Statutory Accounting Principles (E) Working Group
Meeting Agenda
Dec. 11, 2021

A. <u>Consideration of Maintenance Agenda – Pending List</u>

1. Ref #2021-20: Effective Derivatives – ASU 2017-12
2. Ref #2021-21: Related Party Reporting
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12. Ref# 2021-31: Life Reinsurance Disclosure Clarifications

Ref #	Title	Attachment #
2021-20 SSAP No. 86 (Julie)	**Effective Derivatives – ASU 2017-12**	**A**

Summary:
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.

Both regulators and industry representatives have requested further consideration of ASU 2017-12, particularly with regards to the permitted derivative arrangements that U.S. GAAP now allows to qualify as a highly effective hedge. However, due to the revisions from ASU 2017-12, there is a disconnect between U.S. GAAP and SAP regarding certain types of effective hedging relationships. This is problematic as it results in inconsistent documentation of hedging transactions, as well as hinders reporting entities in electing to enter hedging transactions as the benefits are not currently permitted to be reflected in statutory financials.

As detailed in the agenda item, there is support for consistency between U.S. GAAP and SAP in determining effective hedges, however, information is provided on how the differences in SAP accounting can be expanded with the new effective hedge relationships permitted under ASU 2017-12. The agenda item identifies issues and reporting elements that may not have been originally intended with the SAP provisions adopted in SSAP No. 86. It also identifies elements in SAP that may need to be clarified or modified with the expansion of effective hedging relationships to ensure the reporting impact from these derivative transactions are clearly identifiable in the statutory financial statements. <u>The elements identified for possible modification do not include a fundamental change in the SAP provisions that permit an amortized cost measurement method for highly effective derivatives based on the measurement method for the hedged item. However, regulator and industry comments are welcome as to whether a fundamental change to the measurement method 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</u>

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 be considered.

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

(Note: The agenda goes into detail on each of these approaches and provides the SAP assessment. Only key highlights are included below. Please also note that this derivative review is separate from the fixed index annuity discussion that is occurring in a separate agenda item.)

- 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.

    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. If the derivative were in a liability position and offsetting a debt / liability item, the mechanics would result in an offsetting entry to reduce the 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. 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 agenda item suggests considering changes to the guidance to revise how this derivative transaction (and other derivative transactions hedging liabilities) shall be reported in the financial statements.

- Last of Layer - 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.

    SAP Assessment - 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:

    - To be consistent with U.S. GAAP, SAP revisions are suggested to ensure that individual assets are not adjusted at hedge termination, and that a portfolio approach is utilized.

    - 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.

- A key aspect 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. 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 or classified as an ineffective hedge. 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.)

- 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 portfolio guidance is in a proposed ASU which is expected to be finalized by the end of the year.)

- <u>Hedges of Interest Rate Risk When the Hedged Item Can be Settled Before Scheduled Maturity</u> - 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.) The entity need not consider other factors that would affect this decision (for example, credit risk) when assessing hedge effectiveness.

  <u>SAP Assessment</u> - 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. 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.

- <u>Expansion of Excluded Derivative Components in Assessment of Hedge Effectiveness</u> - 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.

  <u>SAP Assessment</u>: 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. 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.

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.

Ref #	Title	Attachment #
2021-21 SSAP No. 25 SSAP No. 43R (Julie)	**Related Party Reporting**	**B**

Summary:
This agenda item has been drafted in response to recent discussions on the reporting and disclosure requirements for investments with related parties. This agenda 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.

In summary, the agenda item proposes revisions to SSAP No. 25 and 43R 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.

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.

Although the agenda item details the revisions to SSAP No. 25 and 43R and the new reporting disclosure, the reporting codes proposed for the year-end 2022 investment schedules are detailed below:

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.

Ref #	Title	Attachment #
2021-22 SSAP No. 97 (Jim)	**Schedule D-6-1, Supplemental Reporting**	**C**

Summary:
This agenda item has been drafted to propose supplemental (electronic only) 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*.

While SSAP No. 97 details several filing requirements, one such requirement is that annually, certain SCAs must be filed with the NAIC for confirmation of 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. It is important to note that 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).

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 reporting 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 is operationally onerous for state regulators.

Recommendation:
NAIC staff recommends that the Working Group forward a proposal to the Blanks (E) Working Group to supplement the reporting of SCA investments in Schedule D-6-1. 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. Note, this agenda item does not propose statutory revisions.

Ref #	Title	Attachment #
2021-23 SSAP No. 43R (Jim)	**SSAP No. 43R – Financial Modeling – Updated Guidance**	**D**

Summary:
This agenda item reflects updated NAIC designation/NAIC designation category guidance, which was adopted on Oct. 20 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).

The P&P Manual governs the financial modeling process, however when the modeling guidance was first adopted, it was identified that a summarized process should also be reflected in the AP&P Manual. However, as the financial modeling concept is no longer new, NAIC staff have proposed two alternatives for possible exposure. **Option #1** will retain summarized modeling guidance in SSAP No. 43R, which is proposed to be updated for this and any subsequent modeling modifications when adopted by the VOSTF. **Option #2** proposes 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.

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*. Depending on the exposure options elected by the Working Group, either one, or both, of the aforementioned alternatives could be exposed for public comment.

***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~~es~~ the insurers' carrying value. ~~f~~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.).

***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 governs the designation process.)** The paragraph below demonstrates the proposed, ending result.

Designation Guidance – (*Not shown with tracked changes as the current guidance would be mostly deleted.)*

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). 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.

Ref #	Title	Attachment #
2021-24 Blanks (Jake)	**Cryptocurrency General Interrogatory**	**E**

Summary:
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 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.

At the request of 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. Examples of inquiries include 1) are cryptocurrencies held (and if so, which reporting schedules are the cryptocurrencies reported), and 2) are cryptocurrencies accepted for the payment of premiums.

Recommendation:
NAIC staff recommends that the Working Group forward a proposal to the Blanks (E) Working Group to add a new general interrogatory to the annual blanks to require the disclose of when cryptocurrencies are directly held or permitted for the remittance of premiums. Note, this agenda item does not propose statutory revisions.

Ref #	Title	Attachment #
2021-25 SSAP No. 19 SSAP No. 73 (Jake)	**Leasehold Improvements After Lease Termination**	**F**

Summary:
During 2019, the Working Group adopted substantive revisions to *SSAP No. 22—Leases*, which created *SSAP No. 22R—Leases*. 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.

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 the situations was not addressed 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 articulate that in any scenario in which a lease terminates early, that all remaining leasehold improvements shall be immediately expensed.

Recommendation:
NAIC staff recommends 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.

Ref #	Title	Attachment #
2021-26EP Various (Jim)	**Editorial Update (Substantive vs Nonsubstantive)**	**G**

Summary:
Pursuant to a Aug. 14 referral from the Financial Condition (E) Committee, the edits propose herein update certain, remaining 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. 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.

Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose proposed edits to change certain, remaining terminology references of "substantive" and "nonsubstantive." The proposed revisions are 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.

NAIC staff note - it is anticipated that terminology changes will generally only occur on a <u>go-forward basis</u> 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 (starting with actions/exposure occurring on/after Jan. 1, 2022) when considering future revisions to statutory accounting.

Ref #	Title	Attachment #
2021-27 SSAP No. 72 (Jake)	***ASU 2021-04 - Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options***	**H**

Summary:
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. In summary, the ASU 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. The guidance regarding issued warrants is discussed in *SSAP No. 72—Surplus and Quasi-Reorganization*, paragraph

10. However conversely, the ASU 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*.

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.

Ref #	Title	Attachment #
2021-28 SSAP No. 68 (Jim)	***ASU 2021-03, Intangibles – Goodwill and Other (Topic 350) – Accounting Alternative for Evaluating Triggering Events***	**I**

Summary:
In March 2021, the FASB *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. 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.

Statutory guidance for goodwill is covered in *SSAP No. 68— Business Combinations and Goodwill*, however *INT 06-07: Definition of Phrase "Other Than Temporary"* is the authoritative guidance for when to consider that an impairment has occurred. In essence, INT 06-07 requires that impairment be assessed when 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).

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.

Ref #	Title	Attachment #
2021-29 SSAP No. 22R (Jake)	**ASU 2021-05 - Variable Lease Payments**	**J**

Summary:
In July 2021, FASB issued *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. However, as *SSAP No. 22R—Leases* requires nearly all leases to be treated as operating leases for statutory accounting, adoption of this guidance would be redundant and unnecessary.

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. Under statutory accounting almost all leases are classified as operating leases, thus this U.S. GAAP guidance is deemed not necessary.

Ref #	Title	Attachment #
2021-30 Appendix D (Jake)	**ASU 2021-06 – Amendments to SEC Paragraphs**	**K**

Summary:
The Financial Accounting Standards Board issued *Accounting Standard Update* (ASU) *2021-04, 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.

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 2021-04 as not applicable to statutory accounting.

Ref #	Title	Attachment #
2021-31 SSAP No. 61 (Robin)	**Life Reinsurance Disclosure Clarifications**	**L**

Summary:
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 and Health Reinsurance* in agenda item 2017-28: Reinsurance Risk Transfer for Short Duration Contracts. Preparers and auditors have highlighted unclear elements in the disclosures that could use additional clarification. Requested clarifications and responses are detailed in the recommendation section, but they include items regarding 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. In the statutory annual statement filing the disclosures are in Note 23H and are not data captured. The proposed revisions to SSAP No. 61R narrow the scope of the disclosures and clarify what is required in the disclosures.

Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose the revisions to SSAP No. 61R disclosures illustrated below. These items are recommended for a shortened comment period to allow for possible adoption in early 2022 with a year-end 2021 effective date. The proposed revisions provide clarifications and, in some cases, narrow the scope of disclosure. No additional disclosures are proposed. Having the disclosure revisions final for year-end 2021 will assist preparers and auditors.

Recommended Revisions to SSAP No. 61R:

78. Disclosures for paragraphs 79-84 are required to be included with the annual audit report financial statements beginning with the period ended December 31, 2020, regarding reinsurance contracts. The disclosures required within paragraphs 79-84 ~~shall~~ can be included in accompanying supplemental schedules or the notes of the annual audit report beginning in year-end 2020. If not applicable, an affirmative statement that no such contracts were identified is acceptable. These disclosures shall be limited to reinsurance contracts entered into, renewed or amended on or after January 1, 1996. This limitation applies to the annual audit report only and does not apply to the statutory annual statement interrogatories and the property and casualty reinsurance summary supplemental filing.

79. Disclose any ceding reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) subject to A-791 that includes a provision, which limits the reinsurer's assumption of significant risks identified as in A-791. Examples of risk-limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. If true, indicate the number of reinsurance contracts to which such provisions apply. For contracts subject to A-791, indicate if deposit accounting was applied for all contracts, which limit significant risks.

80. Disclose any ceding reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) not subject to A-791, for which reinsurance accounting was applied and includes a provision that limits the reinsurer's assumption of risk. Examples of risk-limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. Note that a stop loss or excess of loss reinsurance agreement with deductibles or loss caps which apply to the entire contract and are not adjustable based on other features, do not require disclosure under this paragraph. If true, indicate the number of reinsurance contracts to which such provisions apply. If affirmative, indicate if the reinsurance credit was reduced for the risk-limiting features.

81. Disclose if any assumed or ceded reinsurance contracts contain features (except reinsurance contracts with a federal or state facility) described below which result in delays in payment in form or in fact:

a. Provisions which permit the reporting of losses, or settlements are made, less frequently than quarterly or payments due from the reinsurer are not made in cash within ninety (90) days of the settlement date (unless there is no activity during the period).

b. Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

82. Disclose if the reporting entity has reflected reinsurance accounting credit for any contracts not subject to Appendix A-791 and not yearly renewable term, which meet the risk-transfer requirements of SSAP No. 61R and identify the type of contracts and the reinsurance contracts.

a. Assumption Reinsurance – as discussed in paragraph 60, which are new for the reporting period.

~~b. Non-proportional reinsurance, which does not result in significant surplus relief. If yes, indicate if the insured events(s) triggering contract coverage has been recognized.~~

83. Disclose if the reporting entity ceded any risk which is not subject to A-791 and not yearly renewable term reinsurance, under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:

a. Accounted for that contract as reinsurance under statutory accounting principles (SAP) and as a deposit under U.S. generally accepted accounting principles (GAAP); or

b. Accounted for that contract as reinsurance under U.S. GAAP and as a deposit under SAP.

If the reporting entity does not prepare U.S. GAAP financial statements or its financial statements are not part of upstream U.S. GAAP financial statements, this disclosure can be answered not applicable.

84. If affirmative disclosure is required for paragraph 83, explain why the contract(s) is treated differently for GAAP and SAP

B. Consideration of Maintenance Agenda – Active List

1. Ref #2019-21: SSAP No. 43R
2. Interpretations (INT 20-03 & INT 20-07) – Troubled Debt Restructuring - COVID

Ref #	Title	Attachment #
2019-21 SSAP No. 26R SSAP No. 43R (Julie)	**SSAP No. 43R**	**M & N**

Summary:
Discussions of a principles-based bond project has been occurring since January 2020. On May 20, 2021, the Working Group exposed a principles-based bond definition, along with a glossary and appendices with examples for application purposes. On August 26, 2021, the Working Group received comments from that initial exposure and affirmed the direction of the concepts. With that action, the Working Group directed NAIC staff to utilize those concepts to develop an issue paper and proposed SSAP revisions. The Working Group also requested that the small group of regulator and industry representatives continue to meet to discuss the concepts, particularly with comments on specific issues and review proposed language to incorporate changes into statutory accounting.

Since the August 2021 Working Group direction, the small group has been meeting regularly to continue discussions. The focus of these discussions has included residual tranches of securitizations (along with the stapling of investments if an insurer reporting entity is required to acquire (or hold) residual tranches with subordinated tranches), high-level proposals to incorporate more granular reporting, and the determination and definition of "sufficiency" for purposes of whether an asset-backed security has sufficient credit enhancement.
For this 2021 Fall National Meeting, two documents have been developed for potential exposure:

1) Reporting Options – Discussion Draft
2) ABS Credit Enhancement

The first document presents possible reporting changes to incorporate improved transparency and granularity with investment reporting under the bond proposal project. This document requests information on potential changes in reporting lines, a new sub-schedule D-1 to detail certain asset-backed securities (ABS), and potential changes to the columns and reported information in Schedule D-1. A key proposal element is to move away from the current "general categories" for reporting and replace those groupings with more useful reporting lines based on the type of investment. The exposure specifically requests comments on the removal of the general categories, whether those changes would hinder any tools or analyses performed, and then on potential more-granular reporting lines. Other requests detailed in the document include information that would be beneficial on the new sub-schedule D-1 (e.g., balloon payments, expected payoff dates, etc.), as well as current reporting elements on Schedule D-1 and elements that would be beneficial to capture.

The second document presents proposed revisions to revise the "sufficiency" definition previously captured in the bond proposal definition. This pertains to the requirement for all ABS to have sufficient credit enhancement to qualify for reporting as a bond on Schedule D-1. Pursuant to continued discussion with the small regulator / industry group, it was identified that the original exposed guidance for sufficient credit enhancement could be interpreted to be satisfied if a rating from a credit rating provider (CRP) was received. The original intent was to not make the "sufficiency" determination equivalent to a credit assessment as credit ratings should not drive accounting classification. As a result of these discussions, the guidance for "sufficient credit enhancement" has been revised. The revised guidance intends to reflect more of a principal concept and instead reflects a "substantive credit enhancement." This guidance indicates that the intent is to clarify that the ABS structure puts the holder in a different economic position than if owning the underlying collateral directly. Enhancements that are nominal or lack economic substance do not put a holder in a different economic position.

Recommendation:
NAIC staff recommends that the Working Group expose 1) the discussion draft of reporting options, and 2) proposed revised guidance for defining and determining whether an asset-backed security has substantive credit enhancement to qualify for reporting as a bond on Schedule D-1.

NAIC staff has been working to develop an issue paper and revisions to the SSAPs per the August 2021 Working Group direction. Due to concerns with an extensive exposure at the same time as industry is completing and filing the annual statutory financial statements, an exposure of the preliminary documents has not been recommended at this time. Rather, the regulator / industry small group will continue to meet and refine the guidance to allow for a broad exposure in the first quarter of 2022.

<u>Update on Bond Proposal Small Group Discussions / Development:</u>
The bond proposal small group has met weekly to continue discussion on the principle concepts and the application of the concepts to investment structures. As an update on key items discussed and open items:

- Residual Tranches – Discussion on Collateralized Fund Obligations (CFOs) and equity-backed ABS led to the discussion of residual tranches and the resulting SAPWG changes adopted Nov. 10 and the corresponding blanks change expected for year-end 2022.

- Informal Coordination of VOSTF / SAPWG / CATF – Discussion on appropriate RBC charges for residual tranches and other potential RBC impacts from the development of the principles-based bond definition resulted with the development 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 the related RBC Working Groups.

- Open Items on 43R – The small group is continuing discussion on the refinancing restrictions for equity-backed securities as well as stapled investments. Other elements still pending include clarification of an "operating entity" for determining insurer credit obligations as well as accounting and reporting guidance for investments that no longer qualify for Schedule D-1 under the principles-based bond definition.

Ref #	Title	Attachment #
INT 20-03 INT 20-07 (Julie)	**Troubled Debt Restructuring Due to COVID-19 & Troubled Debt Restructuring of Certain Debt Instruments Due to COVID- 19**	**O & P**

Summary:
INT 20-03 and INT 20-07 were adopted in response to modifications that were 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, 2021, but were extended to January 2, 2022, in accordance with the extension of the CARES Act. These INTs have been included within this agenda to explicitly identify that the INTs are scheduled to expire. From preliminary information received, it is appropriate at this time to let the INTs expire.

- INT 20-03 provided provisions to allow reporting entities to follow the April 7, 2020 "Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus" and provisions of the CARES Act in determining whether the modification shall be reported as a troubled debt restructuring.

- INT 20-07 provided limited-time practical expedients in determining whether a modification under SSAP No. 36 is insignificant, and therefore is not a concession. If a modification is not a concession, recognition of the modification as a troubled debt restructuring is not required. For practical expedients, it was determined that if a restructuring 1) results with a change that reflects a 10% or less shortfall amount in the contractual amount due, and 2) results in an extension of the maturity of the debt by no more than three years, the modification shall be considered insignificant and thus not requiring troubled debt accounting. Additionally, the interpretation clarified that restructurings that solely modify debt covenants are not considered troubled debt restructurings.

Recommendation:
Unless comments are received otherwise, NAIC staff recommends that the Working Group allow the INTs to automatically expire on Jan. 2, 2022.

ANY OTHER MATTERS

a. Review of GAAP Exposures – Attachment Q - (Jim)
The attachment details the items currently exposed by FASB. NAIC staff recommends reviewing the issued ASUs under the standard SAP maintenance process.

Industry is invited to provide additional comments on FASB projects and developments.

b. Update on Working Group referral to CASTF – (Robin)

Casualty Actuarial and Statistical (C) Task Force met on December 7th to initially discuss a recommendation regarding the Working Group referral on agenda item 2019-49 regarding diversity in reporting for retroactive intercompany reinsurance contracts which meet the exception which allows for prospective reporting. NAIC staff will provide a verbal update on CASTF actions.

c. Identify Key Pending Items from SAPWG Maintenance Agenda and Prioritize Projects *(as time allows)*

- FASB Current Expected Credit Loss (CECL) Model (ASU 2016-13) – Under the Consolidated Appropriations Act (CAA) signed Dec. 27, 2020, which provided a variety of economic relief matters, the effective date of the FASB guidance in *ASU 2016-13, Financial Instruments – Credit Losses* was further delayed. Under the CAA, large public insured depository institutions, bank holding companies and their affiliates have the option of postponing implementation of the CECL standard until 2022. (The effective date for these entities was originally 2020 and the effective date has been delayed three times.) The effective date for non-SEC filers (public and private) is believed to be January 2023. NAIC staff continues to monitor discussions on this standard but believes discussion on this issue should resume. Comments from regulators and industry are welcome on bringing this issue back to the forefront as well as potential proposals to consider for statutory accounting.

- Goodwill – Prior to the COVID-19 pandemic there were ongoing discussions involving goodwill, particularly with pushdown goodwill and attributing goodwill to underlying entities held in a holding company. A summary of the agenda items and actions previously taken by the Working Group are summarized below. Although continued discussion and clarification is likely warranted, NAIC staff highlights that enhanced goodwill disclosures will be captured in the year-end 2021 statutory financial statements. NAIC staff suggests a review of the disclosure results prior to continuing discussion on this topic.

  - Agenda item 2019-12 seeks to address *ASU 2014-17, Business Combinations – Pushdown Accounting, a Consensus of the FASB Emerging Issues Task Force*. This ASU was issued to provide guidance on whether and at what threshold an acquired entity can apply pushdown accounting in its separate financial statements. Pushdown accounting is a convention where the purchase of a subsidiary is recorded (on the subsidiary's books) for its purchase price, rather than its historical book value. In effect, the acquiree's assets and liabilities are adjusted to reflect the purchase price and to the extent that the purchase price exceeds fair value, the excess is recognized as goodwill. The issue discussed was that the application of pushdown could cause optionality in the financial statements as entities elect to or not to apply pushdown accounting to U.S. GAAP entities.

- Agenda item 2019-14: Attribution of Goodwill proposed to expand the statutory guidance regarding the "attribution" of purchase price, and more specifically, goodwill in situations where an insurance company acquires a holding company that itself owns multiple companies. This agenda item was drafted to ensure consistency in the application of goodwill (and purchase price) to the ultimate underlying SCAs. The primary item was to ensure that "associated" goodwill of a particular SCA (in the holding company) was removed from an insurer's financial statements in the event the SCA is sold/disposed. Interested parties contended that allocation of goodwill (outside of pushdown accounting), would not be reflected in the audited financial statements of the SCA. As SCAs generally require an audit for admission, the SCA audit would not individually reflect "associated goodwill" as the audited financials only entail the SCA's assets, liabilities, or equity. NAIC staff concur with this concern.

➢ Response - in December 2019, the Working Group adopted revisions to SSAP No. 68 to clarify that all goodwill from an insurance entity's acquisition of SCAs, **regardless of whether pushdown accounting is applied**, is subject to the existing 10% admittance limitation. This control will ensure that regardless of if pushdown has been applied, the goodwill that has been pushed down, is still subject to the aggregate 10% admittance limitation.

➢ Response – in July 2020, the Working Group adopted <u>several</u> additional goodwill disclosures from agenda item 2020-03: Enhanced Goodwill Disclosures. Effective for year-end 2021, Footnote 3(A) will now require that the original amount of goodwill associated with a purchase be disclosed. In addition, the Working Group adopted a new disclosure, implemented through a data-capture footnote, to detail the intangible assets used to calculate a reporting entity's adjusted capital and surplus. Further, the footnote will identify the current period admitted goodwill as a percentage of adjusted capital and surplus. These new goodwill disclosures will improve the validity and accuracy of intangible assets currently being reported in the financial statements and will greatly assist in regulatory review, especially in cases where a reporting entity may be nearing the goodwill admission limitation of 10%. It is anticipated that annual reports regarding goodwill percentages will be provided to the Working Group by NAIC staff.

- <u>Derivatives Hedging Fixed Indexed Products (Agenda Item 2020-36)</u> – NAIC staff has identified this topic to be priority project but the development of SAP revisions are 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. However, if regulators support moving forward with separate derivative guidance, NAIC staff will proceed in that direction. Comments from regulators and industry on the desired direction are welcome.

- <u>State ACA Reinsurance Programs (Agenda Item 2021-19) –</u> 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. The primary issue identified is that while some state programs have a flow of funds similar to the original federal transitional reinsurance program, other state programs have different arrangements.

Comment Deadline for Exposures is Friday, February 18, 2022, for all items except agenda item 2021-31, which has a January 14, 2022, comment deadline to allow for possible adoption prior to the filing of the financial statements and their audited reports.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2021/13. Fall National Meeting/Meeting/0 -12-2021 SAPWG Meeting Agenda.docx

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

Issue: Effective Derivatives – ASU 2017-12

Check (applicable entity):

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

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

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

<u>Although NAIC staff agrees 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</u>. 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 notes 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 agrees 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 recommends 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 views 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 has 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 believes 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.)

<u>Fair Value Hedges of Interest Rate Risk in Which the Hedged Item Can be Settled Before Scheduled Maturity:</u> 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.

<u>SAP Assessment</u>: 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.

<u>Items to Consider:</u> 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

<u>Staff Recommendation:</u>
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.

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

Issue: Related Party Reporting

Check (applicable entity):

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

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 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.

<u>Affiliate Definition and Identified Reporting Issues:</u>

The *Insurance Holding Company System Regulatory Act* (Model #440) defines "affiliate" and "control" as:

- <u>Affiliate</u>: 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.

- <u>Control</u>: 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.
<u>Proposed Related Party Revisions</u>

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 rights[1] 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*

[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 interest[1], 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.

[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

Convergence with International Financial Reporting Standards (IFRS): Not applicable.

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[4] 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 4a 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

[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[5] 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[6] 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~~[7]. 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[8] 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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~~[5] 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.~~

[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-reference 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.

~~[7] 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.~~

[8] 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

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

Issue: Schedule D-6-1, Supplemental Reporting

Check (applicable entity):

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

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 date shall be applied. Filers must provide previous years' audit reports to verify an audit report dated after August 31 in order to not be charged a late fee for a Sub 2 filing that is filed after the August 31 deadline. The value approved by the NAIC at the conclusion of the Sub 2 form filing is reported by the insurance company on its financial statement blank. If the 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.

52. Insurance companies shall use one of the valuation methods described in paragraph 8 to calculate the value of their investments in insurance and non-insurance SCA companies. An insurance company shall calculate the value of its investments in foreign insurance and all non-insurance company SCA entities and report the value to the NAIC no later than August 31, or 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. T**he 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

Valuation of Shares of Subsidiary, Controlled or Affiliated Companies

1	2	3	4	5	6	7	8	9	Stock of Such Company Owned by Insurer on Statement Date	
CUSIP Identification	Description Name of Subsidiary, Controlled or Affiliated Company	Foreig n	NAIC Company Code	ID Number	NAIC Valuation Method	Book/Adjusted Carrying Value	Total Amount of Goodwill Included in Book/Adjusted Carrying Value	Nonadmitted Amount	10 Number of Shares	11 % of Outstandin g
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1999999 Totals									XXX	XXX

1. Total amount of goodwill nonadmitted $..

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 1~~5~~9 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

Provide the amount nonadmitted, if any, included in Column 4 of the Asset page.

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

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2021/13. Fall National Meeting/Meeting/C - 21-22 - Schedule D-6-1, Supplemental Reporting.docx

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

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

Check (applicable entity):

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

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

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.	
8	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?
9	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?
10	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?

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

Convergence with International Financial Reporting Standards (IFRS): Not Applicable

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~~es~~ the insurers' carrying value. ~~f~~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 governs 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 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.~~

~~**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

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2021/13. Fall National Meeting/Meeting/D - 21-23 - SSAP No. 43R - Financial Modeling - Updated Guidance.docx

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

Issue: General Interrogatory for Cryptocurrencies

Check (applicable entity):

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

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 or 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 were 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.

Name of Cryptocurrency:

Provide the name of each cryptocurrency accepted for payments of premiums or held directly.

Immediately Converted to USD, Directly Held, or Both:

For each cryptocurrency listed, provide one of the following responses:

- Immediately converted to USD
- Directly held,
- Both.

Accepted for Payment of Premiums:

If the cryptocurrencies are accepted for the payment of premiums provide the response of "YES" in the column otherwise the response in the column should be "NO".

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

38.1 Does the reporting entity directly hold cryptocurrencies? Yes [ ] No [ ]

38.2 If the response to 38.1 is yes, on what schedule are they reported? ....

39.1 Does the reporting entity directly or indirectly accept cryptocurrencies as payment for premiums on policies? Yes [ ] No [ ]

39.2 If the response to 39.1 is yes, are the cryptocurrencies held directly or are they immediately converted to U.S. dollars?

39.21 Hold directly Yes [ ] No [ ]

39.22 Immediately converted to U.S. dollars Yes [ ] No [ ]

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.

1 Name of Cryptocurrency	2 Immediately Converted to USD, Directly Held, or Both	3 Accepted for Payment of Premiums

Staff Review Completed by: Jake Stultz, NAIC Staff, November 2021

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2021/13. Fall National Meeting/Meeting/E - 21-24 - Cryptocurrency General Interogatory.docx

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

Issue: Leasehold Improvements After Lease Termination

Check (applicable entity):

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

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

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

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

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

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

FASB Emerging Issues Task Force No. 89-14, Valuation of Repossessed Real Estate, FASB Emerging Issues Task Force No. 90-8, Capitalization of Costs to Treat Environmental Contamination, FASB Emerging Issues Task Force No. 95-23, The Treatment of Certain Site Restoration/Environmental Exit Costs When Testing a Long-Lived Asset for Impairment, FASB Emerging Issues Task Force 97-11: Accounting for Internal Costs Relating to Real Estate Property Acquisitions, FASB Emerging Issues Task Force No. 98-8: Accounting for Transfers of Investments That Are in Substance Real Estate and FASB Emerging Issues Task Force No. 00-13, Determining Whether Equipment is "Integral Equipment" Subject to FASB Statements No. 66 and No. 98, which clarifies the term "integral equipment" as used in this statement.

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

SSAP No. 19:

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

SSAP No. 73:

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

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): The Working Group adopted substantive revisions in agenda item 2016-02 to SSAP No. 22 to incorporate language from *ASU 2016-02, Leases (Topic 842)*, which retained the treatment of leases as operating leases by the lessor but incorporated some of the new language and guidance from ASU 2016-02.

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

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

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

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

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the

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

SSAP No. 73:

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

Staff Review Completed by Jake Stultz, September 2021

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2021/13. Fall National Meeting/Meeting/F - 21-25 - Leasehold Improvements after Lease Termination.docx

NAIC Accounting Practices and Procedures Manual
Editorial and Maintenance Update
December 11, 2021

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

SSAP/Appendix	Description/Revision
Various	Pursuant to a 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:

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~~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 pubic 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~~substantively amends~~ amended to reflect new SAP concepts or superseded by other ~~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 ~~substantively 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~~substantive 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~~ R~~r~~evisions 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 7: Summary of Changes, Volume I, Page xxiii

Section 2 summarizes ~~the nonsubstantive~~ revisions that clarify existing ~~to~~ 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~~ R~~r~~evisions that clarify existing statutory accounting principles are effective when adopted unless a specific effective date is noted.

Edit 8: Summary of Changes (heading in table), Volume I, Page xxiii

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

Edit 9: Summary of Changes (heading in table), Volume I, Page xxiii

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

Edit 10: Preamble, Volume I, Page P-5

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.

Edit 11: Preamble, Volume I, Page P-9

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~~ C~~c~~hanges 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 of 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.

Edit 12: Table of Contents (How to use this Manual), Volume II, 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 13: Table of Contents (How to use this Manual), Volume II, 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~~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 pubic 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~~ R~~r~~evisions 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~~ 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~~ R~~r~~evisions 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

Edit 21: Appendix F: NAIC Policy Statement of Statutory Accounting Principles Maintenance Agenda Process, Volume II, Page F-5

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.

Edit 22: Appendix F: NAIC Policy Statement of Statutory Accounting Principles Maintenance Agenda Process, Volume II, Page F-5

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 S~~SAP~~s~~ 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 ~~to~~ SAP 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.

Edit 23: Appendix F: NAIC Policy Statement of Statutory Accounting Principles Maintenance Agenda Process, Volume II, Page F-5

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.

Edit 24: Appendix F: NAIC Policy Statement of Statutory Accounting Principles Maintenance Agenda Process, Volume II, Page F-6

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.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2021/13. Fall National Meeting/Meeting/G - 21-26EP Fall 2021 - (Sub vs. NonSub).docx

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):

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

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. 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

Convergence with International Financial Reporting Standards (IFRS): 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*.

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):

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

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.(INT 00-28) Contingent consideration issued in a purchase business combination that is embedded in a security or that is in the form of a separate financial instrument shall be recorded by the issuer at fair value at the acquisition date.

4. **For those acquired SCA entities accounted for in accordance with paragraphs 8.b.i., 8.b.ii., 8.b.iii. or 8.b.iv. of SSAP No. 97, and joint venture, partnership or limited liability company entities accounted for in accordance with paragraph 8 of SSAP No. 48, goodwill is defined as the difference between the cost of acquiring the entity and the reporting entity's share of the book value of the acquired entity. When the cost of the acquired entity is greater than the reporting entity's share of the book value, positive goodwill exists.** When the cost of the acquired entity is less than the reporting entity's share of the book value, negative goodwill exists. Goodwill resulting from assumption reinsurance shall be recorded as a separate write-in for other-than-invested assets. All other goodwill shall be reported in the carrying value of the investment.

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

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

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.(INT 01-18)

Impairment

9. **For any decline in the fair value of an entity, acquired through a purchase, that is other than temporary(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 <u>when</u> an impairment has occurred. <u>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).</u>

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

Convergence with International Financial Reporting Standards (IFRS): Not applicable – *IAS 36 Impairment of Assets*, requires an annual assessment of the impairment for goodwill.

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):

22. This statement rejects *ASU 2021-03, Intangibles – Goodwill and Other – Accounting Alternative for Evaluating triggering Events,* *ASU 2019-06, Intangibles—Goodwill and Other Business Combinations, and Non-for-Profit Entities, ASU 2017-04, Simplifying the Test for Goodwill Impairment*, *ASU 2016-03, Intangibles—Goodwill and Other, Business Combinations, Consolidation, Derivatives and Hedging*; *ASU 2014-02, Accounting for Goodwill (a consensus of the Private Company Council)*, *ASU 2012-02, Testing Indefinite-Lived Intangible Assets for Impairment*, *ASU 2011-08, Testing Goodwill for Impairment* and *ASU 2010-28, When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*; *Accounting Principles Board Opinion No. 16, Business Combinations*; *FASB Statement No. 38, Accounting for Preacquisition Contingencies of Purchased Enterprises, an amendment of APB Opinion No. 16*; *Accounting Principles Board Opinion No. 17*, *Intangible Assets*; *FASB Statement No. 79, Elimination of Certain Disclosures for Business Combinations by Nonpublic Enterprises*; *FASB Statement No. 141, Business Combinations*; and *FASB Statement No. 142, Goodwill and Other Intangible Assets.*

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

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2021/13. Fall National Meeting/Meeting/I - 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):

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

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

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2021/13. Fall National Meeting/Meeting/J - 21-29 - ASU 2021-05 Variable Lease Payments.docx

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):

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

Description of Issue:
The Financial Accounting Standards Board issued *Accounting Standard Update* (ASU) *2021-04, 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 2021-04, 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

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2021/13. Fall National Meeting/Meeting/K - 21-30 - ASU 2021-06 SEC Paragraphs.docx

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

Issue: Life Reinsurance Disclosure Clarifications

Check (applicable entity):

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

Description of Issue:
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. Th**e** disclosures were adopted in *SSAP No. 61R—Life and Health Reinsurance* in agenda item 2017-28: Reinsurance Risk Transfer for Short Duration Contracts. Preparers and auditors have highlighted unclear elements in the disclosures that could use additional clarification. Requested clarifications and responses are detailed in the recommendation section, but they include items regarding 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. In the statutory annual statement filing the disclosures are in Note 23H and are not data captured. The proposed revisions to SSAP No. 61R narrow the scope of the disclosures and clarify what is required in the disclosures.

Existing Authoritative Literature:

SSAP No. 61R—Life and Health Reinsurance includes the following disclosures:

78. Disclosures for paragraphs 79-84 are required to be included with the annual audit report financial statements beginning with the period ended December 31, 2020, regarding reinsurance contracts. The disclosures required within paragraphs 79-84 shall be included in accompanying supplemental schedules of the annual audit report beginning in year-end 2020. These disclosures shall be limited to reinsurance contracts entered into, renewed or amended on or after January 1, 1996. This limitation applies to the annual audit report only and does not apply to the statutory annual statement interrogatories and the property and casualty reinsurance summary supplemental filing.

79. Disclose any reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) subject to A-791 that includes a provision, which limits the reinsurer’s assumption of significant risks identified as in A-791. Examples of risk-limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. If true, indicate the number of reinsurance contracts to which such provisions apply. For contracts subject to A-791, indicate if deposit accounting was applied for all contracts, which limit significant risks.

80. Disclose any reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) not subject to A-791, for which reinsurance accounting was applied and includes a provision that limits the reinsurer’s assumption of risk. Examples of risk-limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. If true, indicate the number of reinsurance contracts to which such provisions apply. If affirmative, indicate if the reinsurance credit was reduced for the risk-limiting features.

81. Disclose if any reinsurance contracts contain features (except reinsurance contracts with a federal or state facility) described below which result in delays in payment in form or in fact:

a. Provisions which permit the reporting of losses, or settlements are made, less frequently than quarterly or payments due from the reinsurer are not made in cash within ninety (90) days of the settlement date (unless there is no activity during the period).

b. Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

82. Disclose if the reporting entity has reflected reinsurance accounting credit for any contracts not subject to Appendix A-791 and not yearly renewable term, which meet the risk-transfer requirements of SSAP No. 61R and identify the type of contracts and the reinsurance contracts.

a. Assumption Reinsurance – new for the reporting period.

b. Non-proportional reinsurance, which does not result in significant surplus relief. If yes, indicate if the insured events(s) triggering contract coverage has been recognized.

83. Disclose if the reporting entity ceded any risk which is not subject to A-791 and not yearly renewable term reinsurance, under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:

a. Accounted for that contract as reinsurance under statutory accounting principles (SAP) and as a deposit under generally accepted accounting principles (GAAP); or

b. Accounted for that contract as reinsurance under GAAP and as a deposit under SAP.

84. If affirmative disclosure is required for paragraph 83, explain why the contract(s) is treated differently for GAAP and SAP.

The SSAP No. 61R disclosures were developed based on existing *SSAP No. 62R—Property and Casualty Reinsurance* disclosures with modifications for life and health reinsurance guidance. SSAP No. 62R includes the following disclosures:

113. Disclosures for paragraphs 114-119 represent annual statement interrogatories, which are required to be included with the annual audit report beginning with audit reports on financial statements as of and for the period ended December 31, 2006. The disclosures required within paragraphs 114-119 shall be included in accompanying supplemental schedules of the annual audit report beginning in year-end 2006. These disclosures shall be limited to reinsurance contracts entered into, renewed or amended on or after January 1, 1994. This limitation applies to the annual audit report only and does not apply to the statutory annual statement interrogatories and the reinsurance summary supplemental filing.

114. Disclose if any risks are reinsured under a quota share reinsurance contract with any other entity that includes a provision that would limit the reinsurer's losses below the stated quota share percentage (e.g. a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions)? If yes, indicate the number of reinsurance contracts containing such provisions and if the amount of reinsurance credit taken reflects the reduction in quota share coverage caused by any applicable limiting provision(s).

115. Disclose if the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:

a. A contract term longer than two years and the contract is noncancellable by the reporting entity during the contract term;

b. A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;

c. Aggregate stop loss reinsurance coverage;

d. A unilateral right by either party (or both parties) to commute the reinsurance contract, whether conditional or not, except for such provisions which are only triggered by a decline in the credit status of the other party;

e. A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or

f. Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

116. Disclose if the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders. This disclosure is limited to reinsurance contracts with written premium cessions or loss and loss expense reserve cessions described in this paragraph that meet the criteria of paragraph 116.a. or paragraph 116.b. This disclosure excludes cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member.

a. The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or

b. Twenty–five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates in separate reinsurance contract.

117. If affirmative disclosure is required for paragraph 115 or 116, provide the following information:

a. A summary of the reinsurance contract terms and indicate whether it applies to the contracts meeting paragraph 115 or 116;

b. A brief discussion of management's principal objectives in entering into the reinsurance contract including the economic purpose to be achieved; and

c. The aggregate financial statement impact gross of all such ceded reinsurance contracts on the balance sheet and statement of income.

118. Except for transactions meeting the requirements of paragraph 36, disclose if the reporting entity ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:

a. Accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles (SAP) and as a deposit under generally accepted accounting principles (GAAP); or

b. Accounted for that contract as reinsurance under GAAP and as a deposit under SAP.

119. If affirmative disclosure is required for paragraph 118, explain in a supplemental filing why the contract(s) is treated differently for 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 2017-28 adopted the SSAP No. 61R disclosures in paragraphs 78-84. The disclosures were developed at the request of the Financial Analysis (E) Working Group and were based on existing disclosures in *SSAP No. 62R—Property and Casualty Reinsurance* in paragraphs 114-119 that are designed to identify contracts with risk limiting features or other items that may need additional regulatory review. The disclosures had to be modified to meet the requirements of SSAP No. 61R and *Appendix A-791- Life and Health Reinsurance Agreements*

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 the revisions to SSAP No. 61R disclosures illustrated below. These items are recommended for a shortened comment period to allow for possible adoption in early 2022 with a year-end 2021 effective date. The proposed revisions provide clarifications and, in some cases, narrow the scope of disclosure. No additional disclosures are proposed. Having the disclosure revisions final for year-end 2021 will assist preparers and auditors.

1. Does the Statutory Accounting Principles (E) Working Group expect the disclosures to be filed as a supplemental schedule in the audited financial statements even when all answers are not applicable or none? **(This is the most common question that the auditing firms received.)**

   Response: If there are no contracts with the applicable features, a narrative note would be sufficient. See suggested edit to paragraph 78 which provides that the information can be in a note or a supplemental schedule. NAIC staff notes that Note 23H is not data captured in the statutory annual statement filing.

2. Is the supplemental schedule specific to ceded reinsurance only?

   Response: While some of the disclosures are primarily designed to identify ceding contracts which may require additional scrutiny to verify that too large of a reinsurance credit was taken by the ceding entity, the scope of the disclosures includes all reinsurance contracts unless specifically identified otherwise. See proposed clarifications to limit paragraphs 79 and 80 to ceding contracts. This clarification would be similar to corresponding paragraphs in SSAP No. 62. Also, a clarification also specifies that paragraph 81 is applicable to both assumed and ceding contracts.

3. With regard to paragraph 80, would a stop loss or excess of loss reinsurance agreement with a loss cap or with deductibles (which are common contractual provisions) be required to be disclosed?

   Response: Paragraph 80 provides the following:

   > 80. Disclose any reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) not subject to A-791, for which reinsurance accounting was applied and includes a provision that limits the reinsurer's assumption of risk. Examples of risk-limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. If true, indicate the number of reinsurance contracts to which such provisions apply. If affirmative, indicate if the reinsurance credit was reduced for the risk-limiting features.

   Paragraph 80 is a modification of the following SSAP No. 62R disclosure:

114. Disclose if any risks are reinsured under a quota share reinsurance contract with any other entity that includes a provision that would limit the reinsurer's losses below the stated quota share percentage (e.g. a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions)? If yes, indicate the number of reinsurance contracts containing such provisions and if the amount of reinsurance credit taken reflects the reduction in quota share coverage caused by any applicable limiting provision(s).

Response: Paragraph 80 was modified to capture contracts not subject to A-791 and not quota share contracts as shown in SSAP No. 62R, paragraph 114 because the requirements of A-791 do not allow significant risks which are required to be ceded to be limited. As currently drafted, the disclosure is written too broadly in that it may be capturing more nonproportional contracts with "standard" features than what is useful. See proposed clarification to paragraph 80 in the illustration below to remove stop loss or excess of loss reinsurance agreements with deductibles or loss caps that apply to the entire contract and are not adjustable based on other features from the disclosure.

4. Please clarify the intent and what information should be disclosed in subparagraphs 82.a and 82. b.

   a. We thought that for paragraph 82. a, the intent related to ceding companies with assumption reinsurance agreements (paragraph 60 of SSAP 61R) entered into during the current year for which indemnity reinsurance is being applied for policyholders who have not yet agreed to the transfer to the new insurer or for which the regulator has not yet approved the novation to the new insurer.

Response: Paragraph 82. a. is intended to reference assumption reinsurance agreements referenced in paragraph 60 of SSAP No. 61R entered into during the current year for which reinsurance credit is reported. It does not make a distinction regarding those that have or have not been approved by the policyholder. A simple reading of the disclosure is intended - to identify new assumption reinsurance agreements. This paragraph does not have a similar paragraph in SSAP No. 62R. See edits to SSAP No. 61R illustrated below which add reference to the contracts in paragraph 60.

   b. With regard to paragraph 82. b, what is the concern related to non-proportionate contracts that do <u>not</u> provide significant surplus relief?

Response: Paragraph 82. b is proposed for deletion, as it does not provide useful information. This is because it would require disclosure of contracts which do not provide significant surplus relief and it is unclear what types of assumption reinsurance would be captured. This paragraph does not have a similar paragraph in SSAP No. 62R. See edits to SSAP No. 61R illustrated below.

5. How should an entity answer paragraphs 83-84 if no GAAP financial statements are prepared?

Response: If the reporting entity and or its holding company group does not prepare GAAP financials this is not an analysis that would be required. See proposed clarification in paragraph 83 below. AICPA representatives noted, and NAIC staff agrees, that because of A-791 differences there may be more life and health contracts reported differently for GAAP.

<u>Recommended Revisions to SSAP No. 61R:</u>

78. Disclosures for paragraphs 79-84 are required to be included with the annual audit report financial statements beginning with the period ended December 31, 2020, regarding reinsurance contracts. The disclosures required within paragraphs 79-84 ~~shall~~ <u>can</u> be included in accompanying supplemental schedules<u> or the notes</u> of the annual audit report beginning in year-end 2020. <u>If not applicable, an affirmative statement that no such contracts were identified is acceptable.</u> These disclosures shall be limited to reinsurance contracts entered into, renewed or amended on or after January 1, 1996. This limitation applies

to the annual audit report only and does not apply to the statutory annual statement interrogatories and the property and casualty reinsurance summary supplemental filing.

79. Disclose any ceding reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) subject to A-791 that includes a provision, which limits the reinsurer's assumption of significant risks identified as in A-791. Examples of risk-limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. If true, indicate the number of reinsurance contracts to which such provisions apply. For contracts subject to A-791, indicate if deposit accounting was applied for all contracts, which limit significant risks.

80. Disclose any ceding reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) not subject to A-791, for which reinsurance accounting was applied and includes a provision that limits the reinsurer's assumption of risk. Examples of risk-limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. Note that a stop loss or excess of loss reinsurance agreement with deductibles or loss caps which apply to the entire contract and are not adjustable based on other features, do not require disclosure under this paragraph. If true, indicate the number of reinsurance contracts to which such provisions apply. If affirmative, indicate if the reinsurance credit was reduced for the risk-limiting features.

81. Disclose if any assumed or ceded reinsurance contracts contain features (except reinsurance contracts with a federal or state facility) described below which result in delays in payment in form or in fact:

a. Provisions which permit the reporting of losses, or settlements are made, less frequently than quarterly or payments due from the reinsurer are not made in cash within ninety (90) days of the settlement date (unless there is no activity during the period).

b. Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

82. Disclose if the reporting entity has reflected reinsurance accounting credit for any contracts not subject to Appendix A-791 and not yearly renewable term, which meet the risk-transfer requirements of SSAP No. 61R and identify the type of contracts and the reinsurance contracts.

a. Assumption Reinsurance – as discussed in paragraph 60, which are new for the reporting period.

~~b. Non-proportional reinsurance, which does not result in significant surplus relief. If yes, indicate if the insured events(s) triggering contract coverage has been recognized.~~

83. Disclose if the reporting entity ceded any risk which is not subject to A-791 and not yearly renewable term reinsurance, under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:

a. Accounted for that contract as reinsurance under statutory accounting principles (SAP) and as a deposit under U.S. generally accepted accounting principles (GAAP); or

b. Accounted for that contract as reinsurance under U.S. GAAP and as a deposit under SAP.

If the reporting entity does not prepare U.S. GAAP financial statements or its financial statements are not part of upstream U.S. GAAP financial statements, this disclosure can be answered not applicable.

84. If affirmative disclosure is required for paragraph 83, explain why the contract(s) is treated differently for GAAP and SAP

Staff Review Completed by: Robin Marcotte, NAIC Staff - November 2021

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. <u>Reporting Lines</u>

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.

<u>General Categories Proposed to be Eliminated:</u>
(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>U.S. Government</u>: 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*.

<u>All Other Governments</u>: 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>U.S. States, Territories and Possessions (Direct and Guaranteed)</u>: 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>U.S. Political Subdivisions of States, Territories and Possessions (Direct and Guaranteed):</u> General obligations of cities, counties, townships, etc., as well as bonds issued by utility companies owned by these entities.

<u>U.S. Special Revenue and Special Assessment Obligations and All Non-Guaranteed Obligations of Agencies and Authorities of Governments and Their Political Subdivisions</u>: 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*.

<u>Industrial and Miscellaneous (Unaffiliated)</u>: 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:

U.S. Government Obligations ....

Other U.S. Government Securities...

Non-U.S. Sovereign Jurisdiction Securities ....

Municipal Bonds – General Obligations..

Municipal Bonds – Special Revenue ....

Project Finance Bonds Issued by Operating Entities ....

Affiliated Project Finance Bonds Issued by Operating Entities...

Corporate Bonds ....

Affiliated Corporate Bonds ....

Qualifying Single-Tenant Lease-Backed Securities (ETC, EETC and CTLs) ....

Affiliated Qualifying Single Tenant Leased-Backed Securities..

Bonds Issued from Business Development Corps, Closed End Funds & REITS ....

Affiliated Business Development Corps, Closed End Funds & REITS ....

Mandatory Convertible Bonds ....

Affiliated Mandatory Convertible Bonds ....

Bank Loans – Issued ....

Affiliated Bank Loans - Issued ....

Bank Loans - Acquired...

Affiliated Bank Loans - Acquired..

SVO-Identified Bond Exchange Traded Funds – Fair Value ....

SVO-Identified Bond Exchange Traded Funds – Systematic Value..

Certificates of Deposit ....

Other Issuer Credit Obligations ....

Total Issuer Credit Obligations...

Total Affiliated Issuer Credit Obligations ....

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
Sufficient Credit Enhancement - December 11, 2021

Introduction: Since the initial exposure of the principles-based bond definition, a key discussion point has been on the determination of "sufficiency" in determining the level of credit enhancement required for asset-backed securities (ABS).

The prior concept of 'sufficiency" pertains to the requirement that a holder of an ABS be in a different economic position than if they held the underlying collateral directly. This is a requirement for all ABS securities, regardless of if the ABS is backed by financial or cash-generating non-financial collateral assets. The original exposure identified that the determination of whether the holder of ABS was in a different economic position would be based on whether there was "sufficient credit enhancement." This was then defined in the glossary. However, comments have been raised as to the application of that guidance and whether any ABS that had obtained a credit rating from a CRP could conclude that the ABS had obtained "sufficient credit enhancement." This original intent was not to make the "sufficiency" determination equivalent to a credit assessment, as credit ratings should not be a driver for accounting classification. As a result of these discussions, the small group has evaluated the original exposed draft and has developed alternative language (and terminology) for exposure.

(Note – This discussion is specific to "different economic position" criteria so other aspects of the definition are not included.)

Definition of Asset-Backed Security:

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

There are two defining characteristics that must be present for a security to meet the definition of an asset backed security:

a. The assets owned by the ABS Issuer are either financial assets or cash-generating non-financial assets. Cash-generating non-financial assets are defined as assets that are expected to generate a meaningful[1] level of cash flows toward repayment of the bond through use, licensing, leasing, servicing or management fees, or other similar cash flow generation (for the avoidance of doubt, there must be a meaningful level of cash flows to service the debt, other than through the sale or refinancing of the assets). Reliance on cash flows from the sale or refinancing of cash generating non-financial assets does not preclude a bond from being classified as an asset backed security so long as the condition in the preceding sentence is met. See Appendix II for examples (2, 3 and 4) illustrating the evaluation of the meaningful criteria.

[1] The term "meaningful" is defined in the Glossary.

b. The holder of a debt instrument issued by an ABS Issuer is in a different economic position than if the holder owned the ABS Issuer's assets directly. The holder of the debt instrument is in a different economic position if such debt instrument benefits from substantive~~sufficient[2]~~ credit enhancement through guarantees (or other similar forms of recourse), subordination and/or overcollateralization[3]. In instances where the assets owned by the ABS Issuer are equity interests, the debt instrument must have pre-determined principal and interest payments (whether fixed interest or variable interest) with contractual amounts that do not vary based on the appreciation or depreciation of the equity interests. See Appendix II for examples illustrating the evaluation of the sufficient criteria.

Glossary Definition:

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

The substantive credit enhancement required to be in a different economic position is ~~"sufficient" threshold is~~ specific to each transaction; determined at origination; and refers to the level of credit enhancement a market participant (i.e., knowledgeable ~~reasonable~~ investor transacting at arm's length) would conclude is substantive.~~expected to absorb losses (or decreases in cash flows) to the same degree as other debt instruments of similar quality, under a range of stress scenarios (i.e., scenarios are similar to stress scenarios performed for other debt instruments of the same quality). Losses are those a market participant would estimate and considers historical losses (including loss recoveries) on similar collateral, current market conditions, reasonable and supportable forecasts, and prepayment assumptions associated with the collateral. Excluded from the estimate of expected losses are historical gains on similar collateral and expected market appreciation on the collateral.~~

The first loss tranche (or tranches if the first tranche is not itself ~~sufficient~~substantive) may be issued as part of the securitization in the form of a debt or equity interest, or it may be retained by the sponsor and not issued as part of the securitization. If the first loss tranche is issued as part of the securitization, and held by a reporting entity, the accounting should follow the guidance applicable to the type of instrument (i.e., debt vs. equity); however, regardless of the type of instrument, it does not qualify as a Schedule D bond and should be reported on Schedule BA.

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~~[2] The term "sufficientsubstantive" is defined in the Glossary.~~
[3] The term "substantive credit enhancement" is defined in the Glossary.

Interpretation of the Statutory Accounting Principles Working Group

INT 20-03: Troubled Debt Restructuring Due to COVID-19

INT 20-03 Dates Discussed

March 26, 2020; April 15, 2020; January 6, 2021; January 25, 2021

INT 20-03 References

SSAP No. 36—Troubled Debt Restructuring

INT 20-03 Issue

1. A previously unknown virus began transmitting between October 2019 and March 2020, with the first deaths in the U.S. reported in early March 2020. The disease caused by the virus is known as Coronavirus Disease 2019 (COVID-19). Several states and cities have issued "stay home" orders and forced all non-essential businesses to temporarily close. This led to a significant increase in unemployment and the potential permanent closure of many businesses. Total economic damage is still being assessed however the total impact is likely to exceed $1 trillion in the U.S. alone.

2. In response to COVID-19, Congress and Federal and state prudential banking regulators have considered provisions pertaining to mortgage loans as a result of the effects of the COVID-19. These provisions are intended to be applicable for the term of the loan modification, but solely with respect to a modification, including a forbearance arrangement, an interest rate modification, a repayment plan, and any other similar arrangement that defers or delays the payment of principal or interest, that occurs during the applicable period for a loan that was not more than 30 days past due as of December 31, 2019.

3. Furthermore, guidance has been issued by the Financial Condition (E) Committee to all U.S. insurers filing with the NAIC in an effort to encourage insurers to work with borrowers who are unable to, or may become unable to meet their contractual payment obligations because of the effects of COVID-19. As detailed in that guidance, the Committee, which is the NAIC parent committee of all the solvency policy making task forces and working groups of the NAIC, supports the use of prudent loan modifications that can mitigate the impact of COVID-19.

4. This interpretation considers the interagency guidance issued by Federal and state prudential banking regulators on March 22, 2020 addressing whether the modification of mortgage loan or bank loan terms in response to COVID-19 shall be considered a troubled debt restructuring.

INT 20-03 Discussion

5. *SSAP No. 36—Troubled Debt Restructuring* provides guidance, predominantly adopted from U.S. GAAP, in determining whether a debt restructuring is considered a troubled debt restructuring. Additionally, SSAP No. 36 provides accounting and disclosure guidance when a troubled debt restructuring has been deemed to occur. Pursuant to existing guidance in SSAP No. 36, a debt restructuring is not necessarily considered a troubled debt restructuring and a creditor must assess whether the debtor is experiencing financial difficulties. The guidance also indicates that a delay in payment that is insignificant is not a concession

6. On March 22, 2020, the Federal and state prudential banking regulators issued a joint statement that included guidance on their approach to the accounting for loan modifications in light of the economic impact of the coronavirus pandemic. The guidance was developed in consultation with the staff of the FASB who concur with

the approach and indicated that they stand ready to assist stakeholders with any questions. This interagency statement is provided below and is accessible through the FASB response via the following link:

https://fasb.org/cs/Satellite?c=FASBContent_C&cid=1176174374016&pagename=FASB%2FFASBContent_C%2FNewsPage

Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus

The Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), the Consumer Financial Protection Bureau (CFPB),and the State Banking Regulators (hereafter, the agencies), are issuing this interagency statement to provide additional information to financial institutions who are working with borrowers affected by the Coronavirus Disease 2019 (also referred to as COVID-19). The United States has been operating under a presidentially declared emergency since March 13, 2020, and financial institutions and their customers are affected by COVID-19. The agencies understand that this unique and evolving situation could pose temporary business disruptions and challenges that affect banks, credit unions, businesses, borrowers, and the economy. The agencies will continue to communicate with the industry as this situation unfolds, including through additional statements, webinars, frequently asked questions, and other means, as appropriate.

Working with Customers

The agencies encourage financial institutions to work prudently with borrowers who are or may be unable to meet their contractual payment obligations because of the effects of COVID-19. The agencies view loan modification programs as positive actions that can mitigate adverse effects on borrowers due to COVID-19. The agencies will not criticize institutions for working with borrowers and will not direct supervised institutions to automatically categorize all COVID19 related loan modifications as troubled debt restructurings (TDRs). The agencies will not criticize financial institutions that mitigate credit risk through prudent actions consistent with safe and sound practices. The agencies consider such proactive actions to be in the best interest of institutions, their borrowers, and the economy. This approach is consistent with the agencies' longstanding practice of encouraging financial institutions to assist borrowers in times of natural disaster and other extreme events. The agencies also will not criticize institutions that work with borrowers as part of a risk mitigation strategy intended to improve an existing non-pass loan.

Accounting for Loan Modifications

Modifications of loan terms do not automatically result in TDRs. According to U.S. GAAP, a restructuring of a debt constitutes a TDR if the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. The agencies have confirmed with staff of the Financial Accounting Standards Board (FASB) that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief, are not TDRs. This includes short-term (e.g., six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant. Borrowers considered current are those that are less than 30 days past due on their contractual payments at the time a modification program is implemented.

Working with borrowers that are current on existing loans, either individually or as part of a program for creditworthy borrowers who are experiencing short-term financial or operational problems as a result of COVID-19, generally would not be considered TDRs. For modification programs designed to provide temporary relief for current borrowers affected by COVID-19, financial institutions may presume that borrowers that are current on payments are not experiencing financial difficulties at

the time of the modification for purposes of determining TDR status, and thus no further TDR analysis is required for each loan modification in the program.
Modification or deferral programs mandated by the federal or a state government related to COVID-19 would not be in the scope of ASC 310-40, e.g., a state program that requires all institutions within that state to suspend mortgage payments for a specified period.

The agencies' examiners will exercise judgment in reviewing loan modifications, including TDRs, and will not automatically adversely risk rate credits that are affected by COVID-19, including those considered TDRs. Regardless of whether modifications result in loans that are considered TDRs or are adversely classified, agency examiners will not criticize prudent efforts to modify the terms on existing loans to affected customers.

In addition, the FRB, the FDIC, and the OCC note that efforts to work with borrowers of one-to four family residential mortgages as described in the modification section of this document, where the loans are prudently underwritten, and not past due or carried in nonaccrual status, will not result in the loans being considered restructured or modified for the purposes of their respective risk-based capital rules.

Past Due Reporting

With regard to loans not otherwise reportable as past due, financial institutions are not expected to designate loans with deferrals granted due to COVID-19 as past due because of the deferral. A loan's payment date is governed by the due date stipulated in the legal loan documents. If a financial institution agrees to a payment deferral, this may result in no contractual payments being past due, and these loans are not considered past due during the period of the deferral.

Nonaccrual Status and Charge-Offs

Each financial institution should refer to the applicable regulatory reporting instructions, as well as its internal accounting policies, to determine if loans to stressed borrowers should be reported as nonaccrual assets in regulatory reports. However, during the short-term arrangements discussed in this statement, these loans generally should not be reported as nonaccrual. As more information becomes available indicating a specific loan will not be repaid, institutions should refer to the charge-off guidance in the instructions for the Consolidated Reports of Condition and Income.

Discount Window Eligibility

Institutions are reminded that loans that have been restructured as described under this statement will continue to be eligible as collateral at the FRB's discount window based on the usual criteria.

7. On March 27, 2020, President Trump signed into law the *Coronavirus Aid, Relief and Economic Security Act* (CARES Act). The provisions in Section 4013 specifically address temporary relief from troubled debt restructurings. On December 27, 2020, President Trump signed into law the *Consolidated Appropriations Act, 2021*, which slightly modified and extended the original CARES Act as shown below:

SEC. 4013. TEMPORARY RELIEF FROM TROUBLED DEBT RESTRUCTURINGS.

(a) DEFINITIONS.—In this section:

(1) APPLICABLE PERIOD.—The term ''applicable period'' means the period beginning on March 1, 2020 and ending on the earlier of ~~December 31, 2020~~ January 1, 2022 or the date that is 60 days after the date on which the national emergency concerning the novel coronavirus disease (COVID–19) outbreak declared by the President on March 13, 2020 under the National Emergencies Act (50 U.S.C. 1601 et seq.) terminates.

(2) APPROPRIATE FEDERAL BANKING AGENCY.—The term ''appropriate Federal banking agency''—
(A) has the meaning given the term in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813); and
(B) includes the National Credit Union Administration.

(b) SUSPENSION.—

(1) IN GENERAL.—During the applicable period, a financial institution including an insurance company may elect to— (A) suspend the requirements under United States generally accepted accounting principles for loan modifications related to the coronavirus disease 2019 (COVID–19) pandemic that would otherwise be categorized as a troubled debt restructuring; and (B) suspend any determination of a loan modified as a result of the effects of the coronavirus disease 2019 (COVID–19) pandemic as being a troubled debt restructuring, including impairment for accounting purposes under United States Generally Accepted Accounting Principles.

(2) APPLICABILITY.—Any suspension under paragraph (1)—

(A) shall be applicable for the term of the loan modification, but solely with respect to any modification, including a forbearance arrangement, an interest rate modification, a repayment plan, and any other similar arrangement that defers or delays the payment of principal or interest, that occurs during the applicable period for a loan that was not more than 30 days past due as of December 31, 2019; and

(B) shall not apply to any adverse impact on the credit of a borrower that is not related to the coronavirus disease 2019 (COVID–19) pandemic.

(c) DEFERENCE.—The appropriate Federal banking agency of the financial institution including an insurance company shall defer to the determination of the financial institution, including an insurance company, to make a suspension under this section.

(d) RECORDS.—For modified loans for which suspensions under subsection (a) apply—

(1) financial institutions, including insurance companies, should continue to maintain records of the volume of loans involved; and

(2) the appropriate Federal banking agencies may collect data about such loans for supervisory purposes.

8. On April 7, 2020, the Federal and state prudential banking regulators issued a revised joint statement to reflect the issuance of the CARES Act:

https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200407a1.pdf

Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised)

The Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the Consumer Financial Protection Bureau (CFPB) (hereafter, the agencies), in consultation with the state financial regulators, are issuing this revised interagency statement to provide additional information to financial institutions that are working with borrowers affected by the Coronavirus Disease 2019 (also referred to as COVID19). The United States has been operating under a presidentially declared emergency since March 13, 2020 (National Emergency). The agencies understand that this unique and evolving situation could pose temporary business disruptions and challenges that affect banks, credit unions, businesses, borrowers, and the economy.

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was signed into law. As discussed in more detail below, the CARES Act creates a forbearance program for federally backed mortgage loans, protects borrowers from negative credit reporting due to loan accommodations related to the National Emergency, and provides financial institutions the option to temporarily suspend certain requirements under U.S. generally accepted accounting principles (GAAP) related to troubled debt restructurings (TDR) for a limited period of time to account for the effects of COVID-19.

The agencies originally issued a statement on March 22, 2020, to encourage financial institutions to work prudently with borrowers and to describe the agencies' interpretation of how current accounting rules under U.S. GAAP apply to certain COVID-19-related modifications. This revised interagency statement clarifies the interaction between the March 22, 2020, interagency statement and section 4013 of the CARES Act, Temporary Relief from Troubled Debt Restructurings (section 4013), as well as the agencies' views on consumer protection considerations. The agencies will continue to communicate with the industry as this situation unfolds, including through additional statements, webinars, frequently asked questions, and other means, as appropriate.

Working with Customers: General Safety and Soundness Considerations

The agencies encourage financial institutions to work prudently with borrowers who are or may be unable to meet their contractual payment obligations because of the effects of COVID-19. The agencies view loan modification programs as positive actions that can mitigate adverse effects on borrowers due to COVID-19. The agencies will not criticize institutions for working with borrowers in a safe and sound manner. As described below, institutions generally do not need to categorize COVID-19-related modifications as TDRs, and the agencies will not direct supervised institutions to automatically categorize all COVID-19 related loan modifications as TDRs.

The agencies will not criticize financial institutions that mitigate credit risk through prudent actions consistent with safe and sound practices. The agencies consider such proactive measures to be in the best interest of institutions, their borrowers, and the economy. This approach is consistent with the agencies' longstanding practice of encouraging financial institutions to assist borrowers in times of natural disaster and other extreme events although the agencies recognize that the effects of this event are particularly extreme and broad-based. The agencies also will not criticize institutions that work with borrowers as part of a risk mitigation strategy intended to improve an existing non-pass loan.

Financial institutions have broad discretion to implement prudent modification programs consistent with the framework included in this statement

Accounting and Reporting Considerations

As provided for under the CARES Act, a financial institution may account for an eligible loan modification either under section 4013 or in accordance with ASC Subtopic 310-40.5 If a loan modification is not eligible under section 4013, or if the institution elects not to account for the loan modification under section 4013, the financial institution should evaluate whether the modified loan is a TDR.

Accounting for Loan Modifications under Section 4013

To be an eligible loan under section 4013 (section 4013 loan), a loan modification must be (1) related to COVID-19; (2) executed on a loan that was not more than 30 days past due as of December 31, 2019; and (3) executed between March 1, 2020, and the earlier of (A) 60 days after the date of termination of the National Emergency or (B) December 31, 2020 (applicable period).

Financial institutions accounting for eligible loans under section 4013 are not required to apply ASC Subtopic 310-40 to the section 4013 loans for the term of the loan modification. Financial institutions do not have to report section 4013 loans as TDRs in regulatory reports. However, consistent with section 4013, financial institutions should maintain records of the volume of section 4013 loans. Data about section 4013 loans may be collected for supervisory purposes. Institutions do not need to determine impairment associated with certain loan concessions that would otherwise have been required for TDRs (e.g., interest rate concessions, payment deferrals, or loan extensions). For the most recent information on reporting requirements for section 4013 loans, refer to the Federal Financial Institutions Examination Council Instructions.

Accounting for Other Loan Modifications Not under Section 4013

There are circumstances in which a loan modification may not be eligible under Section 4013 or in which an institution elects not to apply Section 4013. For example, a loan that is modified after the end of the applicable period would not be eligible under Section 4013. For such loans, the guidance below applies.

Modifications of loan terms do not automatically result in TDRs. According to ASC Subtopic 310-40, a restructuring of a debt constitutes a TDR if the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. The agencies have confirmed with staff of the Financial Accounting Standards Board (FASB) that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief are not TDRs under ASC Subtopic 310-40. This includes short-term (e.g., six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or delays in payment that are insignificant. Borrowers considered current are those that are less than 30 days past due on their contractual payments at the time a modification program is implemented.

Accordingly, working with borrowers who are current on existing loans, either individually or as part of a program for creditworthy borrowers who are experiencing short-term financial or operational problems as a result of COVID-19 generally would not be considered TDRs. More specifically, financial institutions may presume that borrowers are not experiencing financial difficulties at the time of the modification for purposes of determining TDR status, and thus no further TDR analysis is required for each loan modification in the program, if:

- The modification is in response to the National Emergency;
- The borrower was current on payments at the time the modification program is implemented; and
- The modification is short-term (e.g., six months).

Government-mandated modification or deferral programs related to COVID-19 would not be in the scope of ASC Subtopic 310-40, for example, a state program that requires institutions to suspend mortgage payments within that state for a specified period.

Credit Risk

The agencies' examiners will exercise judgment in reviewing loan modifications and will not automatically adversely risk rate credits that are affected by COVID-19. All loan modifications should comply with applicable laws and regulations and be consistent with safe and sound practices (including maintenance of appropriate allowances for loan and lease losses or allowances for credit losses, as applicable). Regardless of whether modifications result in loans that are considered TDRs, section 4013 loans, or are adversely classified, agency examiners will not criticize prudent efforts to modify the terms on existing loans to affected customers.

Regulatory Capital

The FRB, the FDIC, and the OCC note that efforts to work with borrowers of one-to-four family residential mortgages as described above, where the loans are prudently underwritten, and not 90 days or more past due or carried in nonaccrual status, will not result in the loans being considered restructured or modified for the purposes of their respective risk-based capital rules.

Past Due Reporting

With regard to loans not otherwise reportable as past due, financial institutions are not expected to designate loans with deferrals granted due to COVID-19 as past due because of the deferral. A loan's payment date is governed by the due date stipulated in the legal agreement. If a financial institution agrees to a payment deferral, this may result in no contractual payments being past due, and these loans are not considered past due during the period of the deferral.
Nonaccrual Status and Charge-Offs

Each financial institution should refer to the applicable regulatory reporting instructions, as well as its internal accounting policies, to determine if loans to stressed borrowers should be reported as nonaccrual assets in regulatory reports. However, during the short-term arrangements discussed in this statement, these loans generally should not be reported as nonaccrual. As more information becomes available indicating a specific loan will not be repaid, institutions should refer to the charge-off guidance in the instructions for the Consolidated Reports of Condition and Income.

Discount Window Eligibility

Institutions are reminded that loans that have been restructured as described under this statement will generally continue to be eligible as collateral at the FRB's discount window based on the usual criteria.

Working with Customers: Consumer Protection Considerations

The agencies encourage financial institutions to consider prudent arrangements that can ease cash flow pressures on affected borrowers, improve their capacity to service debt, increase the potential for financially stressed residential borrowers to keep their homes, and facilitate the financial institution's ability to collect on its loans. Additionally, such prudent arrangements may mitigate the long-term impact of this emergency on consumers by avoiding delinquencies and other adverse consequences.

When working with borrowers, lenders and servicers should adhere to consumer protection requirements, including fair lending laws, to provide the opportunity for all borrowers to benefit from these arrangements. When exercising supervisory and enforcement responsibilities, the agencies will take into account the unique circumstances impacting borrowers and institutions resulting from the National Emergency. The agencies will take into account an institution's good-faith efforts demonstrably designed to support consumers and comply with consumer protection laws. The agencies expect that supervisory feedback for institutions will be focused on identifying issues, correcting deficiencies, and ensuring appropriate remediation to consumers. The agencies do not expect to take a consumer compliance public enforcement action against an institution, provided that the circumstances were related to the National Emergency and that the institution made good faith efforts to support borrowers and comply with the consumer protection requirements, as well as responded to any needed corrective action.

INT 20-03 Consensus

9. The Statutory Accounting Principles (E) Working Group reached a consensus to clarify that a modification of mortgage loan or bank loan terms in response to COVID-19 shall follow the provisions detailed in the April 7, 2020, "Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus" (detailed in paragraph 8) and the provisions of the CARES Act (detailed in paragraph 7) in determining whether the modification shall be reported as a troubled debt restructuring within SSAP No. 36.

10. Original Effective Date: This interpretation is effective for the specific purpose to address loan modifications in response to COVID-19. Consistent with the CARES act, this interpretation is only applicable for the term of the loan modification, but solely with respect to any modification, including a forbearance arrangement,

interest rate modification, a repayment plan and other similar arrangement that defer or delays the payment of principal or interest for a loan that was not more than 30 days past due as of December 31, 2019. As determined in the CARES Act, this interpretation will only be applicable for the period beginning on March 1, 2020 and ending on the earlier of December 31, 2020, or the date that is 60 days after the date on which the national emergency concerning the novel coronavirus disease (COVID–19) outbreak declared by the President on March 13, 2020 under the National Emergencies Act (50 U.S.C. 1601 et seq.) terminates.

11. Extension of Effective Date: On December 27, 2020, President Trump signed into law the *Consolidated Appropriations Act, 2021*, which slightly modified and extended the original CARES Act. These modifications included extending the provisions for temporary relief from troubled debt restructurings. Accordingly, on January 25, 2021, the provisions in this INT were extended to be applicable through the earlier of January 1, 2022 or the date that is 60 days after the date on which the national emergency concerning the novel coronavirus disease (COVID–19), outbreak declared by the President on March 13, 2020 under the National Emergencies Act terminates. With this extension, this INT's effective date corresponds with the current effective dates of the CARES Act. Unless the outbreak under the National Emergencies Act terminates, this INT and will automatically expire on January 2, 2022 (to include year-end 2021 financial statements reporting).

INT 20-03 Status

12. No further discussion is planned.

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Interpretation of the Statutory Accounting Principles Working Group

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

INT 20-07 Dates Discussed

May 5, 2020; May 20, 2020; January 6, 2021; January 25, 2021

INT 20-07 References

SSAP No. 26R—Bonds
SSAP No. 36—Troubled Debt Restructuring
SSAP No. 43R—Loan-Backed and Structured Securities
SSAP No. 103R—Transfer and Servicing of Financial Assets and Extinguishments of Liabilities

INT 20-07 Issue

1. A previously unknown virus began transmitting between October 2019 and March 2020, with the first deaths in the U.S. reported in early March 2020. The disease caused by the virus is known as Coronavirus Disease 2019 (COVID-19). Several states and cities have issued "stay at home" orders and forced non-essential businesses to temporarily close. This led to a significant increase in unemployment and the potential permanent closure of many businesses. Total economic damage is still being assessed however the total impact is likely to exceed $1 trillion in the U.S. alone.

2. In response to COVID-19, Congress and federal and state prudential banking regulators issued provisions pertaining to loan modifications as a result of the effects of COVID-19. These provisions are intended to be applicable for the term of the loan modification, but solely with respect to a modification, including a forbearance arrangement, interest rate modification, repayment plan, or other similar arrangements that defers or delays the repayment of principal and/or interest, that occurs during the applicable period for a loan that was not more than 30 days past due as of December 31, 2019.

3. On April 15, the Statutory Accounting Principles (E) Working Group issued *INT 20-03T: Troubled Debt Restructuring Due to COVID-19*. This interpretation provides guidance for mortgage loans and bank loans, consistent with the CARES Act and an April 7 interagency statement in recognizing troubled debt restructurings in response to COVID-19. Although the original comment letter received from interested parties proposed an expansion to all SSAP No. 26R and SSAP No. 43R debt securities, during the April 15 discussion, the comments presented from interested parties clarified their request to expand the interpretation was primarily related to private placement debt securities. The Working Group requested that interested parties provide more detail on this request.

4. On April 23, the interested parties submitted a comment letter requesting expansion consideration to all debt instruments in scope of SSAP No. 26R and SSAP No. 43R. In making these expanded requests, the interested parties' comment letter stated that from a practical standpoint, actual relief will almost exclusively apply to private placement debt securities. However, by referencing "all debt securities," it will not be necessary to provide a precise definition of a private placement debt security. In addition to considering edits for troubled debt restructuring, the comment letter also requested exceptions to impairment recognition for these securities.

5. The issues addressed in this interpretation include:

   a. Should exceptions be provided to the determination of troubled debt restructurings and impairment for all debt securities in response to COVID-19?

b. Should exceptions be considered in the determination of troubled debt restructurings for non-public debt instruments in which the reporting entity is a direct, active, participant in the modification negotiations?

c. Should exceptions be considered to assist with the determination of insignificant modifications in accordance with SSAP No. 36, paragraph 10?

INT 20-07 Discussion

Consideration of Exceptions for All Debt Securities

6. After evaluating the April 23 interested parties' comment letter, this interpretation considers statutory accounting exceptions to minimize documentation and assessment requirements for specific debt securities. However, due to the importance of state regulators having accurate and reliable financial statement information, this interpretation does not propose the following:

a. Exceptions to the recognition of a troubled debt restructuring for debt securities with modifications that result in non-insignificant concessions to a debtor that is experiencing financial difficulties.

b. Exceptions to the assessment or recognition of impairment for debt instruments.

7. With the conclusion in paragraph 6, this interpretation does not eliminate a reporting entity's responsibility to recognize modifications in debt instruments that to a debtor that is experiencing financial difficulties that qualify as concessions under SSAP No. 36. Furthermore, this interpretation does not delay the assessment and recognition of impairment for debt instruments that are not captured in scope of INT 20-04. As detailed above, these exceptions are not granted due to the importance of state regulators having timely, accurate and reliable financial information.

Consideration of Exceptions if the Reporting Entity is a Direct, Active Participant in Negotiating Modifications

8. Consideration was given as to whether exceptions should be provided for troubled debt restructuring and impairment assessments for situations in which the reporting entity is a direct, active participant in negotiating debt instrument modifications. However, due to the vast nature of non-public instruments that are currently classified as debt instruments that are designed in response to specific insurance reporting entity needs (such as collateralized fund obligations, principal protected notes, and other non-traditional securitizations), using direct, active participation as the sole threshold in determining whether exceptions should be granted was viewed as too expansive to ensure appropriate recognition of non-insignificant concessions and/or known impairments in the statutory financial statements.

Consideration of Provisions to Assist with Existing Troubled Debt Restructuring Guidance

9. Pursuant to existing guidance in SSAP No. 36, not all modifications are considered a troubled debt restructuring. In order to be troubled debt restructuring, a creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise. As such, in order to be considered a troubled debt restructuring, the debtor must be having financial difficulties and the modification must be considered a concession. Pursuant to paragraph 10 of SSAP No. 36, a restructuring that results in only a delay in payment that is insignificant is not a concession. The guidance also indicates that the following factors, when considered together, may indicate that a restructuring results in a delay in payment that is insignificant:

a. The amount of the restructured payments subject to the delay is insignificant relative to the unpaid principal or collateral value of the debt and will result in an insignificant shortfall in the contractual amount due.

b. The delay in timing of the restructured payment period is insignificant to any one of the following:

i. frequency of payments due under the debt

ii. debt's original contractual maturity,

iii. debt's original expected duration.

10. Although this interpretation does not support exceptions that would result with "significant" modifications (concessions) not being recognized, from information received, differing assessments of what could be considered insignificant, and the required documentation, may be prohibitive in providing modifications. Particularly, it has been noted that the assessments are subject to auditor assessment and there are concerns that a modification considered insignificant by a reporting entity may be subsequently assessed as a significant modification by the reporting entity's auditor.

Practical Expedients to Assessing Concessions

11. This interpretation, as a means of assisting with troubled debt restructuring assessments, provides limited-time practical-expedient determinants that can be used in accordance with existing SSAP No. 36 provisions in determining whether a modification shall be considered a troubled debt restructuring. These provisions are intended to assist reporting entities and auditors when considering whether a modification is insignificant. If a modification is considered insignificant, then the modification is not a concession, and recognition of a troubled debt restructuring, and disclosure is not required. If a modification does not meet the practical expedient provisions provided within this interpretation, the modification shall not automatically be considered a "non-insignificant" modification (concession). Rather, the reporting entity can continue to apply the existing guidance in SSAP No. 36 in assessing whether the modification is insignificant and is therefore not a concession. Modifications that qualify as concessions (do not qualify as insignificant) are required to follow the existing guidance in SSAP No. 36 as a troubled debt restructuring.

12. Specifically, this interpretation provides the following limited-time practical expedients:

a. Paragraph 10.a. of SSAP No. 36 identifies that restructured payments are considered insignificant if the delay is insignificant to the unpaid principal or collateral value of the debt and will result in an insignificant shortfall in the contractual amount due. For the duration of this interpretation, debt security restructurings in response to COVID-19 are considered to be insignificant if the restructuring results with a change that reflects a 10% or less shortfall amount in the contractual amount due.

b. Paragraph 10.b. of SSAP No. 36 identifies that restructured payments are considered insignificant if the delay in timing of the restructured payment period is insignificant to the frequency of payments due under the debt, debt's original contractual maturity or the debt's original expected duration. For the duration of this interpretation, debt security restructurings in response to COVID-19 are considered to be insignificant if the restructuring does not result in an extension of the maturity of the debt by more than three years.

13. For the duration of this interpretation, debt security restructurings in response to COVID-19 that solely impact covenant requirements are not considered troubled debt restructurings.

Practical Expedients on Debt Extinguishments and Exchanges

14. In addition to the limited-time practical expedients to SSAP No. 36, this interpretation provides an exception to assess modifications as an exchange of debt instruments under paragraph 22 of *SSAP No. 103R—Transfer and Servicing of Financial Assets and Extinguishments of Liabilities.* Pursuant to the guidance in SSAP No. 103, debt instruments that are exchanged with substantially different terms are reported as an extinguishment and a new debt instrument. Pursuant to the provisions in this interpretation:

a. Modifications that reflect a 10% or less change in contractual cash flows considered insignificant pursuant to paragraph 12.a. do not need to be further evaluated to determine whether the modification is more than minor based on the specific facts and circumstances (and other relevant considerations) surrounding the modification. As such, these investments shall not be reported as an extinguishment and a new debt instrument.

INT 20-07 Consensus

15. The Working Group reached a consensus in response to requests to consider exceptions to statutory accounting guidance for troubled debt restructurings and impairment for all debt instruments. Pursuant to this consensus:

a. This interpretation does not provide exceptions to the recognition of a troubled debt restructuring for debt securities with modifications that result in non-insignificant concessions to a debtor that is experiencing financial difficulties.

b. This interpretation does not provide exceptions to the assessment or recognition of impairment for debt instruments. Pursuant to the guidance in SSAP No. 26R, after a modification for a debt instrument, assessment of OTTI shall be based on the current terms of the debt instrument.

16. In response to assessments on the application of existing SSAP No. 36 provisions, particularly in determining whether a modification is a concession (insignificant), this consensus provides the following limited-time practical expedients in determining whether a modification is a concession under SSAP No. 36:

a. Paragraph 10.a. of SSAP No. 36 identifies that restructured payments are considered insignificant if the delay is insignificant to the unpaid principal or collateral value of the debt and will result in an insignificant shortfall in the contractual amount due. For the duration of this interpretation, debt security restructurings in response to COVID-19 are considered to be insignificant if the restructuring results with a change that reflects a 10% or less shortfall amount in the contractual amount due.

b. Paragraph 10.b. of SSAP No. 36 identifies that restructured payments are considered insignificant if the delay in timing of the restructured payment period is insignificant to the frequency of payments due under the debt, debt's original contractual maturity or the debt's original expected duration. For the duration of this interpretation, debt security restructurings in response to COVID-19 are considered to be insignificant if the restructuring does not result in an extension of the maturity of the debt by more than three years.

17. For the duration of this interpretation, debt security restructurings in response to COVID-19 that solely impact covenant requirements are not considered troubled debt restructurings.

18. In response to assessments on the application of existing SSAP No. 103R provisions, particularly in determining whether a modification that is not a troubled debt restructuring needs to be assessed as an exchange, this consensus provides the following exceptions to SSAP No. 103R:

a. Modifications that reflect a 10% or less change in contractual cash flows considered insignificant under this interpretation do not need to be further evaluated to determine whether the modification is more than minor based on the specific facts and circumstances (and other relevant considerations) surrounding the modification. As such, these investments shall not be reported as an extinguishment and a new debt instrument.

b. Modifications in response to COVID-19 that exceed the practical expedient of a 10% shortfall in contractual cash flows permitted in this interpretation that were assessed and deemed insignificant under paragraph 10 of SSAP No. 36 shall not be considered an exchange of debt instruments with substantially different terms under SSAP No. 103, paragraph 22. (Under SSAP No. 103, an exchange of debt instruments (in a nontroubled debt situation) is accomplished with debt instruments that are substantially different if the present value of cash flows under the terms of the new instruments is at least 10% different from the present value of the remaining cash flows under the terms of the original instrument.) Reporting entities shall work with auditors and regulators with the application of paragraph 10 of SSAP No. 36 to confirm that a change in contractual cash flows in excess of 10% qualifies as insignificant.

19. The Working Group highlights that modifications that would be considered troubled debt restructurings, particularly as they provide a non-insignificant concession, may be presented to the domiciliary state regulatory for a permitted practice exception to prevent troubled debt restructuring recognition and disclosure. However, the Working Group concluded that the need for reliable and accurate financial information does not permit exceptions that would allow wide-spread non-insignificant restructurings to occur and not be recognized on the statutory financial statements.

20. Original Effective Date: This interpretation is effective for the specific purpose to provide practical expedients in assessing whether modifications in response to COVID-19 are insignificant under SSAP No. 36 and in assessing whether a change is substantive under SSAP No. 103R. This interpretation will only be applicable for the period beginning on March 1, 2020 and ending on the earlier of December 31, 2020, or the date that is 60 days after the date on which the national emergency concerning the novel coronavirus disease (COVID–19) outbreak declared by the President on March 13, 2020 under the National Emergencies Act (50 U.S.C. 1601 et seq.) terminates. For clarity, this effective timeframe specifies when modifications in response to COVID-19 can be incorporated using the provisions of this interpretation. Once incorporated, the provisions of this interpretation will continue for the duration of the modification.

21. Extension of Effective Date: On December 27, 2020, President Trump signed into law the *Consolidated Appropriations Act, 2021,* which slightly modified and extended the original CARES Act. These modifications included extending the provisions for temporary relief from troubled debt restructurings. Accordingly, on January 25, 2021, the provisions in this INT were extended to be applicable through the earlier of January 1, 2022 or the date that is 60 days after the date on which the national emergency concerning the novel coronavirus disease (COVID–19), outbreak declared by the President on March 13, 2020 under the National Emergencies Act terminates. With this extension, this INT's effective date corresponds with the current effective dates of the CARES Act. Unless the outbreak under the National Emergencies Act terminates, this INT and will automatically expire on January 2, 2022 (to include year-end 2021 financial statements reporting).

INT 20-07 Status

22. No further discussion is planned.

Application of the INT 20-07 Consensus

Example 1: Payment Holiday with Extension of Payment Term for SSAP No. 26R Instrument

A. Insurer modifies a debt instrument captured in scope of SSAP No. 26R to provide a payment holiday for 6-months in response to COVID-19. For the duration of the payment holiday, no payments are due, however the original maturity of the debt instrument has been extended from 10 years to 10 years and 6 months, with all terms and conditions remaining the same except for the payment holiday.

B. The amount of restructuring is considered insignificant as it results in a less than 10% shortfall in the contractual amount due.

C. At the time of the restructuring, fair value has dropped below amortized cost.

D. At the time of the restructuring, the reporting entity believes it is probable that the reporting entity will collect all amounts due in accordance with the modified terms of the debt instrument. Furthermore, the reporting entity does not intend to sell the instrument.

Example 1 - Application of INT 20-07

1. As this modification only extends the duration 6-months and results in a less than 10% shortfall in the contractual amount due, pursuant to the practical expedients in INT 20-07, the modification is considered insignificant and not a concession under SSAP No. 36. As this modification is not a concession, accounting and reporting as a troubled debt restructuring is not required.

2. As this modification is less than 10% of the contractual cash flows, pursuant to the practical expedients in INT 20-07, further assessment is not required to determine whether the modification is more than minor under SSAP No. 103R. As such, the modification shall not be reported as an extinguishment and a new debt instrument.

3. As the reporting entity believes it is probable that they will collect all amounts due in accordance with the modified terms of the debt instrument, no other-than-temporary impairment recognition is required under SSAP No. 26R. Future assessments of impairment will be based on the modified terms of the debt instrument.

Example 2: Reduction of Covenant Terms for SSAP No. 43R Instrument

A. Insurer modifies a debt instrument captured in scope of SSAP No. 43R to eliminate covenant terms in response to COVID-19. For the remainder of the maturity of the debt instrument, the covenant terms will reflect the modification incorporated in response to COVID-19. There has been no changes to the debt instrument with the exception of the covenant requirements.

B. At the time of the restructuring, fair value has dropped below amortized cost.

C. At the time of the restructuring, the reporting entity has the intent and ability to hold debt instrument to recover the amortized cost basis. Additionally, the reporting entity has not identified that a non-interest related decline exists.

Example 2 - Application of INT 20-07

1. As this modification only pertains to covenant components (and not the amount or timing of payments), pursuant to the practical expedients in INT 20-07, the modification is considered insignificant and not a concession under SSAP No. 36. As this modification is not a concession, accounting and reporting as a troubled debt restructuring is not required.

2. As this modification does not change the contractual cash flows, pursuant to the practical expedients INT 20-07, further assessment is not required to determine whether the modification is more than minor under SSAP No. 103R. As such, the modification shall not be reported as an extinguishment and a new debt instrument.

3. As the reporting entity has the intent and ability to hold the debt security to recover the amortized cost basis, and they have not identified a non-interest related decline, an other-than-temporary impairment is not required under SSAP No. 43R.

Example 3: Reduction in Interest Rate and Covenants for SSAP No. 26R Debt Security

A. Insurer modifies a debt instrument captured in scope of SSAP No. 26R in response to COVID-19 to eliminate interest payments for a 12-month timeframe, and to eliminate covenant requirements for the same 12-month timeframe. This change will represent an 11% shortfall of the contractual amount due.

B. At the time of the restructuring, fair value has dropped below amortized cost.

C. At the time of the restructuring, the reporting entity believes it is probable that the reporting entity will collect all amounts due in accordance with the modified terms of the debt instrument. Furthermore, the reporting entity does not intend to sell the instrument.

Example 3 - Application of INT 20-07

1. As this modification results with a 11% shortfall in the contractual amount due, the reporting entity cannot assume the change is insignificant, and therefore not a concession, under the practical expedients provided within this interpretation.

2. The reporting entity may continue to assess whether this modification is an insignificant change under paragraph 10 of SSAP No. 36. (If the reporting entity elects not to further assess for insignificance, then would proceed with considering the change as a concession.) If the reporting entity concludes that the change is insignificant, and therefore not a concession, then recognition as a troubled debt restructuring is not required. If the change is assessed as insignificant, although the change in cash flows exceeds 10%, the instrument does not need to be assessed as an exchange of debt instruments pursuant to SSAP No. 103R, paragraph 22. An OTTI is not required at the time of the modification if the reporting entity has the intent and ability to hold to recover the modified amortized cost basis and if the reporting entity has not identified that a non-interest related decline exists. Future assessments of impairment will be based on the modified terms of the debt instrument.

3. If the reporting entity concludes that the change is not insignificant under paragraph 10 of SSAP No. 36, then the modification is a concession and further assessment as a troubled debt restructuring is required. Assuming there is no collateral, a realized loss shall be recognized for the difference between fair value and amortized cost. Subsequent to this realized loss recognition, future assessments of impairment will be based on the modified terms of the debt security.

December 11th Fall National Meeting - Review of GAAP Exposures for Statutory Accounting:

Pursuant to a 2014 direction from the SAPWG chair, there is a desire for the Statutory Accounting Principles (E) Working Group to be more proactive in considering FASB exposures that may be significant to statutory accounting and reporting. Historically, the SAPWG has commented on limited, key FASB exposures – mostly pertaining to insurance contracts and financial instruments. To ensure consideration of all FASB exposures, staff has prepared this memorandum to highlight the current exposures, comment deadlines, and to provide a high-level summary of the exposed item's potential impact to statutory accounting. It is anticipated that this information would assist the Working Group in determining whether a comment letter should be submitted to the FASB on the issues. Regardless of the Working Group's election to submit comments to the FASB on proposed accounting standards, under the NAIC Policy Statement on Statutory Accounting Principles Maintenance Agenda Process, issued US GAAP guidance noted in the hierarchy within Section V of the Preamble to the *Accounting Practices and Procedures Manual* must be considered by the Statutory Accounting Principles (E) Working Group.

FASB Exposures: http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1175805074609

Exposed FASB Guidance	Comment Deadline & Initial Staff Comments
Proposed Accounting Standards Update—*Interim Reporting (Topic 270): Disclosure Framework—Changes to Interim Disclosure Requirements*	January 31, 2022

Proposed Accounting Standards Update— *Interim Reporting (Topic 270): Disclosure Framework—Changes to Interim Disclosure Requirements* — *Comment Deadline: January 31, 2022*

Information from FASB Exposure Draft:
On November 1, the FASB issued this proposed Accounting Standards Update (ASU) in conjunction with their ongoing disclosure framework project. The disclosure framework project's objective is to improve the effectiveness of disclosures in the notes to the financial statements by facilitating clear communication of the information required by U.S. GAAP. This ASU is specific to interim reporting (Topic 270). Among other items, this ASU introduces a principle that if a significant event or transaction were to occur (one of which that is not already required to be disclosed per Topic 270), interim disclosure shall occur to explain the effect to the entity.

The proposed amendments would also require that an entity refer a reader of interim financial statements and notes to the previous annual financial statements when providing condensed financial statements or limited notes. In addition, the proposed amendments also would require, if applicable, that the reporting entity explain that the interim results may not be indicative of the annual results or that adjustments have been made to the period to provide a more relevant depiction of the entity's results.

Staff Review and Commentary:
Comment deadline is January 31, 2022.
Review ASU under the SAP Maintenance Process as detail in *Appendix F—Policy Statements*.

