casualty (P/C) disclosures.

Ms. Marcotte noted that subsequent to posting the national meeting materials, NAIC staff also received a question on whether the disclosure was intended to be comparative, meaning the current and prior year. Mr. Bruggeman stated that these disclosures will generally be comparative, but the proposed revisions could be prospective; therefore, prior year 2020 disclosures did not have to be updated with these disclosure changes. Otherwise, he stated that the disclosures should be comparative and include the current and prior year. He noted that the disclosures needed to be exposed to make sure that revisions do not remove state insurance regulator-desired disclosures. He stated agreement with the revisions in paragraphs 83 and 84 regarding non-U.S. GAAP filers. He noted that if early statutory filers submit information before any action is taken by the Working Group, more information may be disclosed than will ultimately be required; however, the clarifications would still assist auditors.

Mr. Monahan stated that the ACLI supports a shortened exposure period and an e-vote for possible adoption by the Working Group.

5. **Discussed Other Matters**

a. **Ref #2019-21: SSAP No. 43R – Update**

Ms. Gann stated that this agenda item, now referred to as the principles-based bond proposal project, intends to define the type of instruments eligible for reporting on Schedule D-1. She provided a brief history of the project, noting that the principles-based definition was exposed in May with comments considered in August. She stated that as part of the direction in August to begin drafting an issue paper and statutory revisions, the Working Group directed ongoing discussions with state insurance regulators and industry to discuss and refine the principles-based bond definition. She stated that as a part of this continued discussion, two items are recommended for exposure. The first is a discussion document, which presents possible reporting changes to incorporate improved transparency and granularity in Schedule D-1. This document requests information on potential changes in reporting lines, a new sub-schedule for Schedule D-1 to detail certain asset-backed securities (ABS), and potential changes to the columns and information currently reported in Schedule D-1. A key proposed element is to move away from the current “general categories” for reporting and replace those groupings with more useful reporting lines based on investment type. The exposure reviews items for possible change consideration and specifically requests comments on the removal of the general categories and whether those changes would hinder any tools or analyses performed. Ms. Gann stated that in terms of a possible new Sub-Schedule D-1, this schedule could include non-traditional reporting items and additional informational items, such as balloon payments and expected payoff dates. In response to comments received from industry, this could also be an opportunity to review how other informational data elements are captured, reviewing for usefulness and relevance for state insurance regulators.
Ms. Gann stated that the second item recommended for exposure proposes revisions to the “sufficiency” definition previously captured in the bond proposal definition, specifically what is required for sufficient credit enhancement for an ABS to qualify for reporting on Schedule D-1. She stated that for an ABS to be reported on Schedule D-1, sufficient credit enhancement must be present so that the holder is in a different economic position than had they directly owned the underlying collateral. In response to comments received, the agenda item now reflects the use of the term “substantive” credit enhancement, as the prior term of “sufficent” was more akin to a credit evaluation, which was not in line with the proposed principal bond concepts.

Mr. Clark stated that the latest phraseology update is in line with the principal concepts, and it will prevent situations where items are placed in a special purpose vehicle (SPV) and the SPV then issues bonds to an insurer. This new phraseology will prevent these situations by ensuring that the bond holder is in a different economic position than had they held the underlying collateral directly. He stated that the updated phraseology corrects prior notions that a quantitative assessment is required to determine the amount of credit enhancement, which was beyond the scope of the project.

Michael Reis (Northwestern Mutual), representing interested parties, stated appreciation for state insurance regulators and NAIC staff for their continued collaboration on this project, noting that they support the principles-based approach and believe a workable solution will be achieved. He stated that several topics remain outstanding, which include transitional reporting (reporting of items that may ultimately move schedules), as well as the accounting and reporting of items that do not meet the principal concepts. Other items of concern to interested parties relate to risk-based capital (RBC) and may need to be addressed through the Capital Adequacy (E) Task Force; however, interested parties remain willing to assist in the project.

Ms. Gann stated that to be sensitive to the time commitments of industry for year-end reporting, the draft issue paper and possible statutory revisions will not be exposed until later in the first quarter of 2022. In addition, the earliest the new principal concepts could be adopted and reflected in Schedule D-1 is likely Jan. 1, 2024. She stated that thus far, the project has included updated reporting guidance of residual tranches and the formation of an informal coordination group involving the chairs/vice chairs of the Statutory Accounting Principles (E) Working Group, Valuation of Securities (E) Task Force, Capital Adequacy (E) Task Force, and related RBC working groups to discuss appropriate RBC charges for residual tranches and other potential RBC impacts from the development of the principles-based bond definition. In addition, several other items remain outstanding. Examples include defining an operating entity, which is required for an issuer obligation classification; when principal payment relies on refinancing; as well as transitional accounting and reporting guidance. Mr. Bruggeman stated that the intent of the informal coordination group is to ensure that all affected parties understand the types of investments that are being specifically addressed in the project, especially those that may be subject to RBC arbitrage.

Mr. Clark made a motion, seconded by Ms. Weaver, to expose the discussion draft of potential reporting options and the proposed revised guidance and related examples for defining and determining whether an ABS has substantive credit enhancement to qualify for reporting on Schedule D-1. The motion passed unanimously.


Ms. Gann stated that INT 20-03: Troubled Debt Restructuring Due to COVID-19 and INT 20-07: Troubled Debt Restructuring of Certain Debt Instruments Due to COVID-19 were adopted in response to modifications that were being made to loans and debt securities in response to COVID-19. The adopted INTs provided exceptions to the application of guidance in SSAP No. 36—Troubled Debt Restructuring. The INTs were originally scheduled to expire as of Dec. 31, but they were extended to Jan. 2, 2022, in accordance with the extension of the Coronavirus, Aid, Relief, and Economic Security (CARES) Act. She stated that NAIC staff received informal comments that industry would not request an extension, and they recommended that the INTs automatically expire on Jan. 2, 2022.

Mr. Monahan stated that the ACLI recommends allowing INT 20-03 and 20-07 to expire on Jan. 2, 2022. With this commentary, the Working Group did not propose further consideration.

c. Review of GAAP Exposure

Ms. Gann stated that the FASB has two U.S. GAAP exposures open for public comment, both of which do not warrant comment from the Working Group. One exposure proposes removing the U.S. GAAP troubled debt restructuring guidance for lenders as no longer necessary under the U.S. GAAP current expected credit loss (CECL) standard. Ms. Gann stated that the proposed FASB revisions may cause further U.S. GAAP to statutory accounting differences, as the CECL standard has not been adopted for statutory accounting.
Ms. Gann stated that in addition to these updates, Insurance Core Principle (ICP) 14, the international standard for asset valuation, is undergoing review. NAIC staff are participating in these discussions and will keep the Working Group informed of any updates.

d. Referral to the Casualty Actuarial and Statistical (C) Task Force – Update

Ms. Marcotte stated that the Casualty Actuarial and Statistical (C) Task Force met Dec. 7 to initially discuss a presentation regarding the Working Group referral on agenda item 2019-49: Retroactive Reinsurance Exception regarding diversity in reporting for retroactive intercompany reinsurance contracts, which meet the exception and allow for prospective reporting. She stated that actions taken on Dec. 7 resulted in a 45-day exposure of the presentation. She stated that the largest issue to address is whether to allocate premium back to prior years on annual statement Schedule P when multiple years of premium are ceded to a reinsurer. She noted that no matter which methodology is used, such contracts produce distortions, and determining what will produce the most useful Schedule P information is relevant. A response from the Task Force is not anticipated until late in the first quarter or early in the second quarter of 2022. Ms. Marcotte also noted that there may be disconnects between some of the SSAP No. 62R—Property and Casualty Reinsurance guidance in paragraphs 36 and 37 and the intercompany pooling guidance in the annual statement instructions.

e. Key Items from the Maintenance Agenda

Ms. Gann provided an update on outstanding projects; a summary of each is as follows:

- **ASU 2016-13, Financial Instruments – Credit Losses:** At a minimum, this topic will require review of statutory accounting’s incurred loss impairment guidance; however, multiple varying viewpoints and consideration will need to be made. One example provided is that the asset valuation reserve (AVR), a credit component utilized only by statutory accounting, could be a substitute for ASU 2016-13; however, only life companies are subject to AVR. While ASU 2016-13 has been delayed multiple times, its effective date for non-SEC filers is January 2023.

- **Goodwill:** While two agenda items remain outstanding (agenda item 2019-12: ASU 2014-17, Business Combinations – Pushdown Accounting and agenda item 2019-14: Attribution of Goodwill), additional disclosures are expected from the 2021 financials. Accordingly, NAIC staff recommend that these topics be deferred until the information from these new disclosures is shared with the Working Group.

- **Derivatives Hedging Fixed Indexed Products:** NAIC staff have identified this topic to be a priority project; however, the development of statutory revisions is currently paused as NAIC staff is monitoring discussions at the Index-Linked Variable Annuity (A) Subgroup. Prior Working Group and industry comments have noted that it would be ideal for both the reserve calculation and derivative guidance to move in tandem.

- **State Affordable Care Act (ACA) Reinsurance Programs:** This agenda item is to provide accounting and reporting guidance regarding state ACA reinsurance programs being run under Section 1332 waivers. NAIC staff will work with industry to develop additional revisions for Working Group consideration that expand the principles-based guidance to address the diversity in state programs identified in the prior exposure.

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.
The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met Jan. 27, 2022. The following Working Group members participated: Dale Bruggeman, Chair (OH); Carrie Mears and Kevin Clark, Co-Vice Chairs (IA); Sheila Travis (AL); Kim Hudson (CA); William Arfanis (CT); Tom Hudson, Nicole Brittingham, and Rylynn Brown (DE); Cindy Andersen and Eric Moser (IL); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Kimberly Rankin (PA); Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI).

1. Reviewed Comments on Exposed Items

The Working Group held a public hearing to review comments (Attachment 1) on previously exposed items.

   a. Agenda Item 2021-18

   Mr. Bruggeman directed the Working Group to agenda item 2021-18: SSAP No. 108 – VM-21 Scenario Consistency Update. Robin Marcotte (NAIC) stated that the Working Group previously received comments on the prior exposure and exposed additional statutory accounting principle (SAP) clarifications to Statement of Statutory Accounting Principles (SSAP) No. 108—Derivatives Hedging Variable Annuity Guarantees. The revisions exposed in December 2021 incorporated edits proposed by Life Actuarial (A) Task Force representatives and interested parties. The intent is to ensure consistency with revisions to VM-21, Requirements for Principle-Based Reserves for Variable Annuities. Ms. Marcotte stated that interested parties do not object to the exposed revisions. The Working Group also received additional informal comments from the Task Force that reorganized text within the document. The informal revisions proposed by a member of the Task Force were shared with interested parties prior to them submitting their comment letter, and the interested parties informally indicated that they do not object to the proposed edits. Ms. Marcotte stated that NAIC staff recommend that the Working Group adopt the exposed revisions classified as an SAP clarification incorporating the edits proposed. These revisions will have a Dec. 31, 2021, effective date so the Valuation Manual and Accounting Practices and Procedures Manual (AP&P Manual) will be synchronized.

   Mike Monahan (American Council of Life Insurers—ACLI), representing interested parties, stated that they appreciate NAIC staff working to include the edits; they do not object to the changes and support moving forward with this agenda item.

   Kim Hudson made a motion, seconded by Ms. Weaver, to adopt the exposed revisions to SSAP No. 108 with the edits presented by NAIC staff (Attachment 2), with an effective date of Dec. 31, 2021. The motion passed unanimously.

   b. Agenda Item 2021-31

   Mr. Bruggeman directed the Working Group to agenda item 2021-31: Life Reinsurance Disclosure Clarifications. Ms. Marcotte stated that this agenda item was exposed in December 2021 to address questions received from members of the American Institute of Certified Public Accountants’ (AICPA) NAIC Task Force regarding the life reinsurance disclosures and the related audited notes that were first effective in December 2020. The disclosures were adopted in SSAP No. 61R—Life, Deposit-Type and Health Reinsurance in agenda item 2017-28: Reinsurance
Risk Transfer for Short Duration Contracts. Preparers and auditors highlighted unclear elements in the disclosures that could use additional clarification. Comments were received from both interested parties and members of the AICPA NAIC Task Force. NAIC staff recommend that the Working Group adopt the exposed SAP clarifications with additional revisions that reflect the following: 1) revisions from the interested parties and the members of the AICPA NAIC Task Force as detailed in the comment letters; and 2) additional NAIC staff proposed edits to paragraph 78 that were developed in discussions with representatives from the AICPA NAIC Task Force. The edits were recommended to be added with a Dec. 31, 2021, effective date to assist preparers and auditors.

Ms. Marcotte summarized the revisions by paragraph. The main revisions in paragraph 78 addressed two issues. The first was the audit report location of the disclosures. The exposed revisions clarified that the information could be in the audited notes or the supplementary schedules. After discussions with members of the AICPA NAIC Task Force, it requested edits to clarify that the information resides in the supplementary schedules to the audited report, unless there are no such contracts subject to the disclosures identified, in which case the information that no such contracts were identified could be located in either the audited note or the supplementary schedule. Ms. Marcotte stated that the reason for this requested clarification was that the notes to the financial statement are subject to more review than the supplemental schedules. Clarification was requested as to whether the audited note in the supplemental schedules was required to be comparative. Comments noted that most supplemental schedules, including the one for similar reinsurance disclosures required by SSAP No. 62R—Property and Casualty Reinsurance, are not comparative and are only for contracts in effect during the current period covered by the statement. NAIC staff verified that the related property and casualty disclosures in the general interrogatories are focused on contracts in effect during the period covered by the statement. Therefore, NAIC staff drafted proposed revisions to further clarify that the audited note did not have to be comparative, meaning the inclusion of contracts in the prior years; i.e., it only needs to address current period contracts covered by the statement. Ms. Marcotte also discussed grammatical edits proposed by interested parties and the removal of a reference to assumed reinsurance contracts from paragraph 81. NAIC staff noted that the revision to paragraph 81 will make the life and health disclosure similar in scope to the related property and casualty disclosure, which addresses ceded contracts.

Mr. Bruggeman noted agreement with the revision to paragraph 81, as it made the text in the beginning of the paragraph consistent with the text of sub paragraphs a. and b. He also stated support for the clarifications, noting that the supplemental schedule is not required to be comparative.

Jean Connolly (PricewaterhouseCoopers LLP), chair of the AICPA NAIC Task Force, stated appreciation for NAIC staff and the Working Group’s assistance in working through the clarifications. She stated that the revisions were what was requested.

Steven Clayburn (ACLI) stated that interested parties were very appreciative of narrowing the scope of the disclosures, and they support the revisions discussed.

Ms. Malm made a motion, seconded by Mr. Smith, to adopt the exposed revisions to SSAP No. 61R on life reinsurance disclosures (Attachment 3), with the effective date of Dec. 31, 2021. The motion passed unanimously.

Ms. Marcotte stated that since the agenda items were adopted after year-end, which is the normal cutoff for edits to the AP&P Manual, the adopted revisions will be included in the updates section at the back of the 2021 and 2022 publication. Additionally, a guidance memo will be sent to the Blanks (E) Working Group for posting regarding the disclosures. Given the timing, NAIC staff will post the two adoptions on the Statutory Accounting Principles (E) Working Group’s web page on the documents tab. NAIC staff will also update the SSAP to annual statement disclosure checklists.
Mr. Bruggeman inquired, and Julie Gann (NAIC) confirmed that a printed hard cover copy of the AP&P Manual is not an option for interested parties now. The NAIC is still working on having a printed copy as a potential option for state insurance regulators through a local printing vendor. Ms. Gann stated that industry representatives would need to acquire an electronic version of the AP&P Manual, which is accessed through Bookshelf.

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

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2022/4- spring nm/hearing/2 - 01-27-22  sapwg minutes .docx
The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met March 2, 2022. The following Working Group members participated: Dale Bruggeman, Chair (OH); Carrie Mears, Vice Chair (IA); Kim Hudson and Susan Bernard (CA); William Arfanis and Michael Estabrook (CT); Tom Hudson and Rylynn Brown (DE); Cindy Andersen and Eric Moser (IL); Stewart Guerin and Melissa Gibson (LA); Judy Weaver (MI); Doug Bartlett and Patricia Gosselin (NH); Bob Kasinow (NY); Kimberly Rankin (PA); Jamie Walker (TX); Doug Stolte and David Smith (VA); and Elena Vetrina (WI).

1. Considered Maintenance Agenda – Active Listing

   a. Agenda Item 2019-21

   Mr. Bruggeman directed the Working Group to agenda item 2019-21: Proposed Bond Definition. Julie Gann (NAIC) provided an overview of the project, stating that in May 2021, the Working Group exposed an original principles-based bond definition and affirmed the direction of the bond proposal after considering the comments in August 2021. Since that time, a small study group, representing state insurance regulators and interested parties have continued discussion and refinement of the principles-based bond definition. Ms. Gann stated that the purpose of holding today’s meeting is to consider exposure of a revised principles-based bond definition and draft issue paper. She stated that although limited edits are proposed to the proposed definition, the issue paper is detailed and intends to document the discussions that have occurred within the study group and the rationale supporting the various components of the bond definition. She stated that neither the proposed bond definition nor the issue paper would be considered authoritative. She stated that statement of statutory accounting principles (SSAP) revisions is not currently proposed as part of this exposure. She stated that with the specific deliberative process for this project, it is anticipated that comments on the issue paper and the revised definition would be considered prior to exposing proposed SSAP revisions.

   Ms. Gann then identified the various revisions to the principles-based bond definition:

   • Proposed revisions include explicit reference to U.S. Treasury Inflation-Protected Securities (TIPS) as an issuer credit obligation, which is in line with current guidance in SSAP No. 26R—Bonds. Ms. Gann stated that the inclusion of these securities was in response to another proposed edit, which clarifies the limitation for investments that have equity-driven results through a derivative or have an equity-based performance reference. With that clarification, U.S. TIPS, which are adjusted for inflation, could inadvertently be precluded from bond treatment.

   • Proposed revisions broaden the approach to identify investments that are in scope when repayment is fully supported by an underlying contractual obligation of a single operating entity that meets the bond definition. Rather than identify specific investments, the concept is included with examples of known investments. Ms. Gann stated that the guidance for “fully supported” was defined to require cash flows for repayment to cover 100% of interest and at least 95% of the principal, which is in line with the NAIC Securities Valuation Office (SVO) guidance related to credit tenant loans (CTLs).
• Proposed revisions delete the hybrid security reference as an explicit issuer credit obligation. This deletion does not intend to indicate that hybrid securities are prohibited from reporting on Schedule D-1—Long-Term Bonds; it only intends to clarify that such items shall be reviewed in accordance with the bond definition and only reported on Schedule D-1 if they qualify. Historically, a hybrid security was defined as a security with both debt and equity components, and a broad exception for such securities under the principles-based bond definition is not viable.

• Proposed revision includes specific identification of exchange-traded funds (ETFs) as issuer credit obligations if they qualify for bond treatment as identified in the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Office). Ms. Gann stated that inclusion of these funds is not a change to the principle concepts, rather it has been added for clarification purposes.

• Proposed revision to clarify that an investment with the potential for “additional returns” must be assessed as if the “additional returns” are a component of the investment’s interest. This revision is to clarify that it is not permissible to have a “stated interest” and then the potential for “additional returns” and conclude that the investment does not have a variable interest based on underlying equity interests.

• Proposed revision to delete the stapling example from Appendix 1, which details situations where securities, despite their legal form, do not in substance represent a creditor relationship. This example originally precluded bond reporting for a qualifying debt tranche if the reporting entity was required to hold equity tranches from the securitization. However, after considering comments from the first exposure period, as well as discussions that occurred within the study group, this example has been eliminated. With this revision, tranches that separately qualify as bonds are permitted to be reported as bonds, and the other tranches would be reported as equity; however, holding both types of securities should not preclude bond reporting for any eligible components. Ms. Mears stated that the origination of this example was to recognize the fact that in some cases, if an insurance company owned both equity and debt components or were required to hold both components as “stapled investments,” they may not necessarily be in a different economic position than had they held the entire investment as an equity investment on Schedule BA—Other Long-Term Assets. However, she stated that the accounting for such an investment should entail the substance of the holding, not necessarily the underlying risk of an investment, which is captured within the purview of the Capital Adequacy (E) Task Force, not statutory accounting. In addition, if a company sold one of their investment components, with the current example, the remaining component could move investment schedules, which is also not a practical solution. Ms. Mears stated that this issue will be considered by the recently formed Risk-Based Capital (RBC) Investment Risk and Evaluation (E) Working Group, which will jointly review the substance and recommend RBC charges for these types of investments.

• Proposed revisions to the example for when a reporting entity invests in a debt instrument issued from a special purpose vehicle that owns underlying equity interests. Ms. Gann stated that the original example was designed to focus on characteristics of an investment that did not qualify as a bond; instead, the example has been revised to provide information to assist users in determining whether a structure could qualify for bond reporting. She stated that the example includes expanded factors to consider in determining whether the rebuttable presumption—i.e., the assumption that a debt instrument collateralized by equity interests does not qualify as a bond—has been overcome.

Ms. Gann stated that staff’s recommendation is to expose both the proposed revisions to the bond definition and the issue paper for public comment. After comments are received, the next steps would be to introduce possible statutory accounting revisions, likely using SSAP No. 26R as the standard for issuer credit obligations and SSAP No.
43R—Loan-Backed and Structured Securities as the standard for asset-backed securities (ABS). Ms. Gann stated that revisions are also anticipated for SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments to clarify that ABS, due to their underlying nature of having a certain level of equity-backed cash flows, should not qualify for securities in the scope of SSAP No. 2R and SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, as that standard currently refers all beneficial interests to SSAP No. 43R.

Ms. Gann stated that comments received from industry on potential reporting options is expected for the Spring National Meeting. However, as part of this exposure, input is requested regarding the reporting of investments that will not qualify as bonds. In addition to the reporting schedule, consideration will need to occur regarding measurement methods (e.g., amortized cost versus lower of cost or fair value). Accordingly, input regarding which approach is supported and what characteristics can be used to identify and support any preferred measurement method is requested during the exposure period.

Ms. Mears made a motion, seconded by Ms. Weaver, to expose the revised principles-based bond definition and draft issue paper for a public comment period ending May 6. In addition, the motion included a recommendation for NAIC staff to continue discussions on the bond definition and develop proposed reporting changes and potential statutory accounting revisions for a subsequent exposure. The motion passed unanimously.

2. Discussed Other Matters

Ms. Gann stated that the agenda for the Spring National Meeting has been posted on the NAIC website. The Working Group’s in-person public meeting is scheduled for Monday, April 4 from 9:45 a.m. to 12:00 p.m. CT. Ms. Gann stated that the meeting will have an audio-only option for those registered and not attending in person. Mr. Bruggeman stated that with the current schedule, regulator-only sessions are planned for immediately before and after the Working Group’s meeting, so the agendas will need to be efficiently discussed to allow attendees to move between meetings.

Mr. Bruggeman stated that in terms of the March 1 statutory filing deadline, the NAIC systems have been a bit delayed, so initial data runs may indicate a company has not filed when they have. It is anticipated that filings will be caught up in the next day, and state insurance regulators should be aware if they are looking for their domestic company filing results.

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

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2022/4- spring nm/hearing/3 - 03-2-22 sapwg minutestpr.docx
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: General Interrogatory for Cryptocurrencies

Check (applicable entity):

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

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

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

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

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): INT 21-01, discussed in the prior section.

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

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

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

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

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

39.2 If the answer to 39.1 is “YES”, indicate if it is the policy of the reporting entity to directly hold cryptocurrency accepted as payment for premiums or immediately convert to U.S. dollars. Select “YES” for both questions if some cryptocurrencies are held directly and others are immediately converted to U.S. dollars.

39.21 Answer “YES” if it is the policy of the reporting entity to directly hold cryptocurrency that was accepted as payment for premiums.

39.22 Answer “YES” if it is the policy of the reporting entity to immediately convert cryptocurrency accepted as payment for premiums to U.S. dollars.

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

<table>
<thead>
<tr>
<th>Name of Cryptocurrency</th>
<th>Immediately Converted to USD, Directly Held, or Both</th>
<th>Accepted for Payment of Premiums</th>
</tr>
</thead>
<tbody>
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</table>

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

<table>
<thead>
<tr>
<th>38.1 Does the reporting entity directly hold cryptocurrencies?</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>38.2 If the response to 38.1 is yes, on what schedule are they reported?</td>
<td></td>
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<tr>
<td>39.1 Does the reporting entity directly or indirectly accept cryptocurrencies as payment for premiums on policies?</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>39.2 If the response to 39.1 is yes, are the cryptocurrencies held directly or are they immediately converted to U.S. dollars?</td>
<td></td>
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</tr>
<tr>
<td>39.3 If the response to 38.1 or 39.1 is yes, list all cryptocurrencies accepted for payments of premiums or that are held directly.</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>1 Name of Cryptocurrency</th>
<th>2 Immediately Converted to USD, Directly Held, or Both</th>
<th>3 Accepted for Payment of Premiums</th>
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© 2022 National Association of Insurance Commissioners 2
Staff Review Completed by: Jake Stultz, NAIC Staff, November 2021

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

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

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

**Check (applicable entity):**

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

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

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

**Existing Authoritative Literature:**

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

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

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

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

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

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

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

Impairment

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

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

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

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

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

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

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

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

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

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

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

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

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

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

4. The Working Group believes that the following items are only a few examples of the factors, which, individually or in combination, indicate that a security’s decline in value is specific to an issuer’s fundamental credit difficulties, or that a non-interest related decline is other than temporary and that a write-down of the carrying value is required:

a. The length of time and the extent to which the fair value has been less than cost;
b. The financial condition and short-term prospects of the issuer, including any specific events that may influence the operations of the issuer, such as changes in technology, that may impair the earnings potential of the asset or the discontinuance of a segment of the business that may affect the future earnings potential; or
c. The intent and ability of the holder to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in value.

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

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

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

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

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

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


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

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


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

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

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/4- Spring NM/Hearing/5 - 21-28 - ASU 2021-03 - Impairment Trigger Events.docx
**Statutory Accounting Principles (E) Working Group**

**Maintenance Agenda Submission Form**

**Form A**

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

**Check (applicable entity):**

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

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

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

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

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

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

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

i. *ASU 2020-02, Leases (Topic 842), Lessors—Certain Leases with Variable Lease Payments* (Rejected in its entirety.)

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

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

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/4- Spring NM/Hearing/6 - 21-29 - ASU 2021-05 Variable Lease Payments.docx

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

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

Check (applicable entity):

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

P/C  Life  Health

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

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

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

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

Convergence with International Financial Reporting Standards (IFRS):
None

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

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

Staff Review Completed by: Jake Stultz, November 2021

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

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/4- Spring NM Hearing/7-21-30-ASU 2021-06 SEC Paragraphs.docx

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

**Check (applicable entity):**

<table>
<thead>
<tr>
<th>Modification of Existing SSAP</th>
<th>P/C</th>
<th>Life</th>
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<tr>
<td>New Issue or SSAP</td>
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**Description of Issue:** This agenda item reflects updated NAIC designation/NAIC designation category guidance recently adopted by the Valuation of Securities (E) Task Force (VOSTF) to the *purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual), for residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS).

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

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

**Existing Authoritative Literature:**

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

**Designation Guidance**

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

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

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

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

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

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

Specific Interim Reporting Guidance Financially Modeled Securities

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

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

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

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

SSAP No. 43R - EXHIBIT A – Question and Answer Implementation Guide

Index to Questions

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<tr>
<td>8-10</td>
<td>Questions 8-10 are specific to securities subject to the financial modeling process. (This process is limited to qualifying RMBS/CMBS securities reviewed by the NAIC Structured Securities Group.) The guidance in questions 8-10 shall not be inferred to other securities in scope of SSAP No. 43R.</td>
</tr>
<tr>
<td>8</td>
<td>Do LBSS purchased in different lots result in a different NAIC designation for the same CUSIP? Can reporting entities use a weighted average method determined on a legal entity basis?</td>
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<td>9</td>
<td>The NAIC Designation process for LBSS may incorporate loss expectations that differ from the reporting entity’s expectations related to OTTI conclusions. Should the reporting entities be required to incorporate recovery values obtained from data provided by the service provider used for the NAIC Designation process for impairment analysis as required by SSAP No. 43R?</td>
</tr>
<tr>
<td>10</td>
<td>For companies that have separate accounts, can the NAIC designation be assigned based upon the total legal entity or whether it needs to be calculated separately for the general account and the total separate account?</td>
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8. **Question** – Do LBSS purchased in different lots result in a different NAIC designation for the same CUSIP? Can reporting entities use a weighted average method determined on a legal entity basis?

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

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

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

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

10.1 The financial modeling process for qualifying RMBS/CMBS securities is required for applicable securities held in either the general or separate account.
Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

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

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

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


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

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

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

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

Designation Guidance

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

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

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

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

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

Specific Interim Reporting Guidance Financially Modeled Securities

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

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

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

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

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

Designation Guidance

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

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

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

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

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

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

Specific Interim Reporting Guidance Financially Modeled Securities

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

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

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

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

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

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

Status:
On December 11, 2021, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed two options for possible revision, as illustrated above, to update the summarized financial modeling guidance in SSAP No. 43R. The first option will retain existing guidance, with updates to reflect Valuation of Securities (E) Task Force adopted edits. The second option removes the
summarized financial modeling guidance and refers users to the *Purpose and Procedures Manual of the NAIC Investment Analysis Office*, which is the source document for financial modeling guidance.

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

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

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

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

Various SSAPs in response to terminology changes of “Substantive” and “Nonsubstantive”  
(Note: for a review of every use “substantive and nonsubstantive,” as well documentation as to proposed modifications, if any, please see pages see attachment G.1.)  

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

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

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

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

New paragraph proposed (To be inserted between the paragraphs starting with "As indicated by the Statutory Hierarchy..." and "The cover page of each SSAP...")
Prior to (adoption date), the term used to describe a new SAP concept or a new SAP concept in an existing SSAP was “substantive” and the term used to describe a SAP clarification was “nonsubstantive.” The new terms will be reflected in materials to describe revisions to statutory accounting principles on a prospective basis and historical documents will not be updated to reflect the revised terms.

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

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

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

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

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

Section 1 summarizes substantive revisions that result with a new SSAP or new SAP concept to statutory accounting principles. Substantive Revisions that introduce original or modified accounting principles and can be reflected in an existing or new SSAP. When substantive revisions that result in a new SAP concept are made to an existing SSAP, the effective date is identified in the Status section, and the revised text within is depicted by underlines (new language) and strikethroughs (removed language). This tracking will not be shown in subsequent manuals. New SSAPs and new SAP concepts that revise existing substantively revised SSAPs are commonly accompanied by a corresponding issue paper that reflects the revisions for historical purposes. If language in an existing SSAP is superseded, that language is shaded and the new or substantively revised SSAP is referenced. Completely superseded SSAPs and nullified interpretations are included in Appendix H.
Section 2 summarizes the nonsubstantive revisions that clarify existing statutory accounting principles. Nonsubstantive These revisions are characterized as language clarifications which do not modify the original intent of a SSAP, or changes to reference material. Nonsubstantive Such revisions are depicted by underlines (new language) and strikethroughs (removed language) and will not be tracked in subsequent manuals. Nonsubstantive Revisions that clarify existing statutory accounting principles are effective when adopted unless a specific effective date is noted.

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

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

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

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

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

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

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

**Edit 14: Table of Contents (How to use this Manual), Volume II, Page xviii**

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

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

**Edit 17: Summary of Changes, Volume II, Page xxiii**

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

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

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

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

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

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

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


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


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


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


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

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

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

**Check (applicable entity):**

- [ ] Modification of Existing SSAP  
- [ ] New Issue or SSAP  
- [x] Interpretation

**P/C** | **Life** | **Health**
---|---|---
[ ] | [ ] | [x]
[ ] | [ ] | [ ]
[ ] | [ ] | [ ]

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

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

The main provisions of this ASU are:

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

2. An entity should measure the effect of a modification or an exchange of a freestanding equity-classified written call option that remains equity classified after modification or exchange as follows:
   a. For a modification or an exchange that is a part of or directly related to a modification or an exchange of an existing debt instrument or line-of-credit or revolving-debt arrangements (hereinafter, referred to as a “debt” or “debt instrument”), as the difference between the fair value of the modified or exchanged written call option and the fair value of that written call option immediately before it is modified or exchanged.
   b. For all other modifications or exchanges, as the excess, if any, of the fair value of the modified or exchanged written call option over the fair value of that written call option immediately before it is modified or exchanged.

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

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

SSAP No. 72:

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

SSAP No. 15:

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

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

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


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

Staff Recommendation:

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

Proposed revisions to SSAP No. 72:

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

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

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

Bond Proposal – Potential Reporting Changes
2021 Fall National Meeting

Introduction: A key aspect of the bond proposal is improved transparency and granularity in reporting.

1. Reporting Lines:
   With the principles-based bond definition, it is recommended that more granular reporting lines be established to capture investments in scope of SSAP No. 26R and SSAP No. 43R. From preliminary assessments, the current general categories are not used for analytical assessments / reports except for US Govt – Full Faith and Credit. As such, this document proposes to replace the current general categories with the inclusion of more useful reporting lines based on the type of investment.

   Exposure Request Detail provided on pages 2-5:
   1. Information is requested on the potential removal of the general categories and whether the elimination would impact any tools or analyses currently performed.
   2. Information is requested on the proposed reporting lines and whether additional categories would be beneficial. (Note – The proposal suggests dedicated reporting lines for certain securities that are now identified by codes. Comments on this approach are requested.)

2. New Sub-Schedule D-1:
   The bond project is currently proposing a new sub-schedule that details bond investments that have certain characteristics (e.g., ABS backed by financial assets that are not self-liquidating and ABS backed by cash-generating non-financial assets not captured within the practical expedient.)

   Exposure Request – Detail provided on page 5:
   1. Information is requested on how investments shall be categorized on this schedule.
   2. Information is requested on additional information / columns desired for these structures.

3. Schedule D-1 Information:
   As the changes to the reporting lines are considered a significant change, it has been proposed that this would be a good time to do a full-scope assessment of the information captured and reported on Schedule D-1. The following items have been identified for possible revision / clarification:

   • Column 3 – Code Column
   • Column 5 – Bond Characteristics
   • Column 26 – Collateral Type
   • Column 34 – Capital Structure Code

   Exposure Request – Detail provided on page 6:
   1. Information is requested on whether other columns / reporting instructions should be clarified as part of the bond proposal project.
   2. Comments are welcome on the additional investment elements should be captured and/or whether certain elements are no longer beneficial to be captured.
1. **Reporting Lines**

The separation of bond investments in accordance with the current general categories is proposed to be replaced. It is proposed that Schedule D-1 have separate reporting lines for issuer credit obligations and asset-backed securities, with more granular lines within each grouping. Based on information received, the proposal retains reporting for categories that were previously used (e.g., U.S. Govt). The intent is to revamp the organization of reporting lines in a way that is believed to be more useful and transparent.

**General Categories Proposed to be Eliminated:**

(Under current reporting, each general category has 4 subcategories of issuer obligations, residential mortgage-backed securities, commercial mortgage-backed securities, and other loan-backed securities.)

- **U.S. Government:** U.S. Government shall be defined as U.S. Government Obligations as defined per the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*.

- **All Other Governments:** This includes bond investments issued by non-U.S. governments, including bonds of political subdivisions and special revenue. This includes bonds issued by utilities owned by non-U.S. governments and bonds fully guaranteed by non-U.S. governments.

- **U.S. States, Territories and Possessions (Direct and Guaranteed):** General obligations of these entities (NAIC members), as well as bonds issued by utility companies owned by these entities. NAIC membership is composed of the 50 states, the District of Columbia, American Samoa, Guam, Northern Marianna Islands, Puerto Rico, and the U.S. Virgin Islands.

- **U.S. Political Subdivisions of States, Territories and Possessions (Direct and Guaranteed):** General obligations of cities, counties, townships, etc., as well as bonds issued by utility companies owned by these entities.

- **U.S. Special Revenue and Special Assessment Obligations and All Non-Guaranteed Obligations of Agencies and Authorities of Governments and Their Political Subdivisions:** Those U.S. government issues not listed as “Securities That Are Considered “Exempt Obligations” For Purposes of Determining The Asset Valuation Reserve And The Risk-Based Capital Calculation” in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*, yet included as “Filing Exemptions for Other U.S. Government Obligations”. This category also includes bonds that are issued by states, territories, possessions and other political subdivisions that are issued for a specific financing project rather than as general obligation bonds. Also include mortgage reference securities that are within the scope of SSAP No. 43R—Loan-Backed and Structured Securities.

- **Industrial and Miscellaneous (Unaffiliated):** This category includes all non-governmental issues that do not qualify for some other category in Schedule D, Part 1, including privatized (non-government ownership) utility companies. Include Public Utilities.
**Potential Schedule D-1 Reporting Lines**

(Note: Items in italics were previously identified using codes in the code columns. To improve reporting, it is proposed that these securities be separately identified through dedicated reporting lines.)

Issuer Credit Obligations:

<table>
<thead>
<tr>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>U.S. Government Obligations</td>
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<tr>
<td>Other U.S. Government Securities</td>
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<tr>
<td>Non-U.S. Sovereign Jurisdiction Securities</td>
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<tr>
<td>Municipal Bonds – General Obligations</td>
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<tr>
<td>Municipal Bonds – Special Revenue</td>
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<tr>
<td>Project Finance Bonds Issued by Operating Entities</td>
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<tr>
<td>Affiliated Project Finance Bonds Issued by Operating Entities</td>
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<tr>
<td>Corporate Bonds</td>
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<td>Affiliated Corporate Bonds</td>
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<tr>
<td>Qualifying Single-Tenant Lease-Backed Securities (ETC, EETC and CTLs)</td>
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<tr>
<td>Affiliated Qualifying Single Tenant Leased-Backed Securities</td>
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<tr>
<td>Bonds Issued from Business Development Corps, Closed End Funds &amp; REITS</td>
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<td></td>
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<tr>
<td>Affiliated Business Development Corps, Closed End Funds &amp; REITS</td>
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<tr>
<td><strong>Mandatory Convertible Bonds</strong></td>
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<tr>
<td>Affiliated Mandatory Convertible Bonds</td>
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<tr>
<td>Bank Loans – Issued</td>
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<td>Affiliated Bank Loans - Issued</td>
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<tr>
<td>Bank Loans - Acquired</td>
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<td>Affiliated Bank Loans - Acquired</td>
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<tr>
<td>SVO-Identified Bond Exchange Traded Funds – Fair Value</td>
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<td><strong>SVO-Identified Bond Exchange Traded Funds – Systematic Value</strong></td>
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<tr>
<td>Certificates of Deposit</td>
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<tr>
<td>Other Issuer Credit Obligations</td>
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<td><strong>Total Issuer Credit Obligations</strong></td>
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<td><strong>Total Affiliated Issuer Credit Obligations</strong></td>
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</tbody>
</table>
Asset-Backed Securities:

Self-Liquidating Financial Asset Backed Securities
  Agency Residential Mortgage-Backed Securities
  Agency Commercial Mortgage-Backed Securities
  Non-Agency Residential Mortgage-Backed Securities
    Affiliated Non-Agency Residential Mortgage-Backed Securities
  Non-Agency Commercial Mortgage-Backed Securities
    Affiliated Non-Agency Commercial Mortgage-Backed Securities
  Other Asset-Backed Securities
    Affiliated Other Asset-Backed Securities
Total Self-Liquidating Financial Asset-Backed Securities
Total Affiliated Self-Liquidating Financial Asset-Backed Securities

Cash-Generating Non-Financial Asset Backed Securities (Practical Expedient)
  Affiliated Cash-Generating Non-Financial Asset Backed Securities (Practical Expedient)
Total Cash-Generated Non-Financial Asset-Backed Securities

Government Sponsored Mortgage-Referenced Securities

Total Other Asset-Backed Securities (Detailed on New Schedule)
  Total Affiliated Other Asset-Backed Securities (Detailed on New Schedule)

Total Asset-Backed Securities
Total Affiliated Asset-Backed Securities

Total Long-Term Bonds (Issuer Credit Obligations & Asset Backed Securities)
Total Affiliated Long-Term Bonds (Issuer Credit Obligations & Asset Backed Securities)
Potential Sub-schedule D-1 Reporting Lines

The sub-schedule D-1 is proposed to capture the individual investment detail for items reported as “Other Asset-Backed Securities” on Schedule D-1.

Other Asset-Backed Securities:

Non-Self-Liquidating Financial Asset Backed Securities

Underlying Collateral of Equity Interests

Affiliated

Underlying Collateral of Non-Equity Interests

Affiliated

Total Non-Self-Liquidating Financial Asset-Backed Securities

Total Affiliated Non-Self-Liquidating Financial Asset-Backed Securities

Cash-Generating Non-Financial Assets (Not Captured in Practical Expedient)

Affiliated

2. New Sub-Schedule D-1:

As detailed above, the bond project is currently proposing a new sub-schedule that details bond investments that have certain characteristics (e.g., ABS backed by financial assets that are not self-liquidating and ABS backed by cash-generating non-financial assets not captured within the practical expedient.)

Exposure Request:

1. Information is requested on how investments shall be categorized on this schedule.

2. Information is requested on additional information / columns desired for these structures. Initial ideas that have been proposed include:

   a. Balloon payment as % of principal at acquisition
   b. Current loan-to-value
   c. PIK – Information on whether payment of interest is deferrable
   d. Amount of PIK interest to date.
   e. Expected payoff date determined at acquisition
   f. Expected payoff date as of the financial statement date
3. **Schedule D-1 Information:**
   As noted, with the change in reporting lines, it has been proposed a review of the columns and instructions also be considered. The following code columns have been potentially identified.

   - **Column 3 – Code Column:** Potential edits include revising this column to focus on restricted asset classification, with other codes either eliminated or moved to other reporting locations.

   - **Column 5 – Bond Characteristics:** With the granular reporting lines, certain codes captured in this column may no longer be necessary. Other potential edits may consider an expansion of information in the call columns (columns 27-29) rather than this location.

   - **Column 26 – Collateral Type:** With the granular reporting by investment type, potential edits may limit the need for this detail for all ABS. Instead, it may be focused on the non-RMBS/CMBS reporting lines. Additionally, comments have been received requesting better detail on the underlying collateral. This may necessitate a need for enhanced reporting of the underlying collateral.

   - **Column 34 – Capital Structure Code:** Potential edits to improve the reporting instructions to ensure proper classification of tranches.

**Exposure Request:**
1. Information is requested on whether other columns / reporting instructions should be clarified as part of the bond proposal project.

2. Comments are welcome on the additional investment elements should be captured and/or whether certain elements are no longer beneficial to be captured. Potential elements related to asset-backed securities include:
   a. **Market Validation** – This will be a code to identify situations where none of the issuance is owned by unrelated parties.
   b. **Participation in residual tranche (Y/N)**

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

Issue: Effective Derivatives – ASU 2017-12

Check (applicable entity):

- Modification of existing SSAP: ☒
- New Issue or SSAP: ☐
- Interpretation: ☐

P/C: ☒
Life: ☒
Health: ☒

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

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

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

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

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

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

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

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

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

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

**Partial Term Hedging:**

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

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

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

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

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

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

For this option, as part of the initial hedge documentation, an analysis shall be completed and documented to support the entity’s expectation that the hedged item (that is, the designated last of layer), is anticipated to be outstanding as of the hedged item’s assumed maturity date in accordance with the entity’s partial-term hedge election. That analysis shall incorporate the entity’s current expectations of prepayments, defaults, and other events affecting the timing and amount of cash flows associated with the closed portfolio of prepayable financial assets or beneficial interests secured by a portfolio of prepayable financial instruments. For purposes of the analysis, the entity may assume that as prepayments, defaults, and other events affecting the timing and amount of cash flows occur, they first will be applied to the portion of the closed portfolio of prepayable financial assets or one or more beneficial interest that is not part of the hedged item - (i.e., not part of the designated last layer.)
Proposed amendments to the ASU are currently being considered by the FASB to provide additional clarifying guidance. One of those elements clarifies that a closed portfolio is not limited to a single hedge. Rather, there can be multiple-layer hedges utilized in a closed portfolio. In response to this proposed clarification, the FASB is changing the name of “last of layer” and renaming it the “portfolio layer method.” Also, since the hedged item reflects a closed portfolio of assets, the FASB has clarified that the change in fair value (gain or loss) of the hedged item (portfolio of assets) attributed to the hedged risk shall not adjust the carrying value of the individual assets in the portfolio. Instead, that amount shall be maintained on a closed portfolio basis and amortized to earnings, with amortization beginning when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged. However, the gain or loss shall be fully amortized prior to the assumed maturity date of the hedged item. (Note: FASB has identified that allocating adjustments to individual assets may lead to uneconomic results if an asset is sold or removed from a closed portfolio. They have also noted that an allocation election would lead to a lack of comparability across entities and potential for earning management.)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Existing Authoritative Literature:**

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

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

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

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

- Although the guidance in SSAP No. 86 prescribes the general concepts for hedges, as well as the measurement guidance for derivatives based on whether they are (or not) highly effective, the application guidance is detailed in Exhibit C – Specific Hedge Accounting Procedures for Derivatives. These procedures are SAP specific due to the fundamental differences in measurement and recognition of derivatives between U.S. GAAP and SAP.
Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

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

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

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

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

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

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

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

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

Review of U.S. derivative guidance and the application to SAP is complex with many facets. This initial document considers consistency in the determination of hedge effectiveness between U.S. GAAP and SAP. The second element pertaining to the accounting and reporting of hedging instruments, including excluded components, will be considered separately, as that guidance has been historically different.

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

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

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

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

Exposure and request for comments - Excerpts of the U.S. GAAP guidance proposed to be adopted are recommended to replace the existing guidance in Exhibit A and Exhibit B of SSAP No. 86. However, these excerpts do not reflect the full U.S. GAAP guidance referenced. This reduction of quoted guidance is simply to manage the extent of detail captured in SSAP No. 86. With exposure of the proposed excerpts and adoption language, the Working Group requests comments on whether certain paragraphs should be removed as unnecessary in the Exhibit and whether other guidance from the referenced U.S. GAAP would be beneficial to be incorporated. (NAIC staff notes that the U.S. GAAP themes previously captured within Exhibit A and B have been retained – with updated ASC language.) Unless noted with tracked changes, the cited paragraphs are proposed to be incorporated directly from U.S. GAAP. (The tracked changes most commonly update GAAP references or paraphrase topics captured in GAAP references.)
EXHIBIT A – DISCUSSION OF HEDGE EFFECTIVENESS

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

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

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

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

2. To qualify for hedge accounting, the hedging relationship, both at inception of the hedge and on an ongoing basis, shall be expected to be highly effective in achieving either of the following: (815-20-25-75)

   a. Offsetting changes in fair value attributable to the hedged risk during the period that the hedge is designated (if a fair value hedge)

   b. Offsetting cash flows attributable to the hedged risk during the term of the hedge (if a cash flow hedge), unless the hedging instrument is used to modify the contractually specified interest receipts or payments associated with a recognized financial asset liability from one variable rate to another variable rate, except as indicated in paragraph 815-20-25-50

3. If the hedging instrument (such as an at-the-money option contract) provides only one-sided offset of the hedged risk, either of the following conditions shall be met: (815-20-25-76)

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

   b. The cash inflows (outflows) from the hedging instrument are expected to be highly effective in offsetting the corresponding change in the cash outflows or inflows of the hedged transaction (if a cash flow hedge).
4. There would be a mismatch between the change in fair value or cash flows of the hedging instrument and the change in fair value or cash flows of the hedged item or hedged transaction in any of the following circumstances, among others: (815-20-25-77)

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

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

      i. Notional amounts

      ii. Maturities

      iii. Quantity

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

      v. Delivery Dates

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

   a. Prospective considerations. The entity's expectation that the relationship will be highly effective over future periods in achieving offsetting changes in fair value or cash flows, which is forward looking, must be assessed on a quantitative basis at hedge inception unless one of the exceptions detailed in ASU 2017-12, paragraph 815-20-25-3(b)(2)(iv)(01)\(^1\) is met. Prospective assessments shall be subsequently performed whenever financial statements or earnings are reported and at least every three months. The entity shall elect at hedge inception in accordance with paragraph 815-20-25-3(b)(2)(iv)(03) whether to perform subsequent retrospective and prospective hedge effectiveness assessments on a quantitative or qualitative basis. See paragraphs 815-20-35-2A through 35-2F for additional guidance on qualitative assessments of hedge effectiveness. A quantitative assessment can be based on regression or other statistical analysis of past changes in fair values or cash flows as well as on other relevant information. The quantitative prospective assessment of hedge effectiveness shall consider all reasonably possible changes in fair value (if a fair value hedge) or in fair value or cash flows (if a cash flow hedge) of the derivative instrument and the hedged items for the period used to assess whether the requirement for expectation of highly effective offset is satisfied. The quantitative prospective assessment may not be limited only to the likely or expected changes in fair value (if a fair value hedge) or in fair value or cash flows (if a cash flow hedge) of the derivative instrument or the hedged items. Generally, the process of formulating an expectation regarding the effectiveness of a proposed hedging relationship involves a probability-weighted analysis of the possible changes in fair value (if a fair value hedge) or in fair value or cash flows (if a cash flow hedge) of the derivative instrument and the hedged items for the hedge period. Therefore, a probable future change in fair value will be more heavily weighted than a reasonably possible future change. That calculation technique is consistent with the definition of the term expected cash flow in FASB

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\(^1\) Reference to this ASU 2017-12 guidance is consistent with the guidance in SSAP No. 86, paragraph 42, footnote 5.
Assessment of Hedge Effectiveness


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

Skipping 815-20-25-79A

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

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

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

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

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

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

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

iii. The portion of the change in time value attributable to changes due to interest rates (rho).

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

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

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

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

For fair value and cash flow hedges, the initial value of the component excluded from the assessment of effectiveness shall be recognized in earnings using a systematic and rational method over the life of the hedging instrument. Any difference between the change in fair value of the excluded component and amounts recognized in earnings under that systematic and rational method shall be recognized in other comprehensive income. Example 31 beginning in paragraph 815-20-55-235 illustrates this approach for a cash flow hedge in which the hedging instrument is an option and the entire time value is excluded from the assessment of effectiveness. (815-20-25-83A)

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

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

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

b. The fair value of the forward contract at inception is zero.
c. Either of the following criteria is met:

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

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

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

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

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

Computing Changes in an Option’s Time Value

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(1.) Maturities

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

(3.) Related notional amounts

(4.) Timing and frequency of payments

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

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

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

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

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

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

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

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

   d. For fair value hedges of a proportion of the principal amount of the interest-bearing asset or liability, the notional amount of the interest rate swap designated as the hedging instrument (see (a) in paragraph 815-20-25-104) matches the portion of the asset or liability being hedged.

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

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

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

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

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

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

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

   c. Either of the following conditions is met:

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

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

d. The repricing dates of the variable-rate asset or liability and the hedging instrument must occur on the same dates and be calculated the same way (that is, both shall be either prospective or retrospective). If the repricing dates of the hedged item occur on the same dates as the repricing dates of the hedging instrument but the repricing calculation for the hedged item is prospective whereas the repricing calculation for the hedging instrument is retrospective, those repricing dates do not match.

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

f. For a cash flow hedge in which the hedged forecasted transaction is a group of individual transactions (as permitted by paragraph 28a of the SSAP guidance paragraph 815-20-25-15(a)), if both of the following criteria are met:

i. The notional amount of the interest rate swap designated as the hedging instrument (see paragraph (a)) matches the notional amount of the aggregate group of hedged transactions.

ii. The remaining criteria for the shortcut method are met with respect to the interest rate swap and the individual transactions that make up the group. For example, the interest rate repricing dates for the variable-rate assets or liabilities whose interest payments are included in the group of forecasted transactions shall match (that is, be exactly the same as) the reset dates for the interest rate swap.

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

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

21. Any discount or premium in the hedged debt's carrying amount (including any related deferred issuance costs) is irrelevant to and has no direct impact on the determination of whether an interest rate swap contains a mirror-image call option under paragraph 17e.1(e). Typically, the call price is greater than the par or face amount of the debt instrument. The carrying amount of the debt is economically unrelated to the amount the issuer would be required to pay to exercise the call embedded in the debt. (815-20-25-108)

22. The fixed interest rate on a hedged item need not exactly match the fixed interest rate on an interest rate swap designated as a fair value hedge. Nor does the variable interest rate on an interest-bearing asset or liability need to be the same as the variable interest rate on an interest rate swap designated as a cash flow hedge. An interest rate swap’s fair value comes from its net settlements. The fixed and variable interest rates on an interest rate swap can be changed without affecting the net settlement if both are changed by the same amount. That is, an interest rate swap with a payment based on LIBOR and a receipt based on a
fixed rate of 5 percent has the same net settlements and fair value as an interest rate swap with a payment based on LIBOR plus 1 percent and a receipt based on a fixed rate of 6 percent. (815-20-25-109)

23. Comparable credit risk at inception is not a condition for assuming perfect effectiveness even though actually achieving perfect offset would require that the same discount rate be used to determine the fair value of the swap and of the hedged item or hedged transaction. To justify using the same discount rate, the credit risk related to both parties to the swap as well as to the debtor on the hedged interest-bearing asset (in a fair value hedge) or the variable-rate asset on which the interest payments are hedged (in a cash flow hedge) would have to be the same. However, because that complication is caused by the interaction of interest rate risk and credit risk, which are not easily separable, comparable creditworthiness is not considered a necessary condition for assuming perfect effectiveness in a hedge of interest rate risk. (815-20-25-111)

Skipped paragraphs 815-20-25-112 through 815-20-25-143

Hedge Effectiveness – After Designation

24. If a fair value hedge or cash flow hedge initially qualifies for hedge accounting, the entity would continue to assess whether the hedge meets the effectiveness test on either a quantitative basis (using either a dollar-offset test or a statistical method such as regression analysis) or a qualitative basis. See paragraphs 815-20-35-2A through 35-2F for additional guidance on qualitative assessments of effectiveness. If the hedge fails the effectiveness test at any time (that is, if the entity does not expect the hedge to be highly effective at achieving offsetting changes in fair values or cash flows), the hedge ceases to qualify for hedge accounting. At least quarterly, the hedging entity shall determine whether the hedging relationship has been highly effective in having achieved offsetting changes in fair value or cash flows through the date of the periodic assessment.) (815-20-35-2)

Effectiveness Assessment on a Qualitative Basis

25. An entity may qualitatively assess hedge effectiveness if both of the following criteria are met: (815-20-35-2A)

a. An entity performs an initial quantitative test of hedge effectiveness on a prospective basis (that is, it is not assuming that the hedging relationship is perfectly effective at hedge inception as described in paragraph 815-20-25-3(b)(2)(iv)(A) through (H)), and the results of that quantitative test demonstrate highly effective offset.

b. At hedge inception, an entity can reasonably support an expectation of high effectiveness on a qualitative basis in subsequent periods.

26. An entity may elect to qualitatively assess hedge effectiveness in accordance with paragraph 25 815-20-35-2A on a hedge-by-hedge basis. If an entity makes this qualitative assessment election, only the quantitative method specified in an entity’s initial hedge documentation must comply with paragraph 815-20-25-81. (815-20-35-2B)

27. When an entity performs qualitative assessments of hedge effectiveness, it shall verify and document whenever financial statements or earnings are reported and at least every three months that the facts and circumstances related to the hedging relationship have not changed such that it can assert qualitatively that the hedging relationship was and continues to be highly effective. While not all-inclusive, the following is a list of indicators that may, individually or in the aggregate, allow an entity to continue to assert qualitatively that the hedging relationship is highly effective: (815-20-35-2C)
a. An assessment of the factors that enabled the entity to reasonably support an expectation of high effectiveness on a qualitative basis has not changed such that the entity can continue to assert qualitatively that the hedging relationship was and continues to be highly effective. This shall include an assessment of the guidance in paragraph 815-20-25-100 when applicable.

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

28. If an entity elects to assess hedge effectiveness on a qualitative basis and then facts and circumstances change such that the entity no longer can assert qualitatively that the hedging relationship was and continues to be highly effective in achieving offsetting changes in fair values or cash flows, the entity shall assess effectiveness of that hedging relationship on a quantitative basis in subsequent periods. In addition, an entity may perform a quantitative assessment of hedge effectiveness in any reporting period to validate whether qualitative assessments of hedge effectiveness remain appropriate. In both cases, the entity shall apply the quantitative method that it identified in its initial hedge documentation in accordance with paragraph (b)(2)(iv)(02). (815-20-35-2D)

29. When an entity determines that facts and circumstances have changed and it no longer can assert qualitatively that the hedging relationship was and continues to be highly effective, the entity shall begin performing subsequent quantitative assessments of hedge effectiveness as of the period that the facts and circumstances changed. If there is no identifiable event that led to the change in the facts and circumstances of the hedging relationship, the entity may begin performing quantitative assessments of effectiveness in the current period. (815-20-35-2E)

30. After performing a quantitative assessment of hedge effectiveness for one or more reporting periods as discussed in paragraphs 28-29, an entity may revert to qualitative assessments of hedge effectiveness if it can reasonably support an expectation of high effectiveness on a qualitative basis for subsequent periods. See paragraphs 815-20-55-79G through 55-79N for implementation guidance on factors to consider when determining whether qualitative assessments of effectiveness can be performed after hedge inception. (815-20-35-2F)

Quantitative Hedge Effectiveness Assessments After Hedge Designation

31. Quantitative assessments can be based on regression or other statistical analysis of past changes in fair values or cash flows as well as on other relevant information. (815-20-35-2G)

32. If an entity elects at the inception of a hedging relationship to use the same regression analysis approach for both prospective considerations and retrospective evaluations of assessing effectiveness, then during the term of that hedging relationship both of the following conditions shall be met: (815-20-35-3)

a. Those regression analysis calculations shall generally incorporate the same number of data points.

b. That entity must periodically update its regression analysis (or other statistical analysis).

33. Electing to use a regression or other statistical analysis approach instead of a dollar-offset approach to perform retrospective evaluations of assessing hedge effectiveness may affect whether an entity can apply hedge accounting for the current assessment period. (815-20-35-4)

34. In periodically (that is, at least quarterly) assessing retrospectively the effectiveness of a fair value hedge (or a cash flow hedge) in having achieved offsetting changes in fair values (or cash flows) under a
dollar-offset approach, an entity shall use either a period-by-period approach or a cumulative approach on individual fair value hedges (or cash flow hedges): (815-20-35-5)

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

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

35. If an entity elects at inception of a hedging relationship to base its comparison of changes in fair value (or cash flows) on a cumulative approach, then that entity must abide by the results of that methodology as long as that hedging relationship remains designated. Electing to utilize a period-by-period approach instead of a cumulative approach (or vice versa) to perform retrospective evaluations of assessing hedge effectiveness under the dollar-offset method may affect whether an entity can apply hedge accounting for the current assessment period. (815-20-35-6)

Assessing Effectiveness Based on Whether the Critical Terms of the Hedging Instrument and the Hedged Items Match

36. If, at inception, the critical terms of the hedging instrument and the hedged forecasted transaction are the same (see paragraphs 10-11815-20-25-84 through 25-84A), the entity can conclude that changes in cash flows attributable to the risk being hedged are expected to be completely offset by the hedging derivative. Therefore, subsequent assessments can be performed by verifying and documenting whether the critical terms of the hedging instrument and the forecasted transaction have changed during the period in review. (815-20-35-9)

37. Because the assessment of hedge effectiveness in a cash flow hedge involves assessing the likelihood of the counterparty’s compliance with the contractual terms of the derivative instrument designated as the hedging instrument, the entity must also assess whether there have been adverse developments regarding the risk of counterparty default, particularly if the entity planned to obtain its cash flows by liquidating the derivative instrument at its fair value. (815-20-35-10)

38. If there are no such changes in the critical terms or adverse developments regarding counterparty default, the entity may conclude that the hedging relationship is perfectly effective. In that case, the change in fair value of the derivative instrument can be viewed as a proxy for the present value of the change in cash flows attributable to the risk being hedged. (815-20-35-11)

39. However, the entity must assess whether the hedging relationship is expected to continue to be highly effective using a quantitative assessment method (either a dollar-offset test or a statistical method such as regression analysis) if any of the following conditions exist: (815-20-35-12)

a. The critical terms of the hedging instrument or the hedged forecasted transaction have changed.
b. There have been adverse developments regarding the risk of counterparty default.

**Possibility of Default by the Counterparty to Hedging Derivative**

40. For an entity to conclude on an ongoing basis that the hedging relationship is expected to be highly effective in achieving offsetting changes in cash flows, the entity shall not ignore whether it will collect the payments it would be owed under the contractual provisions of the derivative instrument. In complying with the requirements of paragraph 8b 215-20-25-75(b), the entity shall assess the possibility of whether the counterparty to the derivative instrument will default by failing to make any contractually required payments to the entity as scheduled in the derivative instrument. In making that assessment, the entity shall also consider the effect of any related collateralization or financial guarantees. The entity shall be aware of the counterparty’s creditworthiness (and changes therein) in determining the fair value of the derivative instrument. Although a change in the counterparty’s creditworthiness would not necessarily indicate that the counterparty would default on its obligations, such a change shall warrant further evaluation. (815-20-35-14)

41. If the likelihood that the counterparty will not default ceases to be probable, an entity would be unable to conclude that the hedging relationship in a cash flow hedge is expected to be highly effective in achieving offsetting cash flows. (815-20-35-15)

42. In contrast, a change in the creditworthiness of the derivative instrument's counterparty in a fair value hedge would have an immediate effect because that change in creditworthiness would affect the change in the derivative instrument's fair value, which would immediately affect both of the following: (815-20-35-16)

   a. The assessment of whether the relationship qualifies for hedge accounting

   b. The amount of mismatch between the change in the fair value of the hedging instrument and the hedged item attributable to the hedged risk recognized in earnings under fair value hedge accounting.

43. Paragraph 16815-20-25-103 states that, in applying the shortcut method, an entity shall consider the likelihood of the counterparty’s compliance with the contractual terms of the hedging derivative that require the counterparty to make payments to the entity. That paragraph explains that implicit in the criteria for the shortcut method is the requirement that a basis exist for concluding on an ongoing basis that the hedging relationship is expected to be highly effective in achieving offsetting changes in fair values or cash flows. (815-20-35-18)

**Change in Hedge Effectiveness Method When Hedge Effectiveness if Assessed on a Quantitative Basis**

44. If the entity identifies an improved method of assessing hedge effectiveness in accordance with the guidance in paragraph 86 215-20-25-80 and wants to apply that method prospectively, it shall do both of the following: (815-20-35-19)

   a. Discontinue the existing hedging relationship

   b. Designate the relationship anew using the improved method.

45. The new method of assessing hedge effectiveness shall be applied prospectively and shall also be applied to similar hedges unless the use of a different method for similar hedges is justified. A change in the method of assessing hedge effectiveness by an entity shall not be considered a change in accounting
principle as defined in Topic 250SSAP No. 3—Accounting Changes and Corrections of Errors. (815-20-35-20)

U.S. GAAP ASC Excerpts Proposed to be Excluded from Exhibit A

This information is included to illustrate the guidance within the adopted ASC references that are not proposed to be captured in Exhibit A. The guidance within these paragraphs would be considered part of the statutory adoption unless they include specific accounting and reporting guidance. Comments are requested on whether any of the following paragraphs should be explicitly captured in Exhibit A.

Skipping 815-20-25-79A

815-20-25-79A See paragraphs 815-20-25-139 through 25-142 about the timing of hedge effectiveness assessments required by paragraph 815-20-25-79 for a private company that is not a financial institution or a not-for-profit entity (except for a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market).

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

815-20-25-86 The remainder of this guidance on hedge effectiveness criteria applicable to both fair value hedges and cash flow hedges is organized as follows:

a. Hedge effectiveness when the hedging instrument is an option or combination of options

b. Hedge effectiveness when hedged exposure is more limited than hedging instrument

c. Hedge effectiveness during designated hedge period

d. Assuming perfect effectiveness in a hedge with an interest rate swap (the shortcut method).

Hedge Effectiveness When the Hedging Instrument Is an Option or Combination of Options

815-20-25-87 The hedge effectiveness criteria applicable to options and combinations of options are organized as follows:

a. Determining whether a combination of options is net written

b. Hedge effectiveness of written options

c. Hedge effectiveness of options in general.

Determining Whether a Combination of Options Is Net Written

815-20-25-88 This guidance addresses how an entity shall determine whether a combination of options is considered a net written option subject to the requirements of paragraph 815-20-25-94. A combination of options (for example, an interest rate collar) entered into contemporaneously shall be considered a written option if either at inception or over the life of the contracts a net premium is received in cash or as a favorable rate or other term. Furthermore, a derivative instrument that results from combining a written option and any other non-option derivative instrument shall be considered a written option. The determination of whether a combination of options is considered a net written option depends in part on whether strike prices and notional amounts of the options remain constant.
Strike Prices and Notional Amounts Remain Constant

815-20-25-89 For a combination of options in which the strike price and the notional amount in both the written option component and the purchased option component remain constant over the life of the respective component, that combination of options would be considered a net purchased option or a zero cost collar (that is, the combination shall not be considered a net written option subject to the requirements of paragraph 815-20-25-94) provided all of the following conditions are met:

a. No net premium is received.

b. The components of the combination of options are based on the same underlying.

c. The components of the combination of options have the same maturity date.

d. The notional amount of the written option component is not greater than the notional amount of the purchased option component.

815-20-25-90 If the combination of options does not meet all of those conditions, it shall be subject to the test in paragraph 815-20-25-94. For example, a combination of options having different underlying indexes, such as a collar containing a written floor based on three-month U.S. Treasury rates and a purchased cap based on three-month London Interbank Offered Rate (LIBOR), shall not be considered a net purchased option or a zero cost collar even though those rates may be highly correlated.

Strike Prices and Notional Amounts Do Not Remain Constant

815-20-25-91 If either the written option component or the purchased option component for a combination of options has either strike prices or notional amounts that do not remain constant over the life of the respective component, the assessment to determine whether that combination of options can be considered not to be a written option under paragraph 815-20-25-88 shall be evaluated with respect to each date that either the strike prices or the notional amounts change within the contractual term from inception to maturity.

815-20-25-92 Even though that assessment is made on the date that a combination of options is designated as a hedging instrument (to determine the applicability of paragraph 815-20-25-94), it shall consider the receipt of a net premium (in cash or as a favorable rate or other term) from that combination of options at each point in time that either the strike prices or the notional amounts change, such as either of the following circumstances:

a. If strike prices fluctuate over the life of a combination of options and no net premium is received at inception, a net premium will typically be received as a favorable term in one or more reporting periods within the contractual term from inception to maturity.

b. If notional amounts fluctuate over the life of a combination of options and no net premium is received at inception, a net premium or a favorable term will typically be received in one or more periods within the contractual term from inception to maturity.

815-20-25-93 In addition, a combination of options in which either the written option component or the purchased option component has either strike prices or notional amounts that do not remain constant over the life of the respective component shall satisfy all of the conditions in paragraph 815-20-25-89 to be considered not to be a written option (that is, to be considered to be a net purchased option or zero cost collar) under paragraph 815-20-25-88. For example, if the notional amount of the written option component is greater than the notional amount of the purchased option component at any date that the notional amount changes within the contractual term from inception to maturity, the combination of options shall be
considered to be a written option under paragraph 815-20-25-88 and, thus, subject to the criteria in the following paragraph.

Hedge Effectiveness of Written Options

815-20-25-94 If a written option is designated as hedging a recognized asset or liability or an unrecognized firm commitment (if a fair value hedge) or the variability in cash flows for a recognized asset or liability or an unrecognized firm commitment (if a cash flow hedge), the combination of the hedged item and the written option provides either of the following:

a. At least as much potential for gains as a result of a favorable change in the fair value of the combined instruments (that is, the written option and the hedged item, such as an embedded purchased option) as exposure to losses from an unfavorable change in their combined fair value (if a fair value hedge)

b. At least as much potential for favorable cash flows as exposure to unfavorable cash flows (if a cash flow hedge).

815-20-25-95 The written-option test in the preceding paragraph shall be applied only at inception of the hedging relationship and is met if all possible percentage favorable changes in the underlying (from zero percent to 100 percent) would provide either of the following:

a. At least as much gain as the loss that would be incurred from an unfavorable change in the underlying of the same percentage (if a fair value hedge)

b. At least as much favorable cash flows as the unfavorable cash flows that would be incurred from an unfavorable change in the underlying of the same percentage (if a cash flow hedge).

815-20-25-96 The time value of a written option (or net written option) may be excluded from the written-option test if, in defining how hedge effectiveness will be assessed, the entity specifies that it will base that assessment only on changes in the option’s intrinsic value. In that circumstance, the change in the time value of the options would be excluded from the assessment of hedge effectiveness in accordance with paragraph 815-20-25-82(a).

815-20-25-97 When applying the written-option test to determine whether there is symmetry of the gain and loss potential of the combined hedged position for all possible percentage changes in the underlying, an entity is permitted to measure the change in the intrinsic value of the written option (or net written option) combined with the change in fair value of the hedged item.

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

Hedge Effectiveness When Hedged Exposure Is More Limited Than Hedging Instrument

815-20-25-100 An entity may designate as the hedging instrument in a fair value hedge or cash flow hedge a derivative instrument that does not have a limited exposure comparable to the limited exposure of the hedged item to the risk being hedged. However, to make that designation, in accordance with paragraph 815-20-25-75, the entity shall establish that the hedging relationship is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period that the hedge is designated. See paragraph 815-20-25-79(a) for additional guidance on prospective considerations of hedge effectiveness in this circumstance.
Hedge Effectiveness during Designated Hedge Period

815-20-25-101 It is inappropriate under this Subtopic for an entity to designate a derivative instrument as the hedging instrument if the entity expects that the derivative instrument will not be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period that the hedge is designated, unless the entity has documented undertaking a dynamic hedging strategy in which it has committed itself to an ongoing repositioning strategy for its hedging relationship.

Skipped paragraphs 815-20-25-112 through 815-20-25-143

>>> Application of Prepayable Criterion

815-20-25-112 An interest-bearing asset or liability shall be considered prepayable under the provisions of paragraph 815-20-25-104(e) if one party to the contract has the right to cause the payment of principal before the scheduled payment dates unless either of the following conditions is met:
   a. The debtor has the right to cause settlement of the entire contract before its stated maturity at an amount that is always greater than the then fair value of the contract absent that right.
   b. The creditor has the right to cause settlement of the entire contract before its stated maturity at an amount that is always less than the then fair value of the contract absent that right.

815-20-25-113 However, none of the following shall be considered a prepayment provision:
   a. Any term, clause, or other provision in a debt instrument that gives the debtor or creditor the right to cause prepayment of the debt contingent upon the occurrence of a specific event related to the debtor’s credit deterioration or other change in the debtor’s credit risk, such as any of the following:
      1. The debtor’s failure to make timely payment, thus making it delinquent
      2. The debtor's failure to meet specific covenant ratios
      3. The debtor's disposition of specific significant assets (such as a factory)
      4. A declaration of cross-default
      5. A restructuring by the debtor.
   b. Any term, clause, or other provision in a debt instrument that gives the debtor or creditor the right to cause prepayment of the debt contingent upon the occurrence of a specific event that meets all of the following conditions:
      1. It is not probable at the time of debt issuance.
      2. It is unrelated to changes in benchmark interest rates, contractually specified interest rates, or any other market variable.
      3. It is related either to the debtor’s or creditor’s death or to regulatory actions, legislative actions, or other similar events that are beyond the control of the debtor or creditor.
   c. Contingent acceleration clauses that permit the debtor to accelerate the maturity of an outstanding note only upon the occurrence of a specified event that meets all of the following
conditions:

1. It is not probable at the time of debt issuance.

2. It is unrelated to changes in benchmark interest rates, contractually specified interest rates, or any other market variable.

3. It is related to regulatory actions, legislative actions, or other similar events that are beyond the control of the debtor or creditor.

Furthermore, a right to cause a contract to be prepaid at its then fair value would not cause the interest-bearing asset or liability to be considered prepayable because that right would have a fair value of zero at all times and essentially would provide only liquidity to the holder.

Application of this guidance to specific debt instruments is illustrated in paragraph 815-20-55-75.

Application of the Shortcut Method to a Portfolio of Hedged Items

Portfolio hedging cannot be used to circumvent the application of the shortcut method criteria beginning in paragraph 815-20-25-102 to a fair value hedge of an individual interest-bearing asset or liability. A portfolio of interest-bearing assets or interest-bearing liabilities cannot qualify for the shortcut method if it contains an interest-bearing asset or liability that individually cannot qualify for the shortcut method.

The fair value hedge requirements of paragraph 815-20-25-12(b)(1) ensure that the individual items in a portfolio share the same risk exposure and have fair value changes attributable to the hedged risk that are expected to respond in a generally proportionate manner to the overall fair value changes of the entire portfolio. That requirement restricts the types of portfolios that can qualify for portfolio hedging; however, it also permits the existence of a mismatch between the change in the fair value of the individual hedged items and the change in the fair value of the hedged portfolio attributable to the hedged risk in portfolios that do qualify. As a result, the assumption of perfect effectiveness required for the shortcut method generally is inappropriate for portfolio hedges of similar assets or liabilities that are not also nearly identical (except for their notional amounts). Application of the shortcut method to portfolios that meet the requirements of paragraph 815-20-25-12(b)(1) is appropriate only if the assets or liabilities in the portfolio meet the same stringent criteria in paragraphs 815-20-25-104(e), 815-20-25-104(g), and 815-20-25-105(a) as required for hedges of individual assets and liabilities.

Application of Whether the Shortcut Method Was Not or No Longer Is Appropriate

In the period in which an entity determines that use of the shortcut method was not or no longer is appropriate, the entity may use a quantitative method to assess hedge effectiveness and measure hedge results without redesignating the hedging relationship if both of the following criteria are met:

1. The entity documented at hedge inception in accordance with paragraph 815-20-25-3(b)(2)(iv)(04) which quantitative method it would use to assess hedge effectiveness and measure hedge results if the shortcut method was not or no longer is appropriate during the life of the hedging relationship.
b. The hedging relationship was highly effective on a prospective and retrospective basis in achieving offsetting changes in fair value or cash flows attributable to the hedged risk for the periods in which the shortcut method criteria were not met.

815-20-25-117B If the criterion in paragraph 815-20-25-117A(a) is not met, the hedging relationship shall be considered invalid in the period in which the criteria for the shortcut method were not met and in all subsequent periods. If the criterion in paragraph 815-20-25-117A(a) is met, the hedging relationship shall be considered invalid in all periods in which the criterion in paragraph 815-20-25-117A(b) is not met.

815-20-25-117C If an entity cannot identify the date on which the shortcut criteria ceased to be met, the entity shall perform the quantitative assessment of effectiveness documented at hedge inception for all periods since hedge inception.

815-20-25-117D The terms of the hedged item and hedging instrument used to assess effectiveness, in accordance with paragraph 815-20-25-117A(b), shall be those existing as of the date that the shortcut criteria ceased to be met. For cash flow hedges, if the hypothetical derivative method is used as a proxy for the hedged item, the value of the hypothetical derivative shall be set to zero as of hedge inception.

**Hedge Effectiveness Criterion Applicable to Fair Value Hedges Only—Effectiveness Horizon**

815-20-25-118 In documenting its risk management strategy for a fair value hedge, an entity may specify an intent to consider the possible changes (that is, not limited to the likely or expected changes) in value of the hedging derivative instrument and the hedged item only over a shorter period than the derivative instrument’s remaining life in formulating its expectation that the hedging relationship will be highly effective in achieving offsetting changes in fair value for the risk being hedged. The entity does not need to contemplate the offsetting effect for the entire term of the hedging instrument.

**Consideration of Prepayment Risk Using the Last-of-Layer Method**

815-20-25-118A In a fair value hedge of interest rate risk designated under the last-of-layer method in accordance with paragraph 815-20-25-12A, an entity may exclude prepayment risk when measuring the change in fair value of the hedged item attributable to interest rate risk.

**Hedge Effectiveness Criteria Applicable to Cash Flow Hedges Only**

815-20-25-119 The hedge effectiveness criteria applicable to cash flow hedges only are organized as follows:

a. Consideration of the time value of money

b. Consideration of counterparty credit risk

c. Additional considerations for options in cash flow hedges

d. Assuming perfect hedge effectiveness in a cash flow hedge of a variable-rate borrowing with a receive-variable, pay-fixed interest rate swap recorded under the simplified hedge accounting approach.

**Consideration of the Time Value of Money**

815-20-25-120 In assessing the effectiveness of a cash flow hedge, an entity generally shall consider the time value of money, especially if the hedging instrument involves periodic cash settlements.
815-20-25-121 An example of a situation in which an entity likely would reflect the time value of money is a tailing strategy with futures contracts. When using a tailing strategy, an entity adjusts the size or contract amount of futures contracts used in a hedge so that earnings (or expense) from reinvestment (or funding) of daily settlement gains (or losses) on the futures do not distort the results of the hedge. To assess offset of expected cash flows when a tailing strategy has been used, an entity could reflect the time value of money, perhaps by comparing the present value of the hedged forecasted cash flow with the results of the hedging instrument.

Consideration of Counterparty Credit Risk

815-20-25-122 For a cash flow hedge, an entity shall consider the likelihood of the counterparty’s compliance with the contractual terms of the hedging derivative instrument that require the counterparty to make payments to the entity. Paragraph 815-20-35-14 states that, for an entity to conclude on an ongoing basis that a cash flow hedging relationship is expected to be highly effective in achieving offsetting changes in cash flows, the entity shall not ignore whether it will collect the payments it would be owed under the contractual provisions of the derivative instrument. See paragraphs 815-20-35-14 through 35-18 for further guidance.

Additional Considerations for Options in Cash Flow Hedges

815-20-25-123 When an entity has documented that the effectiveness of a cash flow hedge will be assessed based on changes in the hedging option’s intrinsic value pursuant to paragraph 815-20-25-82(a), that assessment (and the related cash flow hedge accounting) shall be performed for all changes in intrinsic value—that is, for all periods of time when the option has an intrinsic value, such as when the underlying is above the strike price of the call option.

815-20-25-124 When a purchased option is designated as a hedging instrument in a cash flow hedge, an entity shall not define only limited parameters for the risk exposure designated as being hedged that would include the time value component of that option. An entity cannot arbitrarily exclude some portion of an option’s intrinsic value from the hedge effectiveness assessment simply through an articulation of the risk exposure definition. It is inappropriate to assert that only limited risk exposures are being hedged (for example, exposures related only to currency-exchange-rate changes above $1.65 per pound sterling as illustrated in Example 26 [see paragraph 815-20-55-205]).

815-20-25-125 If an option is designated as the hedging instrument in a cash flow hedge, an entity may assess hedge effectiveness based on a measure of the difference, as of the end of the period used for assessing hedge effectiveness, between the strike price and forward price of the underlying, undiscounted. Although assessment of cash flow hedge effectiveness with respect to an option designated as the hedging instrument in a cash flow hedge shall be performed by comparing the changes in present value of the expected future cash flows of the forecasted transaction to the change in fair value of the derivative instrument (aside from any excluded component under paragraph 815-20-25-82), that measure of changes in the expected future cash flows of the forecasted transaction based on forward rates, undiscounted, is not prohibited. With respect to an option designated as the hedging instrument in a cash flow hedge, assessing hedge effectiveness based on a similar measure with respect to the hedging instrument eliminates any difference that the effect of discounting may have on the hedging instrument and the hedged transaction. Pursuant to paragraph 815-20-25-3(b)(2)(iv), entities shall document the measure of intrinsic value that will be used in the assessment of hedge effectiveness. As discussed in paragraph 815-20-25-80, that measure must be used consistently for each period following designation of the hedging relationship.
Assessing Hedge Effectiveness Based on an Option's Terminal Value

815-20-25-126 The guidance in paragraph 815-20-25-129 addresses a cash flow hedge that meets all of the following conditions:

a. The hedging instrument is a purchased option or a combination of only options that comprise either a net purchased option or a zero-cost collar.

b. The exposure being hedged is the variability in expected future cash flows attributed to a particular rate or price beyond (or within) a specified level (or levels).

c. The assessment of effectiveness is documented as being based on total changes in the option’s cash flows (that is, the assessment will include the hedging instrument’s entire change in fair value, not just changes in intrinsic value).

815-20-25-127 This guidance has no effect on the accounting for fair value hedging relationships. In addition, in determining the accounting for seemingly similar cash flow hedging relationships, it would be inappropriate to analogize to this guidance.

815-20-25-128 For a hedging relationship that meets all of the conditions in paragraph 815-20-25-126, an entity may focus on the hedging instrument’s terminal value (that is, its expected future pay-off amount at its maturity date) in determining whether the hedging relationship is expected to be highly effective in achieving offsetting cash flows attributable to the hedged risk during the term of the hedge. An entity’s focus on the hedging instrument’s terminal value is not an impediment to the entity’s subsequently deciding to dedesignate that cash flow hedge before the occurrence of the hedged transaction. If the hedging instrument is a purchased cap consisting of a series of purchased caplets that are each hedging an individual hedged transaction in a series of hedged transactions (such as caplets hedging a series of hedged interest payments at different monthly or quarterly dates), the entity may focus on the terminal value of each caplet (that is, the expected future pay-off amount at the maturity date of each caplet) in determining whether each of those hedging relationships is expected to be highly effective in achieving offsetting cash flows. The guidance in this paragraph applies to a purchased option regardless of whether at the inception of the cash flow hedging relationship it is at the money, in the money, or out of the money.

815-20-25-129 A hedging relationship that meets all of the conditions in paragraph 815-20-25-126 may be considered to be perfectly effective if all of the following conditions are met:

a. The critical terms of the hedging instrument (such as its notional amount, underlying, maturity date, and so forth) completely match the related terms of the hedged forecasted transaction (such as the notional amount, the variable that determines the variability in cash flows, the expected date of the hedged transaction, and so forth).

b. The strike price (or prices) of the hedging option (or combination of options) matches the specified level (or levels) beyond (or within) which the entity’s exposure is being hedged.

c. The hedging instrument’s inflows (outflows) at its maturity date completely offset the change in the hedged transaction’s cash flows for the risk being hedged.

d. The hedging instrument can be exercised only on a single date—its contractual maturity date.

The condition in (d) is consistent with the entity’s focus on the hedging instrument’s terminal value. If the holder of the option chooses to pay for the ability to exercise the option at dates before the maturity date (for example, by acquiring an American-style option), the hedging relationship would not be perfectly effective.
815-20-25-129A In a hedge of a group of forecasted transactions in accordance with paragraph 815-20-25-15(a)(2), an entity may assume that the timing in which the hedged transactions are expected to occur and the maturity date of the hedging instrument match in accordance with paragraph 815-20-25-129(a) if those forecasted transactions occur and the derivative matures within the same 31-day period or fiscal month.

Hedge Effectiveness of a Net-Purchased Combination of Options

815-20-25-130 The guidance in the following paragraph addresses a cash flow hedging relationship that meets both of the following conditions:

a. A combination of options (deemed to be a net purchased option) is designated as the hedging instrument.

b. The effectiveness of the hedge is assessed based only on changes in intrinsic value of the hedging instrument (the combination of options).

815-20-25-131 The assessment of effectiveness of a cash flow hedging relationship meeting the conditions in the preceding paragraph may be based only on changes in the underlying that cause a change in the intrinsic value of the hedging instrument (the combination of options). Thus, the assessment can exclude ranges of changes in the underlying for which there is no change in the hedging instrument’s intrinsic value.

Hedge Accounting Provisions Applicable to Certain Private Companies

Assuming Perfect Hedge Effectiveness in a Cash Flow Hedge of a Variable-Rate Borrowing with a Receive-Variable, Pay-Fixed Interest Rate Swap Recorded under the Simplified Hedge Accounting Approach


815-20-25-134 The conditions for the simplified hedge accounting approach determine which cash flow hedging relationships qualify for a simplified version of hedge accounting. If all of the conditions in paragraphs 815-20-25-135 and 815-20-25-137 are met, an entity may assume perfect effectiveness in a cash flow hedging relationship involving a variable-rate borrowing and a receive-variable, pay-fixed interest rate swap.

815-20-25-135 Provided all of the conditions in paragraph 815-20-25-137 are met, the simplified hedge accounting approach may be applied by a private company except for a financial institution as described in paragraph 942-320-50-1. An entity may elect the simplified hedge accounting approach for any receive-variable, pay-fixed interest rate swap, provided that all of the conditions for applying the simplified hedge accounting approach specified in paragraph 815-20-25-137 are met. Implementation guidance on the conditions set forth in paragraph 815-20-25-137 is provided in paragraphs 815-20-55-79A through 55-79B.

815-20-25-136 In applying the simplified hedge accounting approach, the documentation required by paragraph 815-20-25-3 to qualify for hedge accounting must be completed by the date on which the first annual financial statements are available to be issued after hedge inception rather than concurrently at hedge inception.
An eligible entity under paragraph 815-20-25-135 must meet all of the following conditions to apply the simplified hedge accounting approach to a cash flow hedge of a variable-rate borrowing with a receive-variable, pay-fixed interest rate swap:

a. Both the variable rate on the swap and the borrowing are based on the same index and reset period (for example, both the swap and borrowing are based on one-month London Interbank Offered Rate [LIBOR] or both the swap and borrowing are based on three-month LIBOR).

b. The terms of the swap are typical (in other words, the swap is what is generally considered to be a “plain-vanilla” swap), and there is no floor or cap on the variable interest rate of the swap unless the borrowing has a comparable floor or cap.

c. The repricing and settlement dates for the swap and the borrowing match or differ by no more than a few days.

d. The swap’s fair value at inception (that is, at the time the derivative was executed to hedge the interest rate risk of the borrowing) is at or near zero.

e. The notional amount of the swap matches the principal amount of the borrowing being hedged. In complying with this condition, the amount of the borrowing being hedged may be less than the total principal amount of the borrowing.

f. All interest payments occurring on the borrowing during the term of the swap (or the effective term of the swap underlying the forward starting swap) are designated as hedged whether in total or in proportion to the principal amount of the borrowing being hedged.

A cash flow hedge established through the use of a forward starting receive-variable, pay-fixed interest rate swap may be permitted in applying the simplified hedge accounting approach only if the occurrence of forecasted interest payments to be swapped is probable. When forecasted interest payments are no longer probable of occurring, a cash flow hedging relationship will no longer qualify for the simplified hedge accounting approach and the General Subsections of this Topic shall apply at the date of change and on a prospective basis.

Timing of Hedge Documentation for Certain Private Companies If Simplified Hedge Accounting Approach Is Not Applied

Concurrent Hedge Documentation

Concurrent with hedge inception, a private company that is not a financial institution as described in paragraph 942-320-50-1 shall document the following:

a. The hedging relationship in accordance with paragraph 815-20-25-3(b)(1)

b. The hedging instrument in accordance with paragraph 815-20-25-3(b)(2)(i)

c. The hedged item in accordance with paragraph 815-20-25-3(b)(2)(ii), including (if applicable) firm commitments or the analysis supporting a last-of-layer designation in paragraph 815-20-25-3(c), or forecasted transactions in paragraph 815-20-25-3(d)

d. The nature of the risk being hedged in accordance with paragraph 815-20-25-3(b)(2)(iii).
A private company that is not a financial institution is not required to perform or document the following items concurrent with hedge inception but rather is required to perform or document them within the time periods discussed in paragraph 815-20-25-142:

a. The method of assessing hedge effectiveness at inception and on an ongoing basis in accordance with paragraph 815-20-25-3(b)(2)(iv) and (vi)

b. Initial hedge effectiveness assessments in accordance with paragraph 815-20-25-3(b)(2)(iv)(01) through (04).

Example 1A beginning in paragraph 815-20-55-80A illustrates hedge documentation when the critical terms of the hedging instrument and hedged forecasted transaction match. Although that Example illustrates the documentation of the method of assessing hedge effectiveness, private companies that are not financial institutions may complete hedge documentation requirements in accordance with paragraphs 815-20-25-139 through 25-140.

Hedge Effectiveness Assessments

For a private company that is not a financial institution, the performance and documentation of the items listed in paragraph 815-20-25-140, as well as required subsequent quarterly hedge effectiveness assessments, may be completed before the date on which the next interim (if applicable) or annual financial statements are available to be issued. Even though the completion of the initial and ongoing assessments of effectiveness may be deferred to the date on which financial statements are available to be issued the assessments shall be completed using information applicable as of hedge inception and each subsequent quarterly assessment date when completing this documentation on a deferred basis. Therefore, the assessment should be performed to determine whether the hedge was highly effective at achieving offsetting changes in fair values or cash flows at inception and in each subsequent quarterly assessment period up to the reporting date.

Hedge Accounting Provisions Applicable to Certain Not-for-Profit Entities

Not-for-profit entities (except for not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market) may apply the guidance on the timing of hedge documentation and hedge effectiveness assessments in paragraphs 815-20-25-139 through 25-142. Specifically, those entities shall document the items listed in paragraph 815-20-25-139 concurrent with hedge inception, but they may perform and document the items listed in paragraph 815-20-25-140 and perform the required subsequent quarterly hedge effectiveness assessments in accordance with paragraph 815-20-25-142 within the time periods discussed in paragraph 815-20-25-142.
Review of U.S. derivative guidance and the application to SAP is complex with many facets. This document is the second of two initial documents and focuses on the accounting and reporting of hedging instruments, including excluded components.

2) Measurement of Excluded Components In Hedging Instruments

Existing guidance in SSAP No. 86, paragraph 40, Exhibit B – Assessment of Hedging Effectiveness, and Exhibit C – Specific Hedge Accounting Procedures for Derivatives address components permitted to be excluded when determining hedge effectiveness and/or the measurement of excluded components. Key elements to note with regards to the existing guidance:

- Components permitted for exclusion in Exhibit B were adopted from U.S. GAAP (FAS 133, paragraph 63) at the time of initial SSAP adoption. Although these have not been updated since original issuance, NAIC staff is proposing (in the Hedge Effectiveness review document) to continue the adoption of U.S. GAAP in determining hedge effectiveness. This will ensure that hedging instruments identified as effective hedges under U.S. GAAP will be considered effective hedges under statutory accounting principles.

- The guidance in paragraph 40 and Exhibit B appears to adopt U.S. GAAP with the treatment of accounting for excluded components at fair value, with changes in fair value recognized as unrealized gains or losses.

- The existing guidance adopted from U.S. GAAP (in paragraph 40 and Exhibit B) is contradictory to guidance in SSAP No. 86, paragraph 23 and Exhibit C. Pursuant to paragraph 23, entities should not bifurcate the effectiveness of derivatives and a derivative instrument is either classified as an effective hedge or an ineffective hedge. If classified as an effective hedge, then the measurement method of the hedged item is used for the hedging instrument (e.g., amortized cost). This guidance does not seemingly permit reporting entities to report part of a hedging instrument at amortized cost, with excluded components reported at fair value. (However, NAIC staff believes this may in fact occur in practice under the provisions of paragraph 40 and Exhibit B.)

- Furthermore, the guidance in Exhibit C for foreign currency swaps and forwards identifies that premiums / discounts shall be amortized into income over the life of the contract. This treatment is different than the fair value / change in unrealized recognition for excluded component detailed in paragraph 40 and Exhibit B. (This guidance has been part of Exhibit C since the original adoption of the SSAP and reflects a difference from U.S. GAAP.)

Interested parties have identified that the SAP treatment of excluded components related to foreign currency transactions are hindering the ability to engage in those transactions and have requested consideration to 1) clarify the inconsistent guidance in SSAP No. 86, and 2) consider SAP specific measurement methods for excluded components to prevent surplus volatility from derivative transactions.

As background information, the classification of derivatives as highly effective is ultimately an income-statement matching tool. Although all derivatives are reported at fair value under U.S. GAAP, if effective hedges, then changes in fair value are allocated to either net income or other comprehensive income (OCI) in a manner that matches and predominantly offsets the fluctuations from the hedged item. (For example, under U.S. GAAP, a fair value hedge requires both the hedging instrument and the hedged item to be reported at fair value, so fluctuations on one of offset by the other.) Under SAP, as the hedged items are not commonly reported at fair value, the guidance in SSAP No. 86 permits the derivative to reflect a measurement method that is more akin to the hedged item. (So, if hedging a bond at amortized cost, the
hedging instrument would also be reported at amortized cost. This prevents fair value fluctuations from the highly effective hedge from causing ‘noise’ in the financial statements throughout the hedge duration.)

Interested parties have communicated that requiring excluded components for foreign currency hedges to be recognized at fair value, with changes in fair value recognized as unrealized gains / losses, the financial statements show volatility that is not reflective of the underlying hedging transaction:

- For foreign currency forward contracts that have a premium / discount (e.g., forward point – difference between the forward contract rate and the spot rate at derivative execution), the amount required is set at origination. Although the change in spot rate over the hedge term could result with a fair value change of the forward point / premium, this change in fair value does not impact the required amount that was set at derivative execution. (Under Exhibit C, the existing guidance would require amortization of the premium, but this is conflicting with paragraph 40 and Exhibit B.) Regardless of if the derivative is terminated early or is identified as ineffective, there is no change to the amount required from the forward point determined at derivative execution. (As such, requiring recognition at fair value, and the change of fair value, does not result with a presentation of the amount owed by the reporting entity.)

- For a foreign currency swap with a cross-currency basis spread, the fair value changes are captured as part of the foreign currency periodic interest accruals. (A forward contract does not have periodic interest accruals, which is why the premium / forward point is proposed to be amortized under the prior example). Furthermore, regardless of if the derivative transaction continues to be effective, at the time of derivative maturity, the cross-currency basis spread is zero. The only time a reporting entity would be obligated to provide payment for a cross-currency basis spread is if the currency swap is terminated prior to maturity. Interested parties have noted that this is unlikely for the following reasons:

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

  o The investment was originally acquired as the risk profile of the foreign bond was attractive to the reporting entity over the term of the investment. So, unless the bond issuer is having significant credit deterioration, it is unlikely an insurer will sell the bond.

  o In the event the foreign bond is terminated early, the derivative would also be terminated early. This will result in both items being removed from the balance sheet, and the offsetting economics would be recognized together in the same period. (So, in this situation, even if a cross-currency basis spread is obligated, it would be offset by the foreign currency impact of the bond.)

  o Industry representatives have identified that it would be even more unlikely for the derivative to be sold while retaining the foreign bond, however, if that was to occur, then the existing guidance for derivative termination would occur.

After considering the scenarios and industry comments for foreign currency excluded components, NAIC staff agrees that requiring these foreign currency excluded components to be reported at fair value, with changes in fair value recognized as unrealized gains / losses throughout the derivative term, results with financial statement impacts that are not reflective of the derivative transactions. Ultimately, the fair value recognition of these components creates surplus volatility / noise, that is not reflective of the intent, nor the final outcome of the derivative instrument. NAIC staff highlights that the key exception to this conclusion would be for scenarios in which a reporting entity was to elect to terminate a derivative in advance of the maturity date. Although existing guidance requires recognition at fair value with the impact in net income
(realized gain/loss) at the time of such termination, NAIC staff believes it would be more appropriate to require recognition at fair value at the time that an entity has decided to terminate a hedging instrument prior to its maturity date. This would be consistent with other statutory accounting guidance that requires recognition at fair value (other than amortized cost) at the time such decisions are made. NAIC staff believes this would be appropriate in situations in which both the hedging instrument and hedged item would be terminated together and situations in which the hedging instrument is terminated while the hedged item continues to be held.

Although the prior discussion, and current industry comments, were focused on foreign currency excluded components, NAIC staff highlights that U.S. GAAP permits other elements to be excluded from the assessment of hedge effectiveness. These include the following:

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

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

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

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

Even if specific guidance is established for the foreign currency forward point and the cross-currency basis spread, statutory accounting guidance would still need clarification on the accounting and reporting for the other excluded components. If these excluded components are reported at fair value, with changes in unrealized gain/loss, NAIC staff highlights that the guidance should be clear in SSAP No. 86 and in the Schedule DB reporting instructions. Based on preliminary information, it seems current reporting for effective hedges is likely inconsistent for hedging instruments that have excluded components. NAIC staff has the impression that the following two options may currently be occurring:

- BACV reflects amortized cost. This would be consistent with SSAP No. 86, paragraph 23, but would be contrary to paragraph 40 and Exhibit B. (This would mean that the excluded components are not being recognized in the statutory financial statements.)

- BACV reflects a combination of amortized cost and fair value for the excluded components. This would be consistent with SSAP No. 86, paragraph 40 and Exhibit B, but would present an odd representation in Schedule DB as a derivative reported as an effective hedge would have an unrealized gain/loss, and the amount shown as an unrealized gain or loss would only be a specific portion of the change in fair value and could not be calculated from the information reported.

Unless subsequent information and discussion supports a different approach for the non-foreign currency excluded components detailed above, NAIC staff agrees that reporting these components at fair value, with fair value changes recognized through unrealized gains/losses is appropriate. In order to facilitate this recognition, NAIC staff recommends clarifications to SSAP No. 86 to specify the commingled reporting of BACV for effective hedges with excluded components, as well as revisions to Schedule DB to capture information on excluded components in new electronic-only columns. NAIC staff also recommends a new disclosure that captures information on all excluded components by classification type.
Proposed SSAP Revisions To Incorporate / Clarify Guidance for Excluded Components

Derivatives Used in Hedging Transactions

22. Derivative instruments used in hedging transactions that meet the criteria of a highly effective hedge shall be considered an effective hedge and are permitted to be valued and reported in a manner that is consistent with the hedged asset or liability (referred to as hedge accounting). For instance, assume an entity has a financial instrument on which it is currently receiving income at a variable rate but wishes to receive income at a fixed rate and thus enters into a swap agreement to exchange the cash flows. If the transaction qualifies as an effective hedge and a financial instrument on a statutory basis is valued and reported at amortized cost, then the swap would also be valued and reported at amortized cost. Derivative instruments used in hedging transactions that do not meet or no longer meet the criteria of an effective hedge, or that meet the required criteria but the entity has chosen not to apply hedge accounting, shall be accounted for at fair value and the changes in the fair value shall be recorded as unrealized gains or unrealized losses (referred to as fair value accounting) 1.

23. Entities shall not bifurcate the effectiveness of derivatives. A derivative instrument is either classified as an effective hedge or an ineffective hedge. Entities must account for the derivative using fair value accounting if it is deemed to be ineffective or becomes ineffective. Derivative instruments classified as effective with excluded components in determining hedge effectiveness pursuant to Exhibit A, paragraph _____, shall account for the derivative and excluded components pursuant to the guidance in paragraph 40. Entities may redesignate a derivative in a hedging relationship even though the derivative was used in a previous hedging relationship that proved to be ineffective. A change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship would not, in and of itself, be considered a termination of the derivative instrument. An entity shall prospectively discontinue hedge accounting for an existing hedge if any one of the following occurs:

a. Any criterion in paragraphs 26-38 is no longer met;

b. The derivative expires or is sold, terminated, or exercised (the effect is recorded as realized gains or losses or, for effective hedges of firm commitments or forecasted transactions, in a manner that is consistent with the hedged transaction – see paragraph 24);

c. The entity removes the designation of the hedge; or

d. The derivative is deemed to be impaired in accordance with paragraph 18. A permanent decline in a counterparty’s credit quality/rating is one example of impairment required by paragraph 18, for derivatives used in hedging transactions.

Hedge Effectiveness

39. The measurement of hedge effectiveness for a particular hedging relationship shall be consistent with the entity’s risk management strategy and the method of assessing hedge effectiveness that was documented at the inception of the hedging relationship, as discussed in paragraph 41.

40. The gain or loss on a derivative designated as a hedge and assessed to be effective is reported consistently with the hedged item. (Therefore, if the hedged item is reported at amortized cost, and the hedging instrument is consistent with that measurement method, fluctuations in fair value would not be recognized as unrealized gains or losses for either the hedging item or hedging instrument.) If an entity’s defined risk management strategy for a particular hedging relationship excludes a specific component of the gain or loss, or related cash flows, on the hedging derivative from the assessment of hedge effectiveness (as discussed in Exhibit BA, paragraph ____), specific accounting treatment shall be followed for the excluded component: ___ of the gain or loss shall be recognized as an unrealized gain

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1 Pursuant to paragraph 19, the gross reported value of a derivative and the determination of unrealized gains or losses shall exclude the impact of financing premiums. Premiums payable or receivable from the acquisition or writing of a derivative shall not be reflected in the gross reporting of derivatives or in determining the fair value change in a derivative.
or loss. For example, if the effectiveness of a hedge with an option contract is assessed based on changes in the option’s intrinsic value, the changes in the option’s time value would be recognized in unrealized gains or losses. Time value is equal to the fair value of the option less its intrinsic value.

a. If the excluded component pertains to the difference between a foreign currency spot price and the forward or future price (e.g., a forward spot rate), then this premium / discount shall be amortized into income over the life of the contract or hedged program. (This guidance addresses the excluded component in Exhibit A, paragraph 8d.)

b. If the excluded component pertains to a foreign currency swap cross-currency basis spread, the impact of fair value changes shall be reflected as a component of the foreign currency swap’s periodic interest accrual. (This guidance addresses the excluded component in Exhibit A, paragraph 8e.)

c. For all other excluded components, the excluded component shall be measured and reported at fair value, with changes in fair value recognized as unrealized gains or losses. (This guidance shall be applied to excluded components detailed in Exhibit A, paragraphs 8a-8c.)

41. Hedging instruments with excluded components shall be identified in the financial statement investment schedule (Schedule DB) and shall be disclosed pursuant to paragraph 41g.

**Proposed New Disclosure Paragraph (This is proposed as a new subparagraph 41g with reordering of subsequent paragraphs.)**

g. For hedging instruments with excluded components for determining hedge effectiveness:

i. In the investment schedule, identify hedging instruments with excluded components, and report the current fair value of the excluded component, the fair value of the excluded component that is reflected in the reported BACV for the hedging instrument (this item would not be applicable for foreign-currency forwards and currency swaps where the forward points or cross-currency basis, respectively, are the excluded component), and the change in fair value reported as an unrealized gains/loss. (Note – These items will be proposed in electronic columns to Schedule DB.)

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

**Proposed Edits to Exhibit C – Foreign Currency Swaps and Forwards**

*Note: Only Specific Excerpts Included*

Specific hedge accounting procedures for derivative instruments are outlined below.

1. **Call and Put Options, Warrants, Caps, and Floors:**

   a. Accounting at Date of Acquisition (purchase) or Issuance (written): The premium paid or received for purchasing or writing a call option, put option, warrant, cap or floor shall either be (i) recorded as an asset (purchase) or liability (written) on the Derivative line on the Assets (or) Liabilities pages or (ii) combined with the hedged item(s) individually or in the aggregate;
b. Statement Value:

i. Open derivatives hedging items recorded at amortized cost:

(a) Options, warrants, caps, and floors purchased or written shall be valued at amortized cost in a manner consistent with the hedged item. (Components of a hedging instrument excluded from the determination of hedge effectiveness shall be recognized at fair value, with changes in fair value recognized as unrealized gains/losses throughout the duration of the hedging instrument. These components are not captured within the guidance for effective hedges detailed within this section.);

(b) The amortization period and methods used shall result in a constant effective yield over the life of the hedged item or program. (For floating rate hedged items, the estimated effective yield shall be based on the current rate so the changes in yields attributable to changes in interest rates will be recognized in the period of change). Specific treatment includes:

(1) Holdings in derivatives purchased or written within a year of maturity or expiry need not be amortized;

(2) For hedges of forecasted transactions or firm commitments, the derivative may be recorded at cost until the hedged transaction occurs or it is determined that the hedge was not effective (see (d) in this section 1.b.i.);

(3) For other derivatives, the amortization period is usually from date of acquisition (issuance) of the derivative to maturity of the hedged item or program.

(c) For hedges where the cost of the derivative is combined with the hedged item, the statement value is zero. The fair value of the derivative and hedged item shall be determined and reported separately, either individually or in the aggregate;

(d) For hedges of forecasted transactions or firm commitments, the derivative shall be recorded at cost until (1) the hedged transaction occurs or (2) it is determined that the hedge was not effective (when the derivative is valued in accordance with (e) in this section);

(e) If during the life of the derivative it or a designated portion of the derivative is no longer effective as a hedge, valuation at amortized cost ceases and the derivative or the designated portion of the derivative shall be valued at its current fair value with gains and losses recognized in unrealized gains or unrealized losses to the extent it ceased to be an effective hedge.

d. Gain/Loss on Termination of an option, warrant, cap or floor accounted for under hedge accounting (includes closing, exercise, maturity, and expiry):

i. Exercise of an Option: The remaining book value of the derivative shall become an adjustment to the cost or proceeds of the hedged item(s) received or disposed of individually or in aggregate;

ii. Sale, maturity, expiry, or other closing transaction of a derivative which is an effective hedge—Any gain or loss on the transaction, except for excluded components, will adjust the basis (or proceeds) of the hedged item(s) individually or in aggregate. Alternatively, if the item being hedged is subject to IMR, the gain
or loss on the terminated hedging derivative may be realized and shall be subject to IMR upon termination. For hedging instruments with excluded components in determining hedge effectiveness, the unrealized gain/loss from the change in fair value of the excluded component shall be realized upon the closing transaction. This gain/loss shall not be used to adjust the basis or proceeds of the hedged item.

iii. Gain/loss on termination of derivatives will be recognized currently in net income (realized gain/loss) to the extent they ceased to be effective hedges.

iv. Upon the redesignation of a derivative from a currently effective hedging relationship:

(a) with an item(s) carried at amortized cost to another effective hedging relationship with an item(s) carried at amortized cost, the derivative shall continue to be recorded at amortized cost and any gain or loss on the derivative shall be recognized.

(b) with an item(s) carried at amortized cost or fair value to an effective relationship with an item(s) carried at fair value, the accounting for the derivative shall be consistent with (ii) above.

(c) with an item(s) carried at fair value to an effective relationship with an item(s) carried at amortized cost, the accounting for the derivative shall be consistent with (ii) above.

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

a. Accounting at Date of Opening Position:

i. Any premium paid or received at date of opening shall either be (a) recorded on the Derivative line on the Assets (or) Liabilities pages or (b) combined with the hedged item(s), individually or in the aggregate;

b. Statement Value:

i. Open derivatives hedging items recorded at amortized cost:

(a) Swaps, collars, and forwards shall be valued at amortized cost in a manner consistent with hedged item. (Components of a hedging instrument excluded from the determination of hedge effectiveness not addressed in 2.b.iii shall be recognized at fair value, with changes in fair value of the excluded component recognized as unrealized gains/losses throughout the duration of the hedging instrument. These components are not captured within the guidance for effective hedges detailed within this section.);

(b) The amortization period and methods used shall result in a constant effective yield over the life of the hedged item or program. (For floating rate hedged items the estimated effective yield shall be based on the current rate so the changes in yields attributable to changes in interest rates will be recognized in the period of change.) Specific treatment includes:

(1) Holdings in derivatives purchased or written within a year of maturity or expiry need not be amortized;
(2) For hedges of forecasted transactions or firm commitments, the derivative shall be recorded at cost until (a) the hedged transaction occurs or (b) it is determined that the hedge was not effective (see (5) in this section 2.b.i.);

(3) For other derivatives the amortization period is usually from date of acquisition (issuance) of the derivative to maturity of the hedged item or program;

(4) For hedges where the cost of the derivative is combined with the hedged item, the statement value is zero. The fair value of the derivative and hedged item shall be determined and reported separately, either individually or in the aggregate;

(5) If during the life of the derivative it or a designated portion of the derivative is no longer effective as a hedge, valuation at amortized cost ceases and the derivative or a designated portion of the derivative shall be valued at its current fair value with gains and losses recorded in unrealized gains or unrealized losses to the extent that it ceased to be an effective hedge. Upon redesignation into an effective hedging relationship, the derivative’s mark to fair value through unrealized gain or loss shall be reversed.

ii. Open derivatives hedging items recorded at fair value (where gains and losses on the hedged item are recognized as adjustments to unassigned funds (surplus)):

(a) Swaps, collars, or forwards shall be valued at current fair value with changes in fair value recognized currently consistent with the hedged item; this will result in unrealized gain/loss treatment with adjustment to unassigned funds (surplus);

(b) For hedges where the derivative is combined with the hedged item, the fair value of the derivative and hedge item shall be determined and reported separately, either individually or in the aggregate. The cost (book value) basis used to figure gain/loss on the derivative is zero.

iii. Open foreign currency swap and forward contracts hedging foreign currency exposure on items denominated in a foreign currency and translated into U.S. dollars where fair value accounting is not being used:

(a) The foreign exchange premium (discount) on the currency contract shall be amortized into income over the life of the contract or hedge program. The foreign exchange premium (discount) is defined as the foreign currency (notional) amount to be received (paid) times the net of the forward rate minus the spot rate at the time the contract was opened. For forward contracts, an excluded component representing a foreign exchange premium (discount) (forward points) on the currency contract shall be amortized into income over the life of the contract or hedge program. Amortization is not required if the contract was entered into within a year of maturity. For foreign currency swaps, an excluded component representing a cross-currency basis spread, is recognized into income through the foreign currency swap’s periodic interest accruals.

Amortization is not required if the contract was entered into within a year of maturity;
(b) A foreign currency translation adjustment shall be reflected as an unrealized gain/loss (unassigned funds (surplus) adjustment) using the same procedures as done to translate the hedged item;

(c) The unrealized gain/loss for the period equals the foreign currency (notional) amount to be received (paid) times the net of the current spot rate minus the prior period end spot rate;

(d) The statement value of the derivative equals the amortized cost plus:

1. For forward contracts, the amortized (premium) discount plus the cumulative unrealized gain/(loss) on the contract.

2. For foreign currency swaps, the cumulative unrealized gain/(loss) on the contract. The cross-currency basis spread is recorded through the Investment Income Due and Accrued or Other Liabilities, as a component of the foreign currency swap's periodic interest accrual.

The cumulative unrealized gain/loss equals the foreign currency (notional) amount to be received (paid) times the net of the current spot rate minus the spot rate at the time the contract was opened;

(e) Recognition of unrealized gains/losses and amortization of foreign exchange premium/discount on derivatives hedging forecasted transactions or firm commitments shall be deferred until the hedged transaction occurs. These deferred gains/losses will adjust the basis or proceeds of the hedged transaction when it occurs;

(f) For hedges where the cost of the foreign currency contract is combined with the hedged item, the statement value on Schedule DB is zero. The fair value of the derivative and hedged item shall be determined and reported separately, either individually or in the aggregate;

(g) If during the life of the currency contract it or a designated portion of the currency contract is not effective as a hedge, the derivative shall be recorded at fair value and valuation at amortized cost shall cease. To the extent it ceased to be an effective hedge, a cumulative unrealized gain/loss (surplus adjustment) will be recognized equal to the difference between the carrying value of the derivative on the balance sheet and the fair value of the derivative if either of the following occur:

1. During the life of the currency contract it or a designated portion of the currency contract is not effective as a hedge.

2. The entity decides to terminate the derivative in advance of scheduled maturity.

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

iv. Open derivatives hedging items recorded at fair value, where gains and losses on the hedged item are recognized currently in earnings: swaps, collars and forwards shall be valued at current fair value with changes in fair value recognized currently in earnings together with the gains and losses on the hedged item.
(a) If during the life of the derivative it or a designated portion of the derivative is no longer effective as a hedge, recognition of changes in fair value through earnings ceases. The derivative shall continue to be valued at its current fair value, but thereafter gains or losses shall be recognized in unrealized gains or unrealized losses to the extent it ceased to be an effective hedge.

c. Cash Flows and Income:

i. Where the cost of the derivative is not combined with the hedged item:

(a) Amortization of premium paid or received on derivatives is an adjustment to net investment income or another appropriate caption within operating income consistent with the reporting of the hedged item;

(b) Periodic cash flows and accruals of income/expense are to be reported in a manner consistent with the hedged item, usually as net investment income or another appropriate caption within operating income.

ii. Where the cost of the derivative is combined with the hedged item, the cash flows and income of the derivative on Schedule DB is zero. All related amortization and cash flow accounting shall be reported with the hedged item instead of with the derivative.

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

i. Exercise—The remaining book value of the derivative shall become an adjustment to the cost or proceeds of the hedged item(s) received or disposed of individually or in aggregate;

ii. Sale, maturity, expiry, or other closing transaction of a derivative which is an effective hedge—Any gain or loss on the transaction, except for excluded components, will adjust the basis (or proceeds) of the hedged item(s) individually or in aggregate. Alternatively, if the item being hedged is subject to IMR, the gain or loss on the terminated hedging derivative may be realized and shall be subject to IMR upon termination.

iii. Gain/loss on termination of derivatives will be recognized currently in net income (realized gain/loss) to the extent they ceased to be effective hedges.

iv. Upon the redesignation of a derivative from a currently effective hedging relationship:

(a) with an item(s) carried at amortized cost to another effective hedging relationship with an item(s) carried at amortized cost, the derivative shall continue to be recorded at amortized cost and no gain or loss on the derivative shall be recognized.

(b) with an item(s) carried at amortized cost or fair value to an effective relationship with an item(s) carried at fair value, the accounting for the derivative shall be consistent with (ii) above.

(c) with an item(s) carried at fair value to an effective relationship with an item(s) carried at amortized cost, the accounting for the derivative shall be consistent with (ii) above.
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Related Party Reporting

Check (applicable entity):

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

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

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

Affiliate Definition and Identified Reporting Issues:

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

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

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

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

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

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

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

1. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.
2. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.
3. An entity where the insurer has given up participation rights as a shareholder to the investee.

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

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

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

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

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

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

Proposed Related Party Revisions

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

c. An entity where the insurer has given up participation rights1 as a shareholder to the investee.

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

8. Any direct or indirect ownership interest of the reporting entity greater than 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation. The Insurance Holding

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1 The term "participating rights" refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee's ordinary course of business and is distinguished from the more limited type of rights referred to as "protective rights". Refer to the sections entitled: “Protective Rights” and “Substantive Participating Rights” in EITF 96-16, Investor's Accounting for an Investee When the Investor Owns a Majority of the Voting Stock but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights. The term “participating rights” shall be used consistent with the discussion of substantive participating rights in this EITF.
Company System Regulatory Act (#440) and the Insurance Holding Company System Model Regulation (#450) include a provision that allows for the disclaimer of affiliation and/or the disclaimer of control for members of an insurance holding company system. The disclaimer must be filed with the state insurance commissioner. Entities whose relationship is subject to a disclaimer of affiliation or a disclaimer of control are related parties and are subject to the related party disclosures within this statement. Such a disclaimer does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

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

6. Investments in these ventures, except for joint ventures, partnerships and limited liability companies with a minor ownership interest¹, shall be reported using an equity method as defined in SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, paragraphs 8.b.i. through 8.b.iv. (The equity method calculation may result with a negative valuation of the investment; therefore, the SSAP No. 97 equity method calculation shall occur regardless of whether the investment is supported by an audit and the reporting entity will nonadmit the investment.) A reporting entity whose shares of losses in a SSAP No. 48 entity exceeds its investment in the SSAP No. 48 entity shall disclose the information required by SSAP No. 97, paragraph 35.a.

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

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

3. Parent and subsidiary are defined as follows:

   a. Parent—An entity that directly or indirectly owns and controls the reporting entity;

   b. Subsidiary—An entity that is, directly or indirectly, owned and controlled by the reporting entity.

4. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies. Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments.
5. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by common management, or (d) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.\(^2\)

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

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

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

   c. An entity where the insurer has given up participating rights\(^3\) as a shareholder to the investee.

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

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

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

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

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

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

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

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


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

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

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

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

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

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

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

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

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

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

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

Proposed edits to SSAP No. 43R:

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

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

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4 The term “participating rights” refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee's ordinary course of business and is distinguished from the more limited type of rights referred to as “protective rights”. Refer to the sections entitled: “Protective Rights” and “Substantive Participating Rights” in EITF 96-16, Investor's Accounting for an Investee When the Investor Owns a Majority of the Voting Stock but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights. The term “participating rights” shall be used consistent with the discussion of substantive participating rights in this EITF.
obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying assets. Some sponsors do guarantee the performance of the underlying assets.

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

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

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

a. Although a loan-backed or structured security may be acquired from a non-related issuer, if the assets held in trust predominantly reflect assets issued by affiliates of the insurance reporting entity, and the insurance reporting entity only has direct recourse to the assets held in trust, the

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6 Currently, only Fannie Mae and Freddie Mac are the government sponsored entities that either directly issue qualifying mortgage-referenced securities or sponsor transactions in which a special purpose trust issues qualifying mortgage-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 mortgage credit risk.

2 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.

9 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.
transaction shall be considered an affiliated investment. In such situations where the underlying collateral assets are issued by related parties that do not qualify as affiliates, these securities shall be identified as related party investments in the investment schedules.

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

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

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

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

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

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

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

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

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

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

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

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

**Status:**

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

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

Issue: Schedule D-6-1, Supplemental Reporting

Check (applicable entity):

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

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

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

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

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

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

Existing Authoritative Literature:

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

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

**Definition [of a SCA]**

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

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

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

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

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

5. Investments in SCA entities meet the definition of assets as defined in SSAP No. 4—Assets and Nonadmitted Assets and are admitted assets to the extent they conform to the requirements of this statement.

EXHIBIT A – SCA REPORTING PROCESS

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

51. Except for domestic SCA insurance company investments accounted for under paragraph 8.b.i., all SCA investments within the scope of this statement, purchased during any one calendar year, shall be reported to the NAIC on a Sub-1 form within 90 days of the acquisition or formation of the investment; this includes nonadmitted, zero-valued and immaterial SCAs. The NAIC will process that filing in the same year but will not at that time approve or disapprove a value for the SCA investment. By August 31 of each year, the insurance company shall submit a Sub-2 filing for the previously purchased SCA investment reported on a Sub-1 form and later that year, the NAIC will approve a value for the transaction. For SCAs that routinely receive their audit reports after the August 31 deadline, a filing deadline of one month after the audit report date for SCAs that routinely receive their audits after August 31 for existing SCA investments, and within 90 days of the acquisition or formation of a new SCA investment.

Initial Reporting of SCA Investments

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

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

Subsequent Reporting of SCA Investments

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

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

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

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

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

Assessment and Review of Sub-2 Form

64. **By August 31 or one month after the audit report date of each year, the NAIC shall initiate a review of all SCA investments for which new Sub-2 form filings have been received as well as an annual update review of Sub-2 SCA investments already logged in the VISION database.** The NAIC review shall encompass a review of the most recent annual statutory reporting by the parent insurance company’s Schedule Y (to ascertain the identity of the members of the holding company system and to ensure that information for all SCA companies has been submitted), a review of the parent’s financial statement blank to review the last reported value for the SCA investments and a review of the VISION database to determine whether SCA debt and SCA preferred securities have been assigned NAIC designations. As part of its analysis, the NAIC shall review the portion of the bond investments carried by the parent or a subsidiary insurer with a Z notation. If the NAIC determines that the portion of the Z bonds shown on the documentation is significant, the NAIC shall not process the Sub-2 filing until the insurance company reports the bonds to permit removal of the Z notation. Beginning with year-end 2019, two new suffixes will apply: YE and IF. YE means that the security is a properly filed annual update that the SVO has determined will not be assigned an NAIC designation by the close of the year-end reporting cycle. The symbol YE is assigned by the SVO pursuant to the carryover administrative procedure described in Part One, Section 3 f) (iii) of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. When the SVO assigns the symbol YE it also assigns the NAIC designation in effect for the previous reporting year. IF means that the security is an initial filing that has been properly filed with the SVO but which the SVO has determined will not be assigned an NAIC designation by the close of the year-end reporting cycle. The symbol IF is assigned by the SVO and communicates that the insurer should self-designate the security for year-end and identify it with the symbol IF. IF, therefore, also communicates to the regulator that the NAIC designation reported by the insurance company was not derived by or obtained from the SVO, but has been determined analytically by a reporting insurance company.
65. Upon completion of the procedures described above, the NAIC will determine whether the value reported by the insurance company on the current SCA filing was calculated in accordance with the instructions for the valuation method chosen and verify that the filed value reflects the adjustments required by paragraph 9.

66. Upon approval of a value (including making necessary adjustments), the NAIC will complete the Sub-2 filing with the approved value in the status field of the VISION database.

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

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

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

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

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

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

**SCHEDULE D – PART 6 – SECTION 1**

<table>
<thead>
<tr>
<th>CUSIP Identification</th>
<th>Description Name of Subsidiary, Controlled or Affiliated Company</th>
<th>Foreign</th>
<th>NAIC Company Code</th>
<th>ID Number</th>
<th>NAIC Valuation Method</th>
<th>Book/Adjusted Carrying Value</th>
<th>Total Amount of Goodwill Included in Book/Adjusted Carrying Value</th>
<th>Nonadmitted Amount</th>
<th>Stock of Such Company Owned by Insurer on Statement Date</th>
</tr>
</thead>
<tbody>
<tr>
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<td>XXX</td>
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<td>XXX</td>
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</tbody>
</table>

1. Total amount of goodwill nonadmitted $…………………………….999,999

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**Reporting Instructions for Schedule D, Part 6, Section 1**

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

**Column 12 through 15 will be electronic only.**

| Column 12 | – Legal Entity Identifier (LEI) |
| Column 13 | – Issuer |
| Column 14 | – Issue |
| Column 15 | – ISIN Identification |
| Column 16 | – Prior Year BACV |
| Column 17 | – Prior Year Nonadmitted Amount |

| Column 18 | – Prior year Sub-2 Verified Value |

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

**Column 18** – Prior year VISION Filing Number

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

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

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

Issue: Leasehold Improvements After Lease Termination

Check (applicable entity):

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

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

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

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

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

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

31. This statement adopts FASB Interpretation No. 43, Real Estate Sales, an Interpretation of FASB Statement No. 66 (FIN 43), which clarifies that the phrase "all real estate sales" includes sales of real estate with property improvements or integral equipment that cannot be removed and used separately from the real estate without incurring significant costs. This statement adopts FASB Emerging Issues Task Force No. 84-17, Profit Recognition on Sales of Real Estate with Graduated Payment Mortgages or Insured Mortgages, FASB Emerging Issues Task Force No. 89-13, Accounting for the Cost of Asbestos Removal,

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

SSAP No. 19:

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

SSAP No. 73:

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

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): The Working Group adopted substantive revisions in agenda item 2016-02 to SSAP No. 22 to incorporate language from ASU 2016-02, Leases (Topic 842), which retains the treatment of leases as operating leases by the lessor but incorporated some of the new language and guidance from ASU 2016-02.

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

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

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

SSAP No. 19:

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the
criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter of their estimated useful life or the remaining lease term, as defined in SSAP No. 22R. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired. The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity lessor. If leased real estate is acquired, recognition of the real estate shall follow the provisions in SSAP No. 40R—Real Estate Investments.

SSAP No. 73:

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

Staff Review Completed by Jake Stultz, September 2021

Status:
On December 11, 2021, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 19 and SSAP No. 73 to ensure that the guidance for the leasehold improvements matches the treatment provided in SSAP No. 40. These edits clarify that amortization of leasehold improvements will immediately end when a lease is terminated and will require that any remaining, unamortized leasehold improvement balance be immediately expensed. This will include scenarios where the lease terminates naturally or when the lessee purchases a property it was leasing.

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</tr>
<tr>
<td>o Ref #2021-21: Related Party Reporting</td>
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February 18, 2022

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: Items Exposed for Comment by the Statutory Accounting Principles Working Group on December 11, 2021 with Comments due February 18

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the exposure drafts released for comment by the NAIC Statutory Accounting Principles (E) Working Group (the Working Group).

We offer the following comments:

Ref #2019-21: Proposed Bond Definition

Pursuant to the direction from the Working Group in October 2020, a small group of regulators and industry have been meeting regularly to draft a bond definition for consideration. The intent of this project is to clarify what should be considered a bond (whether captured in SSAP No. 26R—Bonds or SSAP No. 43R—Loan-Backed and Structured Securities) and reported on Schedule D-1: Long-Term Bonds. This exposure is specific to the proposed bond definition included in the exposed Form A, along with the glossary (page 5) and appendices (pages 6-12), but comments on future developments (such as reporting changes, accounting and reporting guidance for items that do not qualify as bonds, transition guidance, etc.) may also be submitted to assist in the development of these items.

Interested parties appreciate the collaborative effort, between NAIC staff, regulators and interested parties, on this significant and complex project. We note this exposure includes the following three separate and distinct components for which we will provide comments:

1) Sufficiency Discussion – Concept (Attachment N),
2) Sufficiency Discussion – Examples (Attachment N-1),
3) Reporting Options (Attachment M).

Interested parties are supportive of the proposed refinements to the sufficient credit enhancement concept. Interested parties believe the clear articulation of the intent of the required substantive credit enhancement provides for a more understandable and workable proposed bond definition. Likewise, interested parties are supportive of the revised examples, where the new substantive credit enhancement concept has been incorporated.

Interested parties also offer the following comments on the various possible reporting options for Schedule D-1.

1. Reporting Lines:

With the principles-based bond definition, it is recommended that more granular reporting lines be established to capture investments in scope of SSAP No. 26R and SSAP No. 43R. From preliminary assessments, the current general categories are not used for analytical assessments/reports except for U.S. Govt – Full Faith and Credit. As such, this document proposes to replace the current general categories with the inclusion of more useful reporting lines based on the type of investment.

Exposure Request Detail provided on pages 2-5:

1. Information is requested on the potential removal of the general categories and whether the elimination would impact any tools or analyses currently performed.
   • Interested parties have no concerns currently with the proposed removal of the general categories.

2. Information is requested on the proposed reporting lines and whether additional categories would be beneficial. (Note – The proposal suggests dedicated reporting lines for certain securities that are now identified by codes. Comments on this approach are requested.)
   • Interested parties note that one of the challenges with the current Schedule D reporting categories and/or columns is ambiguity which leads to inconsistent reporting among companies. Interested parties recommends working together to ensure the instructions are clear and unambiguous to help prevent this problem with the new reporting schedules. This will benefit both companies and regulators.
   • Interested parties would like a better understanding of the unaffiliated/affiliated split of certain rows in the proposal; for example, are the rows not labelled with ‘Affiliated’ implied to be ‘Unaffiliated’? Or are the affiliated rows a subset of the former? Have you considered an alternative such as removing the lines identifying ‘Affiliated’ investments and utilizing a column to identify them instead? Blanks interested parties are suggesting that an Affiliated or Related Party indicator be utilized in a column for the investment schedules in the Blanks exposure 2021-22BWG (Related Party Reporting).
• Since investments in GNMA are RBC exempt, we recommend that additional lines be added to the ABS section to accommodate these for ease of identification (e.g., US Government Residential Mortgage-Backed Securities; US Government Commercial Mortgage-Backed Securities).

• Consider adding a new category in Issuer Credit Obligation for investments in Surplus Notes/Surplus Debentures which are currently reported on Schedule BA.

2. **New Sub-Schedule D-1:**

The bond project is currently proposing a new sub-schedule that details bond investments that have certain characteristics (e.g., ABS backed by financial assets that are not self-liquidating and ABS backed by cash-generating non-financial assets not captured within the practical expedient.)

**Exposure Request:**

1. Information is requested on how investments shall be categorized on this schedule.
   - Interested parties believe that the proposed ‘sub-schedule’ for Schedule D – Part 1 could be confusing, and the proposed data could be readily incorporated into electronic-only columns for the respective categories in the ‘Other Asset-Backed Securities’ section.
   - Clear instructions for each category under Other ABS will be extremely beneficial.

2. Information is requested on additional information / columns desired for these structures. Initial ideas that have been proposed include:
   a. Balloon payment as % of principal at acquisition
   b. Current loan-to-value
   c. PIK – Information on whether payment of interest is deferrable
   d. Amount of PIK interest to date
   e. Expected payoff date determined at acquisition
   f. Expected payoff date as of the financial statement date.

   • Currently, interested parties would support the proposed data elements for the ‘Other Asset-Backed Securities’ categories being reported in columns instead of in a ‘sub-schedule’. As changes to SSAP No. 26R and SSAP No. 43R are finalized for this project and further evaluation of these investments is done, modifications to the list may be warranted.

   • Interested Parties note that some of this data (e.g., Expected payoff date determined at acquisition) may not be readily available upon transition because it assumes a forward-looking analysis at a point in time that has already occurred (potentially decades in the past). Would a practical expedient be needed upon adoption to populate these types of fields?

3. **Schedule D-1 Information:**

As noted, with the change in reporting lines, it has been proposed a review of the columns and instructions also be considered. The following code columns have been potentially
identified.
- Column 3 – Code Column
- Column 5 – Bond Characteristics
- Column 26 – Collateral Type
- Column 34 – Capital Structure Code

Exposure Request – Detail provided on page 6:
1. Information is requested on whether other columns / reporting instructions should be clarified as part of the bond proposal project.
   - Interested parties are requesting additional time to address possible changes to the definitions of the columns indicated in the proposal. As rows are being changed, it could have a direct impact on what might be included in the columns as to minimize data redundancy.

2. Comments are welcome on the additional investment elements should be captured and/or whether certain elements are no longer beneficial to be captured. Potential elements related to asset-backed securities include:
   a. Market Validation – This will be a code to identify situations where none of the issuance is owned by unrelated parties.
      - Currently, interested parties don’t have an issue with adding this field and we believe the answer could be either yes or no.
      - However, interested parties are not sure if the intent is to have the same meaning as the following – This will be a code to identify situations where all of the issuance is owned by related parties. If so, interested parties recommends removing the double negatives to be less confusing. If not, interested parties may not fully appreciate what is trying to be captured.

   b. Participation in residual tranche (Y/N)
      - Interested parties aren’t sure how to respond to this question. Should the insurer respond Yes if it currently owns a residual tranche of the same securitization (e.g., residual issued from the same vehicle that issued the bond it invested in) or if they have ever owned a participation in the residual tranche?

Ref #2021-20: Effective Derivatives – ASU 2017-12

The Working Group moved this agenda item to the active listing, categorized as substantive, and directed NAIC staff to work with regulators and industry in assessing and developing revisions to facilitate effective hedge assessments consistently between U.S. GAAP and statutory accounting.

ASU 2017-12 provided targeted improvements to the existing GAAP hedge accounting framework that helps reduce some of the cost and complexity of applying hedge accounting and allows for additional hedging strategies that better align with an entity's risk management practices. Substantive changes that weren’t initially adopted in SSAP No. 86 are addressing cross-currency basis spread as an excluded component, partial-term hedging for fair value
hedges, ability to use the benchmark interest rate component of contractual cash flows to calculate the change in fair value of the hedged item in fair value hedges, last-of-layer/portfolio layer method for fair value hedges, and hedges of interest rate risk when the hedged item can be settled before scheduled maturity. Additionally, we are proposing clarifications to existing SSAP No. 86 for the accounting of forward points as an excluded component for currency forwards. Please refer to the attached appendix for proposed mark-ups to SSAP86 for these changes.

Summary of changes proposed to SSAP No. 86:

1. **Clarifications for the accounting of forward points as an excluded component for FX forwards** – Currently there is implicit inconsistency between paragraph 40 and Exhibit C for forward points as excluded components; this results in accounting that doesn’t align with companies’ risk management strategies. Application of the guidance in Paragraph 40 for a FX forward in an effective hedge relationship with an excluded component results in an impact to Surplus that is the same as if hedge accounting had not been applied. We propose resolving this matter by explicitly allowing the guidance in Exhibit C to be applied regardless of whether a component of the derivative is excluded from the assessment of effectiveness. When forward points are an excluded component from the assessment of hedge effectiveness, the forward points would be amortized into income. This would allow for the execution of FX forward effective hedge relationships, which interested parties would consider sound risk management strategies, to receive an accounting treatment that is more favorable relative to hedge accounting not being applied.

2. **Adding cross-currency basis spread as an excluded component** – We propose adding cross-currency basis spread as an excluded component. Doing so better aligns hedge accounting with companies’ risk management strategies, aligns the accounting for FX swaps where the cross-currency basis spread is an excluded component with the proposed accounting for FX forwards where forward points are an excluded component, and brings consistency between U.S. GAAP and Statutory accounting. Changes in the fair value of cross-currency basis spread have historically resulted in a less effective hedge or ineffective hedge because there is no corresponding offset in the hedged item. Excluding the cross-currency basis spread from the assessment of hedge effectiveness is beneficial for fair value hedges of foreign-denominated assets and liabilities. When the value of the cross-currency basis spread is excluded from the assessment of effectiveness, based on proposed changes to Paragraph 40 and Exhibit C, the excluded component would be held at amortized cost. With FX forwards, forward points as excluded components need to be amortized to be recognized in income. For FX swaps, the value of the cross-currency basis spread is embedded in the coupon payments of the swap, so the value is recorded in income each period through the typical swap accrual process.

3. **Adding ability to designate partial-term for fair value hedges** – We propose adding partial-term hedging for fair value hedges because it better aligns hedge accounting with companies’ risk management strategies for managing interest rate risk and brings consistency between U.S. GAAP and Statutory accounting. Currently SSAP No. 86 requires that the full contractual cash flows of the entire hedged item must be used to
calculate the change in the hedged item’s fair value attributed to the benchmark interest rate. With partial term an entity may designate only certain consecutive interest payments of a financial instrument as the hedged item and assume that the principal payment occurs at the end of the hedge term. Partial-term hedging allows entities to calculate the change in the fair value of the hedged item using an assumed term that begins when the first hedged cash flow begins to accrue and ends when the last hedged cash flow is due and payable. When using full contractual cash flows to calculate the change in the hedged item's fair value attributed to changes in the benchmark rate, it can be difficult to achieve a highly effective hedge because the hedging instrument and the hedged item would react differently to changes in interest rates since the principal repayment occurs on different dates.

4. Adding alternative to use the benchmark interest rate component of contractual cash flows to calculate the change in the fair value of the hedged item in fair value hedges – We propose adding an alternative to use the benchmark interest rate component of contractual cash flows to calculate the change in the fair value of the hedged item in fair value hedges because it better aligns hedge accounting with companies’ risk management strategies for managing interest rate risk and brings consistency between U.S. GAAP and statutory accounting. Currently SSAP No. 86 requires that the full contractual cash flows of the entire hedged item be used to calculate the change in the hedged item’s fair value attributed to the benchmark interest rate. Calculating the change in fair value using only the benchmark rate component instead of the entire coupon may better reflect how an entity manages interest rate risk. In addition, it will provide a greater degree of offset between the changes in the fair values of the hedging instrument and the hedged item. Generally, the benchmark rate being hedged and the fixed rate on the hedging swap will match if the swap is “at-market” and executed at the inception of the hedging relationship.

5. Adding last-of-layer/portfolio layer method for fair value hedges – We propose adding last-of-layer/portfolio layer method for fair value hedges because it better aligns hedge accounting with companies’ risk management strategies for managing interest rate risk and brings consistency between U.S. GAAP and statutory accounting. Last-of-layer allows entities to designate as the hedged item the last dollar amount of a closed portfolio of prepayable financial assets, or one or more beneficial interests in a portfolio of prepayable financial instruments. When using this approach, it is assumed that as prepayments occur, they are first applied to the portion of the closed portfolio that are not part of the designated layer. At inception and on each assessment date, the entity would need to determine that the designated layer is expected to be outstanding until the end of the hedge. This approach simplifies the rigid nature of the similar asset test required for portfolio hedging for fair value hedges by allowing the ability to assess qualitatively instead of quantitatively by combining the partial-term fair value hedge election and the election to measure changes in the hedged item by using the benchmark rate component of the contractual coupon cash flows. This makes achieving hedge accounting for a portfolio of prepayable fixed rate assets easier. The similar asset test requirement for portfolio hedges often makes it difficult, if not impossible, for a group of disparate fixed-rate assets to qualify to be hedged on a portfolio basis. The FASB currently has tentative
conclusions for updates to last-of-layer method, so we will need a scope limitation to maintain consistency with GAAP. For example, last-of-layer would only be applicable to closed portfolios of assets, and companies would be prohibited from designating closed portfolios of liabilities.

6. **Adding hedges of interest rate risk when the hedged item can be settled before scheduled maturity** – We propose adding the ability to elect to only consider how changes in the benchmark rate affects the decision to prepay the instrument when it assesses hedge effectiveness and measures the change in the hedged item’s value attributable to the hedged risk because it better aligns hedge accounting with companies’ risk management strategies and brings consistency between U.S. GAAP and statutory accounting. If an entity makes this election, it does not consider how other factors (e.g. credit risk) might affect the decision to prepay the financial instrument.

**Ref #2021-21: Related Party Reporting**

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 25 and SSAP No. 43R, as illustrated in the proposal, to clarify application of the existing affiliate definition and incorporate disclosure requirements for all investments that involve related parties, regardless of whether or not they meet the affiliate definition (“the Related Party Exposure”). In addition, draft annual statement reporting revisions were also exposed, in anticipation of incorporating those revisions into a Blanks (E) Working Group proposal.

Interested parties appreciate NAIC staff meeting with industry to better understand the regulatory concerns and intent of this proposal.

The Related Party Exposure has the following two main goals:

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

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

To accomplish these goals, the Related Party Exposure proposes to make changes to SSAP No 25 - Affiliates and Other Related Parties and SSAP No. 43R - Loan-backed and Structured Securities. We understand that one of the goals of the proposal is to identify investments that are originated, managed, sponsored or serviced (referred to as managed by affiliates for the
remainder of this letter) by an affiliate or related party of the insurer. Interested parties agree that this information can be useful for the regulators, but we believe that it is critical to differentiate investments where there is direct credit exposure to an affiliate from those investments that are only managed by affiliates with no underlying credit exposure to the affiliate or related parties of the insurer. The affiliate reporting distinction is very important for a number of reasons, including but not limited to the following:

a. **Rating Agencies** – Interested parties understand that the rating agencies may apply a higher risk factor to affiliated assets as there is a presumption that anything reported as affiliated has credit risk exposure to an SCA of the insurer.

b. **NAIC Designations** – Affiliated debt investments where there is credit exposure to an SCA of the insurer have to be filed with the SVO to obtain an NAIC designation. Affiliated equity investments in SCAs reported on Schedule D also require filing to confirm their reporting value on Schedule D. Debt investments in CLOs/CDOs that are managed by affiliates but that do not have any credit exposure to an affiliate are filing exempt because they are not deemed affiliated.

Our comments to the proposed changes to SSAP No. 25 and SSAP No. 43 are provided below:

1. **Removal of references to U.S. GAAP guidance from SSAP No. 25** - Interested parties agree with removing the U.S. GAAP reference to FASB Interpretation No. 35 as we agree that the statutory guidance uses a different threshold than US GAAP to determine if significant influence exists over an investee. In addition, the SSAP No. 25 guidance already includes a number of scenarios to rebut the presumption of control, which are similar to the examples provided in the GAAP guidance.

2. **The Working Group’s Proposed changes to SSAP No. 25 to add the following new paragraph:**

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

We understand from conversations with staff that this paragraph is meant to clarify the guidance in paragraph 7 of SSAP No. 25 and paragraph 6 of SSAP No. 97. Investments
in Subsidiary, Controlled and Affiliated Entities. That guidance requires that investments in limited partnerships and other similar entities (i.e. investment funds) that are managed by a general partner that is affiliated to the insurer and where the insurer owns more than 10% of the investment fund’s equity be reported as affiliated investments.

Interested parties understand that the current SSAP No. 25 and SSAP No. 97 guidance already require equity investments in limited partnerships and similar entities to be reported as affiliated if the insurer owns more than 10% of the equity of the limited partnership and the insurer is affiliated to the general partner or managing member for limited liability company structures. One thing to note is that even if the insurer is affiliated to the general partner, the insurer would usually not have any credit exposure to its affiliates in these structures as the underlying assets of the investment fund are usually held with unrelated parties. For this reason, interested parties note that there is a diversity in practice in the reporting of these investment funds on Schedule BA, with some insurers reporting these investments in the affiliated section of Schedule BA and others reporting these investments as unaffiliated. If the intent is to report these types of equity investments as affiliated when the presumption of control cannot be overcome, this will require some reporting changes by some insurers.

In regard to debt investments in investment funds or securitization vehicles managed by the insurer affiliates or related parties as well as mortgage loans managed by affiliates, we note that most insurers currently report those investments as unaffiliated on Schedule D, Schedule BA and Schedule B if there is no underlying credit exposure to affiliates of the insurer. Interested parties would like to highlight again that just because the insurer is affiliated with the manager or servicer of an investment vehicle such as a securitization, if the underlying assets in the structure do not have affiliated credit exposure, the investment itself should not be reported as affiliated as that would not be accurate reporting. See further comments on the SSAP No. 43R proposed changes in item No. 4 below.

The new proposed paragraph also includes a look-through requirement of these investment funds to identify instances where the investment fund owns more than 10% of the common stock of its underlying investees. Interested parties have concerns with this look-through review. Doing a look-through of the underlying investments of investment funds managed by affiliates of the insurer could potentially create a very significant operational burden that may have little or no benefit. The reason why there is potentially little benefit to this is because if these investment funds have purchased an equity investment that represents more than 10% but less than 50% of the voting stock of one of their investees, this would almost never give control to the investment fund. For most entities capitalized with common stock (i.e. voting entities), the parties that control are the ones that own more than 50% of the voting shares. If the Working Group feels that this look-through is necessary, interested parties will need time to get this process implemented. Interested parties believe that the earliest this look-through requirement can be implemented is for year-end 2023 as time will be needed to set up a process with all affiliated funds so that the funds provide a listing of underlying equity investments in
other entities along with the percentage ownership. In addition, we suggest some
wording changes, as shown below in the underlined text to the new paragraph, to link the
new paragraph back to the examples in paragraph 7 to incorporate the examples of when
the presumption of control can be overcome:

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

Interested parties also ask for clarification regarding what the implications are of
identifying an underlying investee of an investment fund as an affiliate. We believe that
any other transactions carried out with the indirect affiliate need to be disclosed in the
related party footnote, but we are unclear as to the impacts to Schedule Y and any other
reporting schedules. The unit of account in this case would be the direct investment in
the affiliated investment fund, not the underlying investments of the investment fund. It
is not clear to us whether the indirect affiliates would also need to be reported on
Schedule Y and/or any other reporting schedules.

3. **Proposed changes under paragraph 6 (a) of SSAP No. 43R regarding insurers’
   investments in securitization vehicles where the underlying assets of the securitization
   predominantly relate to assets with credit exposure to affiliates/related parties of the
   insurer** – Interested parties agree that when the insurer has credit exposure to its SCAs,
even if there are intermediaries as part of the transaction, such investment should be
reported as affiliated in the investment schedules.

4. **Proposed changes to SSAP No. 43R to clarify that investments managed by affiliates
   are viewed as affiliated even if the underlying assets in the structure do not have any
   credit exposure to an affiliate** - Many insurers own asset management subsidiaries which
manage securitization transactions. There is no question that the asset manager itself is an
SCA of the insurer and such asset managers are reported on Schedule Y as affiliates of
the insurer. However, when any debt tranches purchased from those securitization
vehicles do not have any credit exposure to SCAs of the insurer, the debt tranches are not
reported in the affiliated section of Schedule D even if the securitization vehicle is
managed by an affiliate.
It is very important to interested parties that this distinction is understood for Schedule D bond investments. Schedule D bond investments should not be reported as affiliated if they do not have credit exposure to SCAs of the insurer.

We understand from conversations with NAIC staff that this clarification is not intended to change the reporting lines in which investments are currently reported. The expectation is that these investments will now have a new code that will identify these investments as being managed by a related party of the of the insurer but have no credit exposures to related parties.

Interested parties agree with adding new codes to differentiate investments that are simply managed by a related party (including SCAs) from those that in fact have credit exposure to a related party (including SCAs) of the insurer. See further comments to the proposed codes in item 5 below.

5. Proposed annual statement changes to add a new electronic-only column to the investment schedules to identify investments involving related parties – Interested Parties have no objection to the proposed new codes to specify the type of relationship with the manager/sponsor/servicer of an investment vehicle. However, we offer the following comments to provide better clarity as to the applicability of the codes:

   a. Most if not all of an insurer’s general account investments are managed by an affiliated asset manager. The affiliated asset manager makes decisions as to when to buy and sell a specific investment, including reviewing the investment for potential credit losses. We do not believe that it is the intent of the proposal to flag all investments as affiliated only because an affiliated asset manager makes investment decisions over the investment. Insurers already report their relationship with affiliated asset managers in the related party footnote. We believe that the intent of this proposal is to identify investment vehicles that are managed by related parties (including SCAs) as well as investments with direct exposure to related parties (including SCAs) of the insurer. To that end, we believe the codes would predominantly apply to the following types of investments:

      i. CLOs/CDOs or special purpose entities set up to create a securitization vehicle that are managed by related parties (including SCAs) of the insurer.

      ii. Mutual funds/ETFs and other similar funds where the asset manager is a related party of the insurers (including SCAs of the insurer).

      iii. Limited partnerships, limited liability companies or trusts set up as investment vehicles where the general partner or managing member is a related party of the insurer (including SCAs of the insurer).

      iv. Debt and equity investments in affiliates where there is direct credit risk exposure to a related party (including SCAs of the insurer).
b. Codes 2, 3 and 4 of the Related Party Exposure refer to “securitizations and other similar investments” which may imply to some that the codes only apply to Schedule D assets since Schedule D is where debt investments in securitizations are reported. If the codes are expected to apply to all investment vehicles, perhaps the wording can be made clearer by saying “securitizations and other investment vehicles such as mutual funds, limited partnerships and limited liability companies.”

Ref #2021-22: Schedule D-6-1, Supplemental Reporting

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

Interested parties have the following observations regarding this proposal:

• The nature of the NAIC valuation adjustments can be broad and include a range of possibilities. But in looking back to the reductions from the 2020 filings, there are notes for items such as: going concern, lack of audit, audit not provided in English, lack of a U.S. GAAP reconciliation, or other errors, etc. It appears that the most prevalent, by far, is a reduction to match the equity reflected in the audit.

• The adjustment is not intended to match the approved amount, but to adjust subsequent valuations to reflect the current equity that factors in the noted adjustment / issue by NAIC staff from the filing submission. For example, if an insurer didn’t adjust for a surplus note, and staff adjusted their approved year end value to remove the surplus note, the insurer should make sure that a similar adjustment is reflected going forward when reporting the current equity amount.

• In addition, since this is gathering prior year information, we note that regulators will be able to easily identify significant swings in equity values for any particular SCA.

In summary, interested parties recommend that there be a formal process for communicating the adjustment to the state of domicile and a clearly articulated instruction for how the adjustment is to be reported to ensure that the adjustments are communicated to insurers by the state of domicile and that insurers clearly understand how the adjustments are to be reflected.

Ref #2021-23: SSAP No. 43R – Financial Modeling – Updated Guidance

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed two options for possible revision, as illustrated in the proposal, to update the summarized financial modeling guidance in SSAP No. 43R. The first option will retain existing guidance, with updates to reflect Valuation of Securities (E) Task Force adopted edits. The
second option removes the summarized financial modeling guidance and refers users to the Purposes and Procedures Manual of the NAIC Investment Analysis Office, which is the source document for financial modeling guidance.

Interested parties support option one as presented in the exposure. While there are advantages and disadvantages to each option, option 1 provides a meaningful holistic view of how these securities are treated in one spot, and without reference to the P&P manual, which we believe will be useful for financial and annual statement preparers. Interested parties note the following grammatical error in paragraph 27 a – third sentence (tracked changed suggestion):

“For a modeled non-legacy security, meaning one which closed after December 31, 2012, the NAIC designation and NAIC designation category assigned by the NAIC Securities Valuation Office must be used.”

Ref #2021-24: General Interrogatory for Cryptocurrencies

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

Interested parties have no comment on this item.

Ref #2021-25: Leasehold Improvements After Lease Termination

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

Interested parties agree that, in most cases, unamortized lessee owned leasehold improvements should be immediately expensed if the lease is terminated. However, in the situation where the reporting entity purchases a property that it was previously leasing, the immediate expensing may not be appropriate in all circumstances.

SSAP No. 19, Furniture, Fixtures, Equipment and Leasehold Improvements, paragraph 4 defines leasehold improvements as (bolded for emphasis) “lessee expenditures that are permanently attached to an asset” that a reporting entity is leasing under an operating lease.”
In defining this issue, NAIC Staff referred to paragraphs 18 and 31 of SSAP No. 40R, Real Estate Investments, which relate to the sale of real estate. Within the guidance of these paragraphs, it is emphasized by Staff that the sale of real estate includes property improvements or integral equipment, which are defined as any physical structure or equipment attached to the real estate that cannot be removed and used separately without incurring significant costs, such as an office building. Interested parties agree if a reporting entity sells real estate, the asset, including property improvements and integral equipment, should be derecognized and a gain or loss on the sale be realized. However, as noted above, this issue relates to when a reporting entity acquires, not sells, a property that it was leasing.

SSAP No. 40R paragraph 8 states (bolded for emphasis), “The cost of real estate represents the fair value of the consideration exchanged plus any costs incurred to place the real estate asset in usable condition, including but not limited to, brokerage fees, legal fees, demolition, clearing and grading, fees of architects and engineers, any additional expenditures made for equipment and fixtures that are made a permanent part of the structure…” Therefore, under SSAP No. 40R, leasehold improvements are admitted assets.

The proposed revisions to SSAP No. 19 and SSAP No. 73 both state (bolded for emphasis; italics to denote reference to the appropriate party acquiring the leased real estate):

The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity (lessee) lessor. If leased real estate is acquired, recognition of the real estate shall follow the provisions in SSAP No. 40R—Real Estate Investments.

It is noted in the Staff Recommendation that “[i]t is presumed that the purchase of a property from a third party would include the leasehold improvements as part of the full purchase price.” Under this presumption it is logical that the previously recognized leasehold improvements should be immediately expensed, otherwise, the reporting entity would be double counting the assets and related expense. In practice, however, interested parties generally believe this to be an unlikely scenario.

Lease agreements with purchase options can be complex and structured in a myriad of ways depending on how the reporting entity lessee negotiated with the lessor. There may be circumstances that the reporting entity negotiating a reduced price to acquire the real estate formerly leased to compensate for the permanent improvements it previously made. In other situations, the sales price is determined based on the then current fair or appraised value. In this situation, the lessee and lessor will engage a third-party appraiser to establish the sales price. Appraisers generally use the cost, sales comparison, or income approaches to establish the value. Generally, those approaches may not contemplate the specific lessee owned leasehold improvements unless those improvements generate material utility (e.g., expansion of the building itself, or in a ground lease, land improvements or a constructed building, etc.). Accordingly, the reporting entity would not be including in the cost of the acquired real estate
any additional expenditures made for equipment and fixtures that are made a permanent part of the structure as required/allowed by SSAP No. 40R if the amendments to SSAP No. 19 and 73 require them to be written off at acquisition.

Additionally, interested parties believe it would generally be economically punitive to a reporting entity to provide consideration to purchase a leased asset to the landlord (seller) that includes significant costs that the reporting entity lessee already incurred for the leasehold improvements. Also, many States require material purchases of real estate (particularly for HMOs) to be approved by the Department of Insurance. Barring any unique circumstances, it is unlikely a regulator would approve a transaction that requires the reporting entity to pay additional amounts to a lessor for costs its already incurred.

Interested parties are also concerned with the additional complexity the exposure draft will add in applying SSAP No 22R versus ASC 842 for GAAP. As it stands today, there is already a cost basis difference between GAAP and SAP when purchasing the underlying leased asset. SSAP No 22R implies that any deferred rent liability upon termination of a lease would be adjusted off to the P&L (i.e., a gain). For GAAP under ASC 842, any remaining lease liability upon purchase of the leased asset is adjusted to the cost basis of the asset (i.e., effectively deferring the gain) along with the unamortized portion of the lessee owned leasehold improvements. Expensing unamortized leasehold improvements in all circumstances for terminated leases for SAP creates further cost basis differences that will artificially and significantly distort earnings and will be extremely difficult to operationalize.

It is also worth noting that for some interested parties, external auditors and regulators have audited these transactions and have been comfortable that duplication is not occurring.

Interested parties suggest that the following amendments be revised guidance of SSAP No. 19 and 73:

- The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. **When leased real estate is purchased by the reporting entity lessee resulting in termination of the lease, any unamortized lessee owned leasehold improvements should be added to the cost basis of the acquired real estate and recognized in accordance with SSAP No. 40R—Real Estate Investments.** Any unamortized leasehold improvements owned by the reporting entity lessee that have no future economic benefit upon purchase of the leased real estate asset or those included in the purchase price of the acquired real estate should be immediately expensed. This includes situations in which leased real estate is acquired by the reporting entity lessor. If leased real estate is acquired, recognition of the real estate shall follow the provisions in SSAP No. 40R—Real Estate Investments.

**Ref #2021-26EP: Editorial and Maintenance Update**

The Working Group moved this item to the active listing, categorized as nonsubstantive, and
exposed revisions to certain, remaining terminology references of “substantive” and “nonsubstantive,”

In response to an Aug. 14 referral from the Financial Condition (E) Committee, the edits are proposed to update the terminology references of “substantive” and “nonsubstantive,” which have historically been used to describe statutory accounting revisions being considered by the Working Group to the NAIC Accounting Practices & Procedures Manual. The Committee recommended terminology updates to alleviate concerns that users who are not familiar with the historical definitions of these terms may incorrectly perceive that the terms reflect potential financial impact rather than their intended definitions.

Accordingly, where applicable, the current concept/term of:

1) a “substantive” revision is proposed to be replaced with the phraseology of a “New SAP or New SAP concept in an existing SSAP,” and,
2) a “nonsubstantive” revision is proposed to be replaced with the phraseology of a “SAP clarification.”

Interested parties agree that the distinction between substantive (proposed to change to “development of new SSAPs or New SAP Concepts in an Existing SSAPs”) and non-substantive (proposed to change to “Development of SAP Clarifications”) can be confusing and that there would be more clarity in the development process if the distinction were eliminated.

Instead, we recommend that all new standards be handled similarly but that the effective date for each new standard be determined by evaluating the complexity of implementation (e.g., the extent that systems or process changes are required) and the availability of data to insurers to implement the new standard. This determination would be made as guidance is completed and with feedback from industry as to the time needed to adopt proposed reporting and/or disclosure.

Ref #2021-27: **ASU 2021-04 - Issuer’s Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options**

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions, as illustrated in the proposal, to incorporate guidance related to the accounting for the changes in fair value when exchanging equity-classified written call options, while rejecting the remainder of ASU 2021-04 in SSAP No. 72.

Interested parties have no comment on the approach taken in the exposed revisions but recommend that the revisions be expanded to provide more detail to clarify what guidance from GAAP is adopted and what is not (similar to the description generally provided in an SSAP).

Ref #2021-28: **ASU 2021-03, Intangibles – Goodwill and Other (Topic 350) – Accounting Alternative for Evaluating Triggering Events**

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

Interested parties have no comment on this item.

**Ref #2021-29: ASU 2021-05 - Leases (Topic 842), Lessors—Certain Leases with Variable Lease Payments**

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to reject ASU 2021-05 in SSAP No. 22R.

Interested parties have no comment on this item.

**Ref #2021-30: ASU 2021-06—Amendments to SEC Paragraphs in Topic 205, Topic 942 and Topic 946**

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2021-06 as not applicable to statutory accounting.

Interested parties have no comment on this item.

* * *

Thank you for considering interested parties’ comments. If you have any questions in the interim, please do not hesitate to contact us.

Sincerely,

D. Keith Bell 
Rose Albrizio

cc: NAIC staff 
Interested parties
APPENDIX

Suggested Modification to SSAP 86 for Discussions Related to FX Hedging / Excluded Components

Proposed Modifications to the Main Body of SSAP No. 86

40. The gain or loss on a derivative designated as a hedge and assessed to be effective is reported consistently with the hedged item. If an entity’s defined risk management strategy for a particular hedging relationship excludes a specific component of the gain or loss, or related cash flows, on the hedged derivative from the assessment of hedged effectiveness (as discussed in Exhibit B), that excluded component of the gain or loss shall be recognized in accordance with Appendix C, as an unrealized gain or loss. For example, if the effectiveness of a hedge with an option contract is assessed based on changes in the option’s intrinsic value, the changes in the option’s time value would be recognized in unrealized gain or losses. Time value is equal to the fair value of the option less its intrinsic value.

Proposed Modifications to Exhibit B

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

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

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

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

   d. If the effectiveness of a hedge with a foreign currency swap is assessed based on changes in fair value attributable to changes in spot rates, only the change in value of the foreign currency notional amount due to fluctuations in spot prices would be included in the assessment of effectiveness.

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

Proposed Modifications to Exhibit C

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

b. Statement Value
iii. Open foreign currency swap and forward contracts hedging foreign currency exposure on items denominated in a foreign currency and translated into U.S. dollars where fair value accounting is not being used.

(a) For forward contracts, the foreign exchange premium (discount) on the currency contract shall be amortized into income over the life of the contract or hedge program. The foreign exchange premium (discount) is defined as the foreign currency (notional) amount to be received (paid) times the net of the forward rate minus the spot rate at the time the contract was opened.

Amortization is not required if the contract:

1) was entered into within a year of maturity; or
2) is a foreign currency swap. For foreign currency swaps, the equivalent of a forward contract’s premium (discount) is the cross-currency basis spread, which is amortized into income through the foreign currency swap’s periodic interest accruals.

(b) A foreign currency translation adjustment shall be reflected as an unrealized gain/loss (unassigned funds (surplus) adjustment) using the same procedures as done to translate the hedged item;

(c) The unrealized gain/loss for the period equals the foreign currency (notional) amount to be received (paid) times the net of the current spot rate minus the prior period end spot rate;

(d) The statement value of the derivative equals:

1) For forward contracts, the amortized (premium) discount plus the cumulative unrealized gains/(loss) on the contract.
2) For foreign currency swaps, the cumulative unrealized gains/(loss) on the contract. Amortization of the cross-currency basis spread is recorded on the balance sheet as Receivables (Payable) for Investment Income Due & Accrued or Other Liabilities, as a component of the foreign currency swap’s periodic interest accrual.

The cumulative unrealized gain/(loss) equals the foreign currency (notional) amount to be received (paid) times the net of the current spot rate minus the spot rate at the time the contract was opened.

(e) Recognition of unrealized gains/losses and amortization of foreign exchange premium/discount on derivatives hedging forecasted transactions or firm commitments shall be deferred until the hedged transaction occurs. These deferred gains/losses will adjust the basis or proceeds of the hedged transaction when it occurs;

(f) For hedges where the cost of the foreign currency contract is combined with the hedged item, the statement value on Schedule DB is zero. The fair value of the derivative and hedged item shall be determined and reported separately, either individually or in the aggregate;

(g) If during the life of the currency contract it or a designated portion of the currency contract is not effective as a hedge, the hedge relationship shall be discontinued and the derivative shall be recorded at fair value pursuant to paragraph 22. Valuation at amortized cost shall cease. To the extent it ceased to be an effective hedge, a cumulative unrealized gain/loss (surplus adjustment) will be recognized equal to the difference between the carrying value of the derivative on the balance sheet (at the time of de-designation) and the fair value of the derivative (at the time of de-designation) notional amount or designated notional amount times the difference between the forward rate available for the remaining...
maturity of the contract (i.e., the forward rate as of the balance sheet date) and the forward rate at the
time it ceased to be an effective hedge.

Proposed changes to Reporting

**Updated to SSAP 86.62.vi:**

86.62.vi net gain or loss recognized in unrealized gains or losses during the reporting period
representing the component of the derivative instruments’ gain or loss, if any, excluded from the
assessment of hedge effectiveness;

The change in fair value of derivative components excluded from the assessment of effectiveness
(pursuant to paragraph 2 in Exhibit B). These changes in fair value that occurred during the period and
cumulatively over the life to date of the hedge relationship shall be disclosed by derivative type.

Example disclosure

**Two examples to choose from - year to date or cumulative**

For the years ended December 31, 2021 and 2020 there were derivative fair value changes excluded
from the assessment of hedge effectiveness of $3M and $5M, respectively, related to foreign exchange
swaps and $6M and $13M, respectively, related to foreign currency forwards.

At December 31, 2021 and 2020 there were derivative fair value changes excluded from the assessment
of hedge effectiveness of $8M and 10M, respectively, related to foreign exchange swaps and $4M and
$10M, respectively, related to foreign currency forwards.

**Proposed Schedule DB changes for identifier:**

Add an “X” to the Code column 15 indicating the qualifying derivative has a difference between BACV
and FV due to an excluded component.
Suggested Modification to SSAP 86 for Discussions Related to Alignment of Interest Rate Hedging with GAAP (Topic 815/ASU 2017-12)

Proposed Modifications to the Main Body of SSAP 86

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

d. The hedged item is specifically identified as either all or a specific portion or partial term of a recognized asset or liability or of an unrecognized firm commitment. The hedged item is a single asset or liability (or a specific portion or partial term thereof) or is a portfolio of similar assets or a portfolio of similar liabilities (or a specific portion thereof) or closed portfolio of assets where assumed layer is anticipated to be outstanding (or a specific portion thereof). For partial term one or more consecutive selected contractual cash flows where the hedged item begins when the first hedge cash flow begins to accrue and ends when the last hedged cash flow is due and payable, the assumed maturity of the hedged item occurs on the date in which the last hedged cash flow is due and payable;

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

f. For a closed portfolio of prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments, an entity may designate as the hedged item a stated amount of the asset or assets that are not expected to be affected by prepayments, defaults, and other factors affecting the timing and amount of cash flows if the designation is made in conjunction with the partial-term hedging election in paragraph (this designation is referred to throughout as the “last-of-layer method” or “portfolio layer method”).

a. For last-of-layer, an analysis shall be completed and documented to support the entity’s expectation that the hedged item (that is, the designated last of layer) is anticipated to be outstanding as of the hedged item’s assumed maturity date in accordance with the entity’s partial-term hedge election. That analysis shall incorporate the entity’s current expectations of prepayments, defaults, and other events affecting the timing and amount of cash flows associated with the closed portfolio of prepayable financial assets or beneficial interest(s) secured by a portfolio of prepayable financial instruments.

b. For purposes of its analysis, the entity may assume that as prepayments, defaults, and other events affecting the timing and amount of cash flows occur, they first will be applied to the portion of the closed portfolio of prepayable financial assets or one or more beneficial interests that is not part of the hedged item (that is, the designated last of layer); and

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

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

ii. The risk of changes in its fair value attributed to changes in benchmark interest rate risk;
iii. The risk of changes in its fair value attributed to change in the related foreign currency exchange rates; or

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

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

The benchmark interest rate being hedged in a hedge of interest rate risk must be specifically identified as part of the designation and documentation at the inception of the hedge relationship. In calculating the change in the hedged item’s fair value attributable to changes in the benchmark interest rate, the estimated cash flows used in calculating fair value must be based on all of the contractual cash flows of the entire hedged item or the benchmark rate component of the contractual coupon cash flows of the hedged item determined at hedge inception. An entity may designate a fair value hedge of interest rate risk in which the hedged item is a prepayable instrument. The entity may consider only how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity (for example, an entity may consider only how changes in the benchmark interest rate affect an obligor’s decision to call a debt instrument when it has the right to do so). The entity need not consider other factors that would affect this decision (for example, credit risk) when assessing hedge effectiveness. Excluding some of the hedged item’s contractual cash flows (for example the portion of the interest rate coupon in excess of the benchmark interest rate) from the calculation is not permitted. An entity may not simply designate prepayment risk as the risk being hedged for a financial asset. However, it can designate the option component of a prepayable instrument as the hedged item in a fair value hedge of the entity’s exposure to changes in the fair value of that “prepayment” option, perhaps thereby achieving the objective of its desire to hedge prepayment risk. The effect of an embedded derivative of the same risk class must be considered in designating a hedge of an individual risk. For example, the effect of an embedded prepayment option must be considered in designating a hedge of benchmark interest rate risk.

Proposed Modifications to Exhibit B

8. Conditions applicable to fair value hedges only

f. The expiration date of the swaps matches the maturity date or assumed maturity date of the interest-bearing asset or liability.

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

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

i. For last-of-layer If both of the following conditions exist, the quantitative test described for similar asset test may be performed qualitatively and only at hedge inception:

   a. The hedged item is a closed portfolio of prepayable financial assets or one or more beneficial interests.

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

Using the benchmark rate component of the contractual coupon cash flows when all assets have the same assumed maturity date and prepayment risk does not affect the measurement of the hedged item results in all hedged items having the same benchmark rate component coupon cash flows.