Date: 7/21/22

2022 Summer National Meeting
Portland, Oregon

Statutory Accounting Principles (E) Working Group
Wednesday, August 10, 2022
10:00 a.m. – 12:00 p.m.

OVERVIEW AGENDA

HEARING AGENDA

	Hearing Page Number	Attachment
1. SAPWG Hearing – Adoption of Minutes—Dale Bruggeman (OH)	1	1-3
2. SAPWG Hearing – Review and Adoption of Non-Contested Positions —Dale Bruggeman (OH)		
• Ref #2022-04: ASU 2021-10, Government Assistance	1	4
• Ref #2022-05: ASU 2021-09, Leases, Discount Rate for Lessees	2	5
• Ref #2022-06: ASU 2021-07, Compensation – Stock Compensation	3	6
• Ref #2022-07: ASU 2021-08, Business Combinations	4	7
3. SAPWG Hearing – Review of Comments on Exposed Items—Expecting Minimal Discussion —Dale Bruggeman (OH)		
• Ref #2021-20: Effective Derivatives – ASU 2017-12	5	8-10
• Ref #2022-02: SSAP No. 48 – Alternative Valuation of Minority Ownership Interests	8	11
4. SAPWG Hearing – Review of Comments on Exposed Items—Dale Bruggeman (OH)		
• Ref #2022-01: Conceptual Framework - Updates	10	12-14
Comment Letters		15

OVERVIEW AGENDA

MEETING AGENDA

	Meeting Page Number	Attachment
5. SAPWG Meeting – Maintenance Agenda – Pending List—*Dale Bruggeman (OH)*		
• Ref #2022-09: ASU 2022-01: Fair Value Hedging – Portfolio Layer Method	1	A
• Ref #2022-10: ASU 2022-02: Troubled Debt Restructurings and Vintage Disclosures	3	B
• Ref #2022-11: Collateral for Loans	5	C
• Ref #2022-12: Review of INT 03-02: Modification to an Existing Intercompany Pooling Arrangement	6	D-E
• Ref #2022-13: Related Party - Footnote Updates	8	F
6. SAPWG Meeting – Maintenance Agenda – Active Listing—Dale Bruggeman (OH)		
• Ref #2021-25: Leasehold Improvements after Lease Termination	9	G
• Ref #2019-21: Proposed Bond Definition	10	H-K
7. SAPWG Meeting – Any Other Matters Brought Before the Working Group —Dale Bruggeman (OH)		
• Review of U.S. GAAP Exposures	11	L
• Update for LATF coordination	11	M
• Receive a Referral from the Macroprudential (E) Working Group	-	N-O

- **Comment Deadline for all items – Friday, October 7**

Statutory Accounting Principles (E) Working Group
Hearing Agenda
August 10, 2022
10:00 a.m. – Noon (Pacific)

ROLL CALL

Dale Bruggeman, Chair	Ohio	Judy Weaver	Michigan
Kevin Clark/Carrie Mears, Co-Vice Chairs	Iowa	Doug Bartlett/ Pat Gosselin	New Hampshire
Sheila Travis	Alabama	Bob Kasinow	New York
Kim Hudson	California	Melissa Greiner/Matt Milford	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. Spring National Meeting **(Attachment 1)**
2. May 24, 2022 **(Attachment 2)**
3. July 18, 2022 **(Attachment 3)**

The Statutory Accounting Principles (E) Working Group met in regulator-to-regulator sessions on August 4, 2022. This regulator session was pursuant to the NAIC Open Meetings Policy paragraph 3 (discussion of specific companies, entities or individuals) and paragraph 6 (consultations with NAIC staff related to NAIC technical guidance of the *Accounting Practices and Procedures Manual*). No actions were taken during these meetings as the discussion previewed the Summer 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 #2022-04: ASU 2021-10, Government Assistance
2. Ref #2022-05: ASU 2021-09, Leases, Discount Rate for Lessees
3. Ref #2022-06: ASU 2021-07, Compensation – Stock Compensation
4. Ref #2022-07: ASU 2021-08, Business Combinations

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-04 SSAP No. 24 (Jim)	**ASU 2021-10, Government Assistance**	**4 – Agenda Item**	**No Comment**	**IP-2**

Summary:
On April 4, the Working Group exposed revisions to *SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items* to incorporate certain disclosures from *Accounting Standards Update* (ASU) *2021-10, Government Assistance, Disclosures by Business Entities about Government* Assistance, supplementing existing disclosures to require that if a reporting entity experiences unusual or infrequent item and those items is as a result of government assistance, the transaction will require identification as well as a description of the terms and provisions of the assistance received. The agenda item recommended the disclosures apply to all entity types, which was a minor modification from the ASU, which excludes not for profit entities or benefit plans. As a final note, existing disclosures for unusual/infrequent items (captured in financial statement note #21) already contains the requirement to identify the specific line items which have been affected by the events or transactions considered to be unusual and/or infrequent - thus that specific portion of ASU 2021-10 was not proposed for inclusion.

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. 24—Discontinued Operations and Unusual or Infrequent Items* to incorporate certain disclosures from ASU 2021-10. The proposed additions will supplement existing disclosures to require that if the unusual or infrequent item is as the result of government assistance, the transaction will require identification as well as a description of the terms and provisions of the assistance received.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-05 SSAP No. 22R (Jake)	**ASU 2021-09, Leases, Discount Rate for Lessees**	**5 – Agenda Item**	**No Comment**	**IP-2**

Summary:
On April 4, the Working Group exposed revisions to *SSAP No. 22R—Leases* to reject ASU *2021-09, Leases (Topic 842), Discount Rate for Lessees That Are Not Public Business Entities* for statutory accounting. ASU 2021-09 was issued as part of FASB's post-implementation review to address issues found during the implementation of the new lease guidance from *ASU 2016-02, Leases (Topic 842)*. Topic 842 generally requires the capitalization of leases, which is calculated by discounting the lease payments utilizing the implicit rate in the lease, or if not determinable, the lessee's incremental borrowing rate. However, the standard also provides nonpublic entities with a practical expedient, permitting the use of a risk-free rate (e.g., U.S. Treasury Rate) for the capitalization calculation. The amendments in ASU 2021-09 state that when the rate implicit in the lease is readily determinable for any individual lease, that the lessee should use that rate (rather than a risk-free rate or an incremental borrowing rate), regardless of whether it has made the risk-free rate election.

The guidance provided in this ASU is specific to the financing lease treatment under U.S. GAAP, and since *SSAP No. 22R*—Leases requires nearly all leases to be treated as operating leases for statutory accounting, adoption of this guidance would be unnecessary.

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

Recommended Action:
NAIC staff recommends the Working Group adopt the exposed SAP clarifications which reject ASU 2021-09 in *SSAP No. 22R—Leases*. As statutory accounting requires most leases to be classified as operating leases, this U.S. GAAP guidance is not necessary.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-06 SSAP No. 104R (Jim)	**ASU 2021-07, Compensation – Stock Compensation**	**6 – Agenda Item**	**No Comment**	**IP-3**

Summary:
On April 4, the Working Group exposed revisions to *SSAP No. 104R—Share-Based Payments* to incorporate a practical expedient in ASU *2021-07, Compensation – Stock Compensation (Topic 718), Determining the Current Price of an Underlying Share for Equity-Classified Share-Based Awards.* The amendments in ASU 2021-07 provides nonpublic companies with a practical expedient to determine fair value for share-based payments. When equity share options or similar instruments are granted in a share-based payment transaction, the fair value (which is used to determine expense recognition at inception and during any subsequent award modification) is estimated using an option-pricing model valuation technique.

In terms of option-priced models, the Black-Scholes-Merton model is considered to be one of the most widely used as it has less complexity than other pricing models. However, despite its reduced complexity, it (and various other pricing models) requires numerous inputs. For public entities, the determination of these values is generally readily available, however for nonpublic entities, many of these inputs are not easily determinable. The practical expedient in this ASU is the third such practical expedient permitted in Topic 718, of which the previous two have previously been adopted and are currently permissible for use in *SSAP No. 104R—Share-Based Payments*. Integration of this third practical expedient is consistent with previous decisions by the Working Group to adopt the prior two practical expedients regarding option-pricing modeling input permitted by FASB.

The language proposed by NAIC staff directs that the practical expedient is only available when a reporting entity is not able to reasonably estimate the current fair value. While this language is technically broader than what was adopted by FASB (as ASU 2021-07 directly references non-public companies), the proposed language is consistent with prior Working Group adoptions and by default, should not be utilized by public entities – as they would be able to reasonably estimate fair value, which is likely the publicly traded share price.

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 *SSAP No. 104R—Share-Based Payments* which incorporate the practical expedient for the current price input, a required component for the option-pricing models – models in which are utilized in the determination of fair value for share-based payments. Integration of this third practical expedient is consistent with previous decisions by the Working Group with its adoption of two prior practical expedients regarding option-pricing modeling input permitted by FASB. The language proposed directs that the practical expedient is only available when a reporting entity is not able to reasonably estimate the current fair value. While this language is technically broader than what was adopted by FASB (as ASU 2021-07 directly references non-public companies), the proposed language is

consistent with prior Working Group adoptions and by default, should not be utilized by public entities – as they would be able to reasonably estimate fair value.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-07 SSAP No. 47 SSAP No. 68 (Jim)	**ASU 2021-08, Business Combinations**	**7 – Agenda Item**	**No Comment**	**IP-3**

<u>*Summary:*</u>
On April 4, the Working Group exposed revisions to *SSAP No. 47—Uninsured Plans* and *SSAP No. 68—Business Combinations and Goodwill* to reject ASU *2021-08, Business Combinations, Accounting for Contract Assets and Contract Liabilities from Contracts with Customers* for statutory accounting. ASU 2021-08 requires that acquiring entities apply Topic 606 (the topic that specifies the accounting for revenue and liabilities resulting from contacts with customers), when valuing and recognizing contract related assets and liabilities in a business combination. Prior to the issuance of ASU 2021-08, acquirers would generally only recognize such items based on their fair values on the date of acquisition. When assessing liabilities at fair value, acquirers would generally only recognize an acquiree's deferred revenue (i.e., a contract liability), to the extent the acquirer had a legal obligation to perform a service or remit a product. However, to only recognize a contract liability to the extent of a legal obligation is contrary to Topic 606 as it states that performance obligations may (and often) extend beyond legal obligations – with examples including implied promises and customer business practices within the contract with a customer, regardless of whether such promises were legally enforceable.

For statutory accounting, other than the reporting of statutory goodwill, the acquiree's book value of all associated assets (and liabilities) are reported on the acquirer's books. As ASU 2021-08 requires the acquirer to utilize the acquiree's book value, measured via Topic 606, for contract liabilities, the practice (unless the acquiree has not previously or has incorrectly applied Topic 606) while conceptually consistent statutory accounting requirements, requires a measurement method previously rejected by statutory accounting.

<u>*Interested Parties' Comments:*</u>
Interested parties have no comment on this item.

<u>*Recommended Action:*</u>
NAIC staff recommends the Working Group adopt the exposed SAP classifications which reject ASU 2021 - 08 in *SSAP No. 47—Uninsured Plans* and *SSAP No. 68—Business Combinations and Goodwill.* The exposed revisions in SSAP No. 68 also include notation that rejection of ASU 2021-08 does not impact the determination of U.S. GAAP book value in an acquired entity (i.e., U.S. GAAP net book value, which is utilized for the determination of statutory goodwill, should not be modified as a result of the rejection of ASU 2021-08).

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 #2021-20: Effective Derivatives – ASU 2017-12
2. Ref #2022-02: SSAP No. 48 – Alternative Valuation of Minority Ownership Interests

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2021-20 SSAP No. 86 (Julie)	**Effective Derivatives – ASU 2017-12**	**8 – Agenda Item 9 – New Exhibit A 10 - Measurement**	**In Support**	**IP-1**

Summary:
During the 2021 Fall National Meeting, the Working Group exposed an agenda item that summarized key changes detailed in *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.

During the 2022 Spring National meeting, the Working Group exposed two documents for public comment. The first document (labeled 21-20 SSAP No. 86 – Exhibit A 3-2-22), proposed revisions in the form of a new Exhibit A (which will replace both Exhibit A and Exhibit B of SSAP No. 86 that adopts with modification U.S. GAAP guidance in determining hedge effectiveness. The second document (labeled 21-20 SSAP No. 86 – Excluded Components - 3-17-22), proposed measurement methods for excluded components in hedging Ref # 2021-20.

Interested Parties' Comments:
Interested parties support the changes and we look forward to working with the staff on the further updates.

Recommended Action:
NAIC staff recommends that the Working Group adopt the exposed revisions, reflecting new SAP concepts, to incorporate new guidance in SSAP No. 86 (as a new Appendix A) on assessing hedge effectiveness as well as the exposed revisions to incorporate new guidance on permitted excluded components and the appropriate measurement for those excluded items with an effective date of January 1, 2023, with early application permitted. The exposed revisions adopt, with modification, U.S. GAAP. The adoption reflects consistent guidance for initial and subsequent hedge effectiveness, with 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. **In addition to the exposed revisions, NAIC staff has drafted edits to detail the proposed effective date / relevant literature language (detailed below) and shared these proposed edits with interested parties. However, staff recommends confirming with regulators and interested parties on whether this additional language should be exposed prior to adoption.**

With adoption, NAIC staff recommends that the Working Group sponsor a blanks proposal to incorporate new Schedule DB reporting fields (electronic only) and templates to capture the new disclosures for excluded

components detailed in paragraph 41g of the exposed revisions. These reporting revisions will be in effect Dec. 31, 2023. (Entities that early adopt shall provide the required disclosures in narrative form for year-end 2022 and detail the adoption as a change in accounting principle.)

NAIC staff recommends the Jan. 1, 2023, effective date with early application permitted as this effective date will permit the insurers to immediately proceed with changes to be consistent with U.S. GAAP for effective hedge assessments involving excluded components. It will also allow the insurers to proceed towards uniform measurement guidance for the excluded components and remove ambiguity and conflicting guidance within the SAPs. For insurers that have these derivative structures and need time to implement system changes, the Jan. 1, 2023, timeframe provides the ability to incorporate those changes. This could result with variations among insurers at year-end 2022 between those that have early adopted and those that will adopt in 2023. Although the impact of these variations could be significant, the number of insurers impacted is expected to be limited. Additionally, the revisions to SSAP No. 86 captures additional information on excluded components in Schedule DB as well as the notes to the financial statements. For the early adopters, the disclosure templates will not be in place for these disclosures. Entities that early adopt shall capture the disclosure information in a narrative as well as detail the adoption and impact as a change in accounting principle for year-end 2022.

In addition to the revisions detailed in the two attachments (revisions to SSAP No. 86 for excluded components and revisions to incorporate a new Appendix A (replacing both Appendix A and B) for assessing effectiveness), NAIC staff recommends incorporating the following guidance to detail the adoption action and effective date:

Relevant Literature

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

65. This statement adopts, with modification, certain revisions to ASC 815-20 included in ASU 2017-12. Remaining provisions of ASU 2017-12 will be subsequently assessed for statutory accounting and shall not be considered adopted for statutory accounting until that assessment is complete.

a. Revisions effective January 1, 2019 with early adoption permitted, ~~This adoption is~~are limited to specific provisions, and related transition guidance, pertaining to the documentation and assessment of hedge effectiveness and only includes: 1) provisions allowing more time to perform the initial quantitative hedge effectiveness assessment; 2) provisions allowing subsequent assessments of hedge effectiveness to be performed qualitatively if certain conditions are met; and

3) revisions regarding use of the critical terms and short-cut methods for assessing hedge effectiveness.

b. Revisions effective January 1, 2023, with early adoption permitted, are limited to the criteria for initial and subsequent hedge effectiveness detailed in the FASB Accounting Standards Codification (ASC) paragraphs 815-20-25-72 through 815-20-35-20, as modified through the issuance of ASU 2017-12. This adoption reflects statutory modifications to specify that the accounting and reporting of hedging instruments, including excluded components of the instruments, shall follow statutory specific guidance detailed in the statement. The intent of this guidance is to clarify that the determination of whether a hedging instrument qualifies as an effective hedge shall converge with U.S. GAAP, but that the measurement method shall continue to follow statutory specific provisions. The adoption of the referenced ASC paragraphs only extends to revisions incorporated through ASU 2017-12; therefore, any subsequent U.S. GAAP edits would require statutory accounting consideration before considered adopted. ~~The remaining provisions of ASU 2017-12 will be subsequently assessed for statutory accounting and shall not be considered adopted for statutory accounting until that assessment is complete.~~

Effective Date and Transition

74.~~73~~ This statement is effective for derivative transaction entered into or modified on or after January 1, 2003. A modification is any revision or change in contractual terms of the derivative. SSAP No. 31 applies to derivative transaction prior to January 1, 2003. Alternatively, an insurer may choose to apply this statement to all derivatives to which the insurer is a party as of January 1, 2003. In either case, the insurer is to disclose the transition approach that is being used.

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

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

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

d. Revisions adopted April 2019 to explicitly include structured notes in scope of this statement are effective December 31, 2019. Revisions adopted July 2020 to define "derivative premium," require gross reporting of derivatives without the impact of financing premiums and require separate recognition of premiums payable and premiums receivable, are effective January 1, 2021.

e. Revisions adopted August 2022 that adopt with modification the criteria for initial and subsequent hedge effectiveness detailed in the FASB ASC paragraphs 815-20-25-72 through 815-20-35-20, as modified through the issuance of ASU 2017-12 and that incorporate statutory accounting revisions for the accounting and reporting of excluded components are effective January 1, 2023, with early adoption permitted. These revisions shall be applied prospectively for all new and existing hedges. Entities shall detail the adoption of this guidance as a change in accounting principle pursuant to *SSAP No. 3—Accounting Changes and Corrections of Errors.*

The revisions are considered new SAP concepts and will be detailed in an issue paper. NAIC staff recommends that the Working Group direct NAIC staff to proceed with drafting this issue paper, but that

the issue paper also be expanded to contain other statutory derivative revisions currently being considered from U.S. GAAP. (As detailed within the Meeting agenda, there is a new agenda item that reviews the U.S. GAAP guidance for portfolio and partial term hedges.) This would delay adopting the issue paper until all current derivative revisions are discussed and up for adoption. (NAIC staff anticipates that would occur in 2023.)

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-02 SSAP No. 48 (Jim)	**SSAP No. 48 – Alternative Valuation of Minority Ownership Interests**	**11 – Agenda Item**	**In support of option 2**	**IP-2**

Summary:
SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies specifies that if an insurer has less than 10% ownership, measured at the holding company level, or lacks control, the investment is generally required to have a U.S. GAAP financial statement audit. However, when audited U.S. GAAP financials statements are not available, SSAP No. 48 provides three U.S. GAAP audit alternatives, which includes: 1) audited foreign GAAP with an audited U.S. GAAP reconciliation footnote, 2) audited IFRS financial statements, or 3) audited U.S. tax equity financial statements.

Upon inquiries with industry representatives regarding the use of the audited U.S. tax equity alternative, NAIC staff received informal comments from a member of the NAIC's AICPA Task Force which indicated that they were unaware of audit firms issuing audit opinions based on a U.S. tax basis, nor were they aware of any insurer having obtained an U.S. tax basis audit to utilize this U.S. GAAP audit exception. In response, on April 4, the Working Group exposed two alternatives of SAP clarifications to SSAP No. 48.

Option #1 proposed to delete the audited U.S. tax basis equity as a permissible valuation method as this method does not appear to be utilized by insurers.

Option #2 proposed to retain the audited U.S. tax basis equity valuation method but clarify that the audit must reside at the investee level. The clarification that the audit must reside at the investee level is consistent with other explicit requirements in SSAP No. 48 and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities.*

Interested Parties' Comments:
Interested parties recommend that Option #2 be adopted as there are insurers who use this approach for investments in some partnerships.

Recommended Action:
NAIC staff recommends that the Working Group adopt the exposed SAP clarifications to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability* to include the Option #2 proposal, which details the audited U.S. tax basis equity as a permissible valuation method but clarifies that the audit must reside at the investee level. The exposed revisions, which are proposed for adoption adopted revisions, are shown below.

> 9. If audited U.S. GAAP basis financial statements of the investee are not available, joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest (i.e., less than 10%) or lacks control as stipulated in paragraphs 15 and 16 may be recorded based on either of the valuation methodologies allowed under paragraphs 9.a. or 9.b. If either one of the valuation methodologies

allowed under paragraphs 9.a. or 9.b. is used to value the investment, documentation must be maintained regarding the reason that audited U.S. GAAP basis financial statements could not be provided.

a. Non U.S. joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest of less than 10% and for which audited U.S. GAAP basis financial statements of the investee are not available, may be recorded based on:

i the U.S. GAAP basis equity as set forth in the audited footnote reconciliation of the investee's equity and income to U.S. GAAP within the investee's audited foreign GAAP prepared financial statements or,

ii the IFRS basis equity as set forth in the investee's audited IFRS financial statements prepared in compliance, both annually and quarterly, with IFRS as issued by the International Accounting Standards Board (IASB).

b. If audited U.S. GAAP basis financial statements of the investee are not available, joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest of less than 10%, measured at the holding company level, may be recorded based on the underlying audited U.S. tax basis equity. The U.S. tax basis equity audit shall occur at the investee level. For investments recorded based on the underlying audited U.S. tax basis equity, the reporting entity shall review investments held by the joint venture, partnership or limited liability company in accordance with the impairment guidance in paragraphs 18 and 19. The reporting entity must first attempt to obtain audited U.S. GAAP basis financial statements and, if such financial statements are unavailable, must maintain documentation regarding the reason that audited U.S. GAAP basis financial statements could not be provided.

REVIEW of COMMENTS on EXPOSED ITEMS

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

1. Ref #2022-01: Conceptual Framework – Updates

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-01 Preamble SSAP No. 4 SSAP No. 5R (Jim)	**Conceptual Framework - Updates**	**12 – Agenda Item 13 – SSAP No. 4 Issue Paper 14 – SSAP No. 5R Issue Paper**	**Comments Received**	**IP-4**

<u>*Summary:*</u>
In December 2021, the Financial Accounting Standards Board (FASB) issued two new chapters of its conceptual framework. The conceptual framework is a body of interrelated objectives and fundamentals that provides the FASB with a foundation for setting standards and concepts to consider when it resolves questions or develops/modifies accounting and reporting guidance. It is important to note that the Statements of Financial Accounting Concepts are not authoritative and do not establish new or change existing U.S. GAAP. This agenda item was drafted to review each of the newly issued concept chapters and proposed updates to the *Accounting Practices and Procedures Manual* as noted below.

<u>Update 1:</u>
FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements* introduced updated definitions of certain key elements used in financial reporting – the definition of an asset and liability.

- FASB has updated the **definition of an ASSET** to be defined as a present right of an entity to an economic benefit. The asset definition possesses two essential characteristics in that 1) an asset is a present right and 2), the right is to an economic benefit.

- FASB has updated the **definition of a LIABILITY** to be defined as a present obligation of an entity to transfer an economic benefit. The liability definition possesses two essential characteristics in that 1) the liability is a present obligation, and 2) the obligation requires an entity to transfer or otherwise provide economic benefit to others. (For the purposes of this characteristic, *transfer* is typically used to describe obligations to pay cash or convey assets, while the term *provide* is used to describe obligations to provide services or stand by to do so.)

<u>Update 2:</u>
FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7, Presentation* identifies factors that the FASB will consider when deciding how items should be displayed on the financial statements. Chapter 7 describes the information to be included in the financial statements and how appropriate presentation can contribute to the objective of financial reporting – to communicate financial information about an entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources (goods and services) to the entity. Chapter 7 superseded sections of *Statement of Financial Accounting Concept 5* (a superseded concept statement that is specifically referenced in the Preamble); however, it did not result in fundamental changes to the principal concepts of financial reporting.

Accordingly, on April 4, the Working Group exposed revisions to incorporate:

1) FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which updates the definitions of an asset and a liability. In conjunction with this exposure, the Working Group exposed two draft issue papers for historical documentation of these SAP clarifications *to SSAP No. 4—Assets and Nonadmitted Asset* and *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*.

2) FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7, Presentation*, to update reference to a superseded concept statement in the Preamble.

Interested Parties' Comments:
Interested parties appreciate the extension of the comment deadline and the opportunity to comment on Ref# 2022-01 that was released for comment by the NAIC Statutory Accounting Principles (E) Working Group (the Working Group) during its meeting on April 4 in Kansas City.

We offer the following comments:

Ref #2022-01: Conceptual Framework – Updates

Liability

Interested parties are concerned with the change for the liability definition as the FASB notes it will change the definition of a liability, expanding the population of liabilities and it will need to be reviewed on a standard basis. On expanding the population of liabilities, paragraph 12 states that the FASB recognized "the revised definition potentially expands the population of liabilities to include certain obligations to issue or potentially issue an entity's own shares rather than settle an obligation exclusively with assets. In essence, clarifying that instruments with characteristics of both liabilities and equity may in fact be classified as liabilities in certain situations."

We noted that there is not an analysis by the SAPWG of the impact on the various SSAP's of incorporating the guidance. The FASB states that *needs* to be done "Thus, the FASB concluded that the specific facts and circumstances at the standards level (or in the case of statutory accounting, at the SSAP level) must be utilized to determine whether the entity has created a constructive obligation and must recognize a liability." Please see the shaded text from the FASB excerpts below.

> From the Liability Paper:
>
> 9. The updated liability definition from Concept Statement No. 8 no longer includes the term *probable* or the phrase *in the future* and *as a result of past transactions or events.* The FASB concluded that the term *probable* has historically been misunderstood as implying that a future obligation must meet a probability to a certain threshold before the definition of a liability was met. Thus, if the probability of a future transfer of an asset (or the requirement to provide a service) was low, a liability would likely not be recognized. In removing the term *probable* (and replacing it with "present obligation"), FASB concluded that in almost all situations, the presence of an obligation will be apparent. It stated that most present obligations are legally enforceable, including obligations arising from binding contracts, agreements, statutes, or other legal or contractual means. Chapter 4 also discusses the prevalence of certain business risks and how to assess if they result in the recognition of a liability. The FASB concluded that while certain businesses have a risk that a future event will cause them to transfer an economic benefit (an asset), the risk itself does not represent a present obligation because exposure to a potential negative consequence does not constitute a present obligation.
>
> 10. However, the FASB also stated that situations lacking clear legal or contractual evidence of a present obligation may pose particular challenges that may make it difficult to discern whether a present obligation exists. In these settings, the FASB stated that constructive obligations or other noncontractual obligations are

created by circumstance rather than by explicit agreement. In the absence of an explicit agreement, sufficient information to distinguish a present obligation is likely only available at the specific standards level. Thus, the FASB concluded that the specific facts and circumstances at the standards level (or in the case of statutory accounting, at the SSAP level) must be utilized to determine whether the entity has created a constructive obligation and must recognize a liability.

12. When reviewing the substance of the revisions, the FASB concluded that the updated definition resulted in a clearer and more precise definition. Furthermore, while it did not fundamentally change the historical concept of a liability, the revised definition potentially expands the population of liabilities to include certain obligations to issue or potentially issue an entity's own shares rather than settle an obligation exclusively with assets. In essence, clarifying that instruments with characteristics of both liabilities and equity may in fact be classified as liabilities in certain situations.

13. In general, the FASB did not anticipate that the liability definition revisions would result in any material changes in instrument reclassification (e.g., items now being classified as a liability when previously they were not considered liabilities). Again, FASB Concept Statements are not authoritative and thus the guidance in any specific standard will still be utilized for instrument measurement and classification. For statutory accounting purposes, the updated definition should be viewed similarly, that is it does not change fundamental concepts, change current practices, or introduce a new, original or a modified accounting principle. The revisions to the definition of a liability clarify the definitional language and do not modify the original intent of SSAP No. 5R and thus the changes are deemed to be a statutory accounting principle clarification.

Consistent with the FASB approach that an evaluation needs to be done at the standards level, interested parties recommend that for the case of statutory accounting the Working Group complete an SSAP-by-SSAP analysis to identify potential effects prior to amending the definition of liability to avoid unintended consequences.

<u>*Recommended Action:*</u>
Both SSAP No. 4 and SSAP No. 5R are regarded as foundational statements for statutory accounting and they are referenced by many other statements. NAIC staff recommends that the Working Group adopt the exposed SAP clarification revisions to 1) *SSAP No. 4—Assets and Nonadmitted Assets*, and the draft issue paper which document the changes in definition of an asset and rationale why the revisions are considered SAP clarifications in nature, and 2) the Preamble to update reference to a superseded FASB concept statement.

For the exposed revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets* and the related issue paper, NAIC staff notes it is important that SAP is as conservative or more conservative than FASB in defining liabilities (conservatism concept). NAIC staff does not recommend that staff be directed to perform a detailed SSAP by SSAP analysis requested by interested parties. However, NAIC staff defers to the Working Group preference if it would like to provide another exposure of the liabilities guidance to allow the opportunity for interested parties to identify if the adoption of the exposed liabilities guidance would create a specific concern regarding a particular situation that would be required to be reported as a liability. (Essentially, this would require the identification of a scenario that is not reported as a liability or loss contingency now that industry believes would be required to be reported as a liability or loss contingency under the new liability definition, and for which industry believes that liability or loss contingency reporting would be inappropriate.) <u>NAIC staff is of the opinion that if an instrument meets the current SAP or the new FASB definition for a liability, it should be reflected as a liability for statutory accounting purposes.</u>

- FASB treats these assets and liabilities definitions as nonauthoritative Concept statements and defers details to specific statement. By putting the definitions into SSAPs, the definitions have an authoritative status for SAP.

- In terms of the exposed clarifications to the Preamble, the revisions update reference to a superseded FASB concept statement. (Interested parties did not provide any comments on this aspect of the exposure).

- In terms of the exposed clarifications to SSAP No. 4 and its related draft issue paper, as described in the agenda item (and issue paper), the revised definition should not result in reclassification of any assets as the objective of the updated definition was to simplify and clarify the historical definition. (Interested parties did not provide any comments on this aspect of the exposure.)

- In terms of the exposed clarifications to SSAP No. 5R and its related draft issue paper, as described in the agenda item (and issue paper), the revised definition should generally not result in reclassification of any liabilities. While both FASB and the draft issue paper did identify the possibility of rare circumstances of items now meeting the definition of a liability, both FASB and the agenda item refer financial statement preparers to reference the specific standard (or SSAP) for financial accounting and reporting. Interested parties have suggested the Working Group review "SSAP-by-SSAP" to determine if amending the definition of a liability could have any potential unintended consequences. However, while a specific example was not included, NAIC staff support the review of any specific circumstance when/if it arises. **<u>NAIC staff is of the opinion that if an instrument meets the current SAP or the new FASB definition for a liability, it should be reflected as a liability for statutory accounting purposes</u>**. Statutory accounting prescribes the recognition of liabilities that meet the technical definition of a liability and requires the recognition of loss contingencies. In addition, paragraph 37 of the preamble states that "liabilities require recognition as they are incurred. Certain statutorily mandated liabilities may also be required to arrive at conservative estimates of liabilities and probably loss contingencies (e.g., interest maintenance reserves, asset valuation reserves, and others)." This fact pattern, in combination with the preamble's concept of conservatism, should not result in an item meeting the technical definition of a liability that is not reported as such for statutory accounting. A review by each SSAP to determine specific carveouts (i.e., items that meet the definition of a liability but that are considered by the Working Group for codification to not be reported as such) will likely require detailed specifics. As such, review of these circumstances is recommended to be outside the scope of this definition change. **However, if preferred by the Working Group, the liabilities changes to SSAP No. 5R and the related issue paper could be re-exposed to allow for industry to provide specific circumstances or scenarios where an item would be reported as a liability under the new, proposed definition, but where it should not be reported as such for statutory accounting. Final consideration could then occur during the Fall National Meeting.**

  If the Working Group does not believe re-exposure of the liability definition is necessary, the Working Group could proceed with adoption of the SSAP No. 5R revisions as well as the corresponding issue paper.

The comment letters are included in Attachment 15 (6 pages).

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Statutory Accounting Principles (E) Working Group
Meeting Agenda
August 10, 2022
10:00 a.m. – Noon (Pacific)

A. Consideration of Maintenance Agenda – Pending List

1. Ref #2022-09: ASU 2022-01: Fair Value Hedging – Portfolio Layer Method
2. Ref #2022-10: ASU 2022-02: Troubled Debt Restructurings and Vintage Disclosures
3. Ref #2022-11: Collateral for Loans
4. Ref #2022-12: Review of INT 03-02: Modifications to an Existing Intercompany Pooling Arrangement
5. Ref #2022-13: Related Party - Footnote Updates

Ref #	Title	Attachment #
2022-09 SSAP No. 86 (Julie)	**ASU 2022-01: Fair Value Hedging – Portfolio Layer Method**	**A – Agenda Item**

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

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

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

- Expands the scope to include nonprepayable financial assets.

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

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

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

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

Initial staff assessments on the U.S. GAAP guidance considered potential issues with how hedge basis adjustments are reflected, as U.S. GAAP prevents basis adjustments directly to assets hedged in a portfolio. However, after discussing with industry, and analyzing how the differences in measurement / recognition between U.S. GAAP and SAP impact this assessment, the basis adjustment impact for portfolio layer method hedges will only occur at the time of dedesignation. This is because SAP generally uses an amortized cost approach for effective hedges (if the hedged item is valued at amortized cost), and the derivative mirrors that measurement method. Under U.S. GAAP, where they both use a fair value method, basis adjustments occur frequently to reflect the change in fair value. With the SAP measurement approach, fair value hedge basis adjustments only occur at hedge termination or at dedesignation. As such, this is not a key SAP impact.

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

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

Recommendation:
NAIC staff has been working with industry representatives on ASU 2022-01 for portfolio layer method hedges, as well as on the U.S. guidance for partial term derivatives issued in ASU 2017-12. With these efforts, industry has provided NAIC staff suggested edits to incorporate key aspects of the U.S. GAAP guidance for portfolio layer method hedges and partial-term hedges into SSAP No. 86. **NAIC staff recommends that the Working Group classify this agenda item as a New SAP Concept and expose the proposed edits for comment. It is also recommended that the Working Group direct NAIC staff to prepare one issue paper with all recent and upcoming derivative revisions.** (The issue paper will contain other derivative revisions recently considered from U.S. GAAP.) Summary of Revisions Proposed in this Agenda Item – Portfolio Layer Method and Partial Term:

- SSAP No. 86: Revisions are proposed to paragraph 26 (fair value hedges) to detail criteria for portfolio and partial-term hedges. A small disclosure edit is proposed to paragraph 62 and guidance for reporting when the hedge is discontinued is proposed for inclusion in Exhibit C. Revisions have also been proposed to identify the adoption of *ASU 2022-01, Fair Value Hedging – Portfolio Layer Method* and to adopt with modification the guidance for partial-term hedges from ASU 2017-12. For the current proposal, the partial term hedge guidance is limited to hedged assets (not liabilities.) This is different from U.S. GAAP, but further statutory discussion is needed on basis adjustments when hedging liabilities, especially under partial term. It has been suggested that the Working Group move forward with incorporating the guidance for hedged assets at this time, as that addresses the current industry need, and consider guidance for hedged liabilities subsequently. (It was noted that industry is not aware of situations of partial-term liability hedges. Furthermore, the adjustment for hedged liabilities is a broader issue in SSAP No. 86, so the revisions would be more expansive.) Portfolio layer method hedges are limited to recognized assets under U.S. GAAP, so proposed guidance for SAP for those hedges is consistent. (Industry has identified that the FASB may consider expanding the scope of portfolio layer method hedges to liabilities. If this occurs, consideration will then occur for statutory accounting.)

- Exhibit A – Assessment of Hedge Effectiveness: Limited revisions to paragraphs 17-18 to mirror updated U.S. GAAP guidance and add a new section

Ref #	Title	Attachment #
2022-10 SSAP No. 36 (Julie)	**ASU 2022-02: Troubled Debt Restructurings and Vintage Disclosures**	**B – Agenda Item**

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

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

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

Although consideration of ASU 2016-13 is still pending statutory accounting review, from initial assessments and industry outreach, a full adoption of the CECL standard is not likely to be supported. This is because 1) insurers more commonly hold assets at amortized cost under SAP and at fair value (as available for sale) under U.S. GAAP

– so the CECL model would significantly impact the measurement method under SAP, but not under U.S. GAAP, and 2) the asset-valuation reserve (AVR), a statutory accounting guidance applicable to life and fraternal insurers, establishes a reserve to offset potential credit-related investment losses on most investment categories. With ASU 2016-13 applicable to small public and non-public U.S. GAAP filers as of Jan. 1, 2023, NAIC staff are currently soliciting input from industry on key CECL impacts to assess for statutory accounting purposes. Once that information is received, a further review will occur on ASU 2016-13 to determine the extent that CECL concepts should be reflected within statutory accounting principles.

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

With ASU 2022-02, expanded disclosures on commitments and modified loans have been incorporated. Although some of the general concepts within the following U.S. GAAP disclosures are captured in SSAP No. 36, paragraph 23, the new U.S. GAAP disclosures are more specific that what was previously incorporated. (These disclosures are detailed in the agenda item.) In addition to the TDR for creditors guidance, ASU 2022-02 also incorporates and revises "vintage" disclosures for gross write-offs for public business entities involving financing receivables and net investment in leases. These disclosures were originally captured as part of the CECL guidance in ASU 2016-13 for all entities, and the revisions modify and restrict the disclosures to public business entities. (These are also detailed in the agenda item.)

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

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

Ref #	Title	Attachment #
2022-11 SSAP No. 20 (Robin)	**Collateral for Loans**	**C – Agenda Item**

Summary:
This agenda item has been drafted to address an inconsistency regarding the collateral loan guidance in *SSAP No. 20—Nonadmitted Assets* and *SSAP No. 21—Other Admitted Assets* These two statements contain guidance about unsecured and secured loans which is complementary.

SSAP No. 20 details the nonadmitted assets status of unsecured loans and loans secured by assets which do not qualify as investments. SSAP No. 20 also references write-off and impairment guidance in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* for impaired and uncollectible loans. SSAP No. 20 provides that improperly collateralized loans include loans that do not have underlying assets that would otherwise qualify as admitted assets and states that such loans are nonadmitted assets because the collateral would be of questionable economic value if needed to fulfill policyholder obligations. SSAP No. 20 includes similar nonadmission guidance regarding loans on personal security, cash advances to officers or agents and for travel advances.

SSAP No. 21 details the requirements for collateral loans which can qualify to be admitted assets. It provides that the collateral loan must be secured by the pledge of an investment. A footnote further describes that investment collateral would be of a type that would be in Section 3 of *Appendix A-001—Investments of Reporting Entities*. SSAP No. 21 also references the nonadmission guidance in SSAP No. 20 for collateral loans secured by assets that do not qualify as investments. The referenced guidance in SSAP No. 20 notes that the underlying assets must qualify as admitted assets.

Both SSAP No. 20 and SSAP No. 21 identify the need for adequate collateral that qualifies as an "invested asset." SSAP No. 20 is explicit that the investment asset collateral must qualify as an admitted asset. Recent discussions with state regulators have highlighted that although SSAP No. 21 references the guidance in SSAP No. 20, that it would be beneficial to also note the need for the collateral to qualify as an admitted invested asset. This agenda item recommends a clarification to SSAP No. 21 that the acceptable invested asset collateral, for collateral loans must qualify as admissible invested assets.

Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose the revisions to SSAP No. 21 to clarify that the invested assets pledged as collateral for admitted collateral loans must qualify as admitted invested assets.

Collateral Loans

4. Collateral loans are unconditional obligations[2] for the payment of money secured by the pledge of a~~n~~ qualifying investment[3] and meet the definition of assets as defined in SSAP No. 4, and are admitted assets to the extent they conform to the requirements of this statement. The outstanding principal balance on the loan and any related accrued interest shall be recorded as an admitted asset subject to the following limitations:

   a. Loan Impairment—Determination as to the impairment of a collateral loan shall be based on current information and events. When it is considered probable that any portion of amounts due under the contractual terms of the loan will not be collected the loan is considered impaired. The impairment shall be measured based on the fair value of the collateral less estimated costs to obtain and sell the collateral. The difference between the net value of the collateral and the recorded asset shall be written off in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*;

b. Nonadmitted Asset—In accordance with *SSAP No. 20—Nonadmitted Assets*, collateral loans secured by assets that do not qualify as investments which would otherwise be admitted shall be nonadmitted. Further, any amount of the loan outstanding which is in excess of the permitted relationship of fair value of the pledged investment to the collateral loan shall be treated as a nonadmitted asset.

[1] For purposes of determining a collateral loan in scope of this statement, a collateral loan does not include investments captured in scope of other statements. For example, *SSAP No. 26R—Bonds* includes securities (as defined in that statement) representing a creditor relationship whereby there is a fixed schedule for one or more future payments. Investments captured in SSAP No. 26R that are also secured with collateral shall continue to be captured within scope of SSAP No. 26R.

[1] A qualifying ~~I~~investment defined as those assets listed in Section 3 of *Appendix A-001—Investments of Reporting Entities* which would ~~,~~if held by the insurer would qualify for admittance. For example, if the collateral would not qualify for admittance under SSAP No. 4 due to encumbrances or other third-party interests, then it does not meet the definition of "qualifying" and the collateral loan, or any portion thereof which is not adequately collateralized, is not permitted to be admitted.

Ref #	Title	Attachment #
2022-12 INT 03-02 (Robin)	**Review of INT 03-02*: Modification to an Existing Intercompany Pooling Arrangement***	**D – Agenda Item E - INT 03-02**

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

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

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

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

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

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

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

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

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

SSAP No. 25 as being for isolated transactions, which is inconsistent with discussions of the Working Group on the applicability of SSAP No. 25.

SSAP No. 62R, paragraph 36d includes an exception to retroactive reinsurance accounting which allows prospective accounting treatment for intercompany reinsurance agreements and any amendments thereto, among companies 100% owned by a common parent or ultimate controlling person provided there is no gain in surplus as a result of the transaction. Paragraph 37 provides that if there is a gain to the ceding entity that a more restrictive method of accounting is required which is less beneficial to the financial statements. Whereas the INT tries to argue that statutory intent is to avoid surplus gain, NAIC staff would note that the goal is not to avoid gain as a result of the reinsurance transaction, but to impose a different accounting if there is a gain. NAIC staff would characterize evaluating reinsurance agreements for SSAP No. 62R, paragraph 36d or paragraph 37 as using the cash flows or corresponding equivalent fair value (cash equivalent) of the amounts payable or receivable in the reinsurance transactions to determine if there is a gain or loss to the ceding entity. The reinsurance cash flows evaluated should be the same as if the bond was sold for fair value and resulting cash equivalent obligation was paid. The fact that the bond sold has a gain or loss is not part of the reinsurance contract evaluation, the reinsurance contract that is an economic transaction evaluation is based on the cash equivalent value of the assets transferred less the liabilities transferred. The evaluation of gain or loss on the intercompany reinsurance transaction should give the same answer if either cash or assets were transferred.

Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose the intent to nullify INT 03-02, as it is inconsistent with SSAP No. 25 guidance regarding economic and non-economic transactions between related parties. The guidance in INT 03-02 can result with in essence, unrecognized gains (dividends) or losses through the using the statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements. Treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions.

Ref #	Title	Attachment #
2022-13 SSAP No. 25 SSAP No. 97 (Jake)	**Related Parties – Footnote Updates**	**F – Agenda Item**

Summary:
On May 24, 2022, the Statutory Accounting Principles (E) Working Group adopted agenda item 2021-21 – Related Party Reporting, which clarified the reporting of affiliate transactions within existing reporting lines in the investment schedules and incorporated new reporting requirements for investment transactions with related parties. During the drafting process, a footnote was added to SSAP No. 25, paragraph 9, and a comment was received from interested parties that suggested to extend the exemption to foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction, which are within the scope of *SSAP No. 30R—Unaffiliated Common Stock*. At the May 24 meeting, the Working Group directed NAIC staff to make this modification.

Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to SSAP No. 25 and SSAP No. 97 to incorporate language to exempt foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction from the look-through provisions included in SSAP No. 25.

B. <u>Consideration of Maintenance Agenda – Active Listing</u>

1. Ref #2021-25: Leasehold Improvements after Lease Termination
2. Ref #2019-21: Proposed Bond Definition

Ref #	Title	Attachment #
2021-25 SSAP No. 19 SSAP No. 73 (Jake)	**Leasehold Improvements after Lease Termination**	**G – Agenda Item**

<u>Summary:</u>
On December 11, 2021, 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 a property that was initially subject to a lease; and per current statutory guidance, the 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 initially 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.

At the 2022 Spring National Meeting, the Working Group directed NAIC staff to work with interested parties to further refine the guidance, and as a result have updated the proposed language to include an exclusion that would allow companies that provide direct healthcare to excludes situations where the real estate lease agreement has a purchase option that contains language that allows leasehold improvements necessary for the functionality of specific health care delivery assets to be excluded from the purchase cost of the real estate. After purchase, the leasehold improvements necessary for the functionality of healthcare delivery assets would follow the guidance for health care delivery assets in SSAP No. 73.

Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as SAP clarification and expose 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. 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 but <u>**proposes a limited, specific exclusion in SSAP No. 73 that allows leasehold improvements necessary for the functionality of specific health care delivery assets to be excluded in some cases from the purchase cost of the real estate**</u>. It is presumed that the purchase of a property from a third party would normally include the leasehold improvements as part of the full purchase price.

Ref #	Title	Attachment #
2019-21 **SSAP No. 26R** **SSAP No. 43R** **(Julie)**	**Proposed Bond Definition**	**H - Bond Definition** **I - Issue Paper** **J - SSAP No. 26R** **K - SSAP No. 43R**

Summary:
Pursuant to direction in October 2020, regulators and key industry representatives, have been working dedicatedly on the bond project to principally define a bond for reporting on Schedule D-1 and to improve accounting and reporting. The intent of this project is to establish principle-based guidance for determining bonds, with a focus of substance over form, in such a manner so that the framework and principles established will be able to work for an increasingly innovative market and will provide regulators and other financial statement users with the transparency for understanding the risks present in an insurer's investment portfolio.

In response to the direction from the July 18 call, the following documents have been prepared for Working Group exposure consideration:

- An updated principles-based bond definition. This document has been revised to reflect limited edits directed on July 18. (Previously exposed edits have been accepted, so only new edits are shown tracked.)

- An updated issue paper that reflects the overall discussion from July 18, as well as the noted edits to guidance. The issue paper has been revised to include discussion of feeder funds and how the assessment should focus on the substance of the underlying investment in determining bond classification.

- Proposed revisions to *SSAP No. 26R—Bonds* and *SSAP No. 43R—Asset Backed Securities* to incorporate the principles-based bond definition in authoritative statutory accounting guidance. (Please note, the revisions to SSAP No. 43R include a SSAP name change from "Loan-backed and Structured Securities".) In addition to incorporating the bond concepts, the revisions to SSAP No. 43R also include various revisions to reorganize or update the guidance. A summary page on both SSAPs details the revisions.

Please note that the bond definition (excluding Appendices) has been captured in its entirety within SSAP No. 26R. Then, only the components that pertain to asset backed securities has been captured in SSAP No. 43R. Although this puts key points in both SSAPs, it does result with duplication. NAIC staff solicits feedback on this approach. It was identified as desirable to include the full definition in one SSAP, but it was noted that not including the elements pertaining to asset backed securities in SSAP No. 43R could result with the need to go back and forth the two standards. Consideration was also given to including all the guidance in a single SSAP, however, it was noted that continued separation, particularly for the nuances of cash flow assessments and bifurcated impairment related to ABS, would result with improved clarity and application to the investments captured within the differing standards. Comments are welcome the proposed approach and with alternative suggestions to ensure ease of application.

In addition to the items proposed for exposure, it should also be noted that the Working Group has also recently exposed significant revisions to the reporting of bond investments with comments due Oct. 7:

- Proposed Reporting Lines - This document exposed July 18 proposes annual statement general instructions (reporting line descriptions) for suggested reporting lines to capture issuer credit obligations and asset-backed securities on Schedule D-1. The general classifications that currently exist are proposed to be deleted and new granular reporting lines are suggested.

- Schedule D-1 A/S Instructions – This document exposed July 18 details the overall approach to add a new Schedule D-1 schedule specific to asset-backed securities. D-1-1 would reflect issuer credit obligations (items captured in scope of SSAP No. 26R) and D-1-2 would reflect asset backed securities (items captured in scope of SSAP No. 43R). This separation of the schedules is supported to enable different reporting columns based on the type of security. Columns that are proposed to be specific to issuer obligations and ABS are noted within the document. In addition to creating new columns, this document also details revisions to existing columns and instructions. There are instances in which columns are proposed to move to electronic only and situations in which the instructions are significantly revised as to what is included.

Recommendation:
NAIC staff recommends that the Working Group expose the updated bond definition, issue paper and SSAP edits for a comment period ending Oct. 7, 2022, to mirror the exposure timeframe of the reporting revisions. NAIC staff recognizes that there is a lot of content exposed, so additional time can be considered if needed. Preliminary comments or questions are welcome anytime during the exposure period. NAIC staff would like to particularly note appreciation for all regulators and industry involved within this project and would like to continue collaborating throughout the exposure timeframe. NAIC staff also notes that additional revisions to other standards and reporting schedules impacted by the changes are still pending. Those revisions are anticipated to be proposed for exposure during the 2022 Fall National Meeting.

ANY OTHER MATTERS

a. Review of GAAP Exposures – Attachment L (Robin)

The attachment details the items currently exposed by the FASB. NAIC staff recommends reviewing the issued ASUs under the standard SAP maintenance process. Comments are not recommended at this time – NAIC staff recommend review of the final issued ASU under the SAP Maintenance Process as detailed in *Appendix F—Policy Statements.*

b. Update for LATF coordination – Attachment M (**Robin**)

The attachment includes a detailed listing of the amendments made to the *Valuation Manual* by the Life Actuarial (A) Task Force since the 2021 NAIC Summer Meeting. The amendments were adopted by the Life Insurance and Annuities (A) Committee on July 20, 2022. The amendments will be considered for adoption by the Executive (EX) Committee and Plenary at the 2022 NAIC Summer. NAIC staff will provide a verbal update regarding coordination.

Comment Deadline for all Exposures is Friday, October 7, 2022.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/7-Summer NM/Meeting/0-8-2022 SAPWG Meeting Agenda.docx