



Date: 11/30/22

*2022 Fall National Meeting  
Tampa, Florida*

**Statutory Accounting Principles (E) Working Group**  
Tuesday, December 13, 2022  
10:00 a.m. – 12:00 p.m.

**OVERVIEW AGENDA**

**HEARING AGENDA**

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<b>2. SAPWG Hearing #1 – Review and Adoption of Non-Contested Positions —Dale Bruggeman (OH)</b>		
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• Ref #2022-10: ASU 2022-02: Troubled Debt Restructurings and Vintage Disclosures	3	6
• Ref #2022-13: Related Party - Footnote Updates	3	7
<b>3. SAPWG Hearing #1 – Review of Comments on Exposed Items—Dale Bruggeman (OH)</b>		
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<b>4. SAPWG Hearing #2 – Review of Comments on INT 22-02</b>		
• INT 22-02: Third Quarter 2022 through First Quarter 2023 Reporting of the Inflation	Pending	Pending
• Comments (Due Dec. 1)	Pending	Pending

**OVERVIEW AGENDA**

**MEETING AGENDA**

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<b>5. SAPWG Meeting – Maintenance Agenda – Pending List—Dale Bruggeman (OH)</b>		
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<b>6. SAPWG Meeting – Maintenance Agenda – Active Listing—Dale Bruggeman (OH)</b>		
• Ref #2017-33: ASU 2017-12 – Derivatives and Hedging	7	I
• Ref #2019-21: Proposed Bond Definition	8	J-K
<b>7. SAPWG Meeting – Any Other Matters Brought Before the Working Group—Dale Bruggeman (OH)</b>		
• Update on the Referral from the Macroprudential (E) Working Group	9	L
• Review of U.S. GAAP Exposures	9	M
➤ <b>Comment Deadline for all items – Friday, February 10, 2023</b>		



**Statutory Accounting Principles (E) Working Group  
Hearing Agenda #1  
December 13, 2022  
10:00 a.m. – 12:00 p.m. (ET)**

**ROLL CALL**

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

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

Note: This meeting will be recorded for subsequent use.

**REVIEW AND ADOPTION OF MINUTES**

- |                            |                       |
|----------------------------|-----------------------|
| 1. Summer National Meeting | <b>(Attachment 1)</b> |
| 2. October 6, 2022, E-Vote | <b>(Attachment 2)</b> |
| 3. October 24, 2022        | <b>(Attachment 3)</b> |
| 4. November 16, 2022       | <b>(Attachment 4)</b> |

The Statutory Accounting Principles (E) Working Group met in regulator-to-regulator sessions on Dec. 8. This regulator session was pursuant to the NAIC Open Meetings Policy paragraph 3 (discussion of specific companies, entities or individuals) and paragraph 6 (consultations with NAIC staff related to NAIC technical guidance of the *Accounting Practices and Procedures Manual*). No actions were taken during these meetings as the discussion previewed the Fall National Meeting agendas and discussed other items with NAIC staff pursuant to the NAIC open meeting policy.

**REVIEW AND ADOPTION of NON-CONTESTED POSITIONS**

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

1. Ref #2022-09: ASU 2022-01: Fair Value Hedging – Portfolio Layer Method
2. Ref #2022-10: ASU 2022-02: Troubled Debt Restructurings and Vintage Disclosures
3. Ref #2022-13: Related Party - Footnote Updates

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-09 SSAP No. 86 (Julie)	ASU 2022-01: Fair Value Hedging – Portfolio Layer Method	5 – Agenda Item	In Support	IP - 7

*Summary:*

On August 10, the Working Group exposed edits to incorporate key aspects of the U.S. GAAP guidance for portfolio layer method hedges and partial-term hedges into *SSAP No. 86—Derivatives*. The Working Group also directed NAIC staff to prepare one issue paper with all recent and upcoming derivative revisions. (The issue paper will contain other derivative revisions recently considered from U.S. GAAP.) Summary of Revisions Proposed in this Agenda Item – Portfolio Layer Method and Partial Term:

- SSAP No. 86: Revisions are proposed to paragraph 26 (fair value hedges) to detail criteria for portfolio and partial-term hedges. A small disclosure edit is proposed to paragraph 62 and guidance for reporting when the hedge is discontinued is proposed for inclusion in Exhibit C. Revisions have also been proposed to identify the adoption of *ASU 2022-01, Fair Value Hedging – Portfolio Layer Method* and to adopt with modification the guidance for partial-term hedges from ASU 2017-12. For the current proposal, the partial term hedge guidance is limited to hedged assets (not liabilities.) This is different from U.S. GAAP, but further statutory discussion is needed on basis adjustments when hedging liabilities, especially under partial term. It has been suggested that the Working Group move forward with incorporating the guidance for hedged assets at this time, as that addresses the current industry need, and consider guidance for hedged liabilities subsequently. (It was noted that industry is not aware of situations of partial-term liability hedges. Furthermore, the adjustment for hedged liabilities is a broader issue in SSAP No. 86, so the revisions would be more expansive.) Portfolio layer method hedges are limited to recognized assets under U.S. GAAP, so proposed guidance for SAP for those hedges is consistent. (Industry has identified that the FASB may consider expanding the scope of portfolio layer method hedges to liabilities. If this occurs, consideration will then occur for statutory accounting.)
- Exhibit A – Assessment of Hedge Effectiveness: Limited revisions to paragraphs 17-18 to mirror updated U.S. GAAP guidance and add a new section

*Interested Parties' Comments:*

Interested parties support the proposed changes.

*Recommendation:*

**NAIC staff recommends that the Working Group adopt the exposed SAP clarifications to SSAP No. 86 with an effective date of January 1, 2023, with early adoption permitted.** (This effective date will be populated in the exposed language in paragraphs 65c and 74f.) This item incorporates guidance from *ASU 2022-01, Fair Value Hedging – Portfolio Layer Method* and certain guidance from *ASU 2017-12, Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities* to incorporate concepts for the portfolio layer method and partial term hedges for recognized assets. An issue paper has been prepared to detail statutory accounting revisions related to derivatives for historical purposes. This item will be considered within the Meeting agenda under the original agenda item reviewing the 2017 U.S. GAAP guidance: 2017-33: *ASU 2017-22 – Derivatives and Hedging*. (Note: the exposure requested comments on the need to permit dedesignation / redesignation of existing hedges and no comments were received. As such, no edits are proposed for such accommodations.)

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-10 SSAP No. 36 (Julie)	ASU 2022-02: Troubled Debt Restructurings and Vintage Disclosures	6 – Agenda Item	No Comment	IP - 7

*Summary:*

On August 10, the Working Group exposed the intent to retain existing guidance in *SSAP No. 36—Troubled Debt Restructuring* along with revisions to the relevant literature section to identify the rejection of ASU 2022-02 and detail the GAAP/SAP differences for the accounting of troubled debt restructurings for creditors. Note that the proposed revisions to SSAP No. 36, paragraph 26 addresses ASU 2022-02 and paragraphs 27-29 detail the historical differences that are currently in paragraphs 26-30. This minor reorganization was completed in a more reader friendly format as it includes moving old effective date language from the relevant literature section to the effective date paragraph. With this exposure, comments are requested on whether the expanded U.S. GAAP disclosures with modifications should be considered for statutory accounting.

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

*Interested Parties’ Comments:*

Interested parties have no comment on this item.

*Recommendation:*

**NAIC staff recommends that the Working Group adopt the exposed SAP revisions to SSAP No. 36.** The revisions reject *ASU 2022-02: Troubled Debt Restructurings and Vintage Disclosures* for statutory accounting. These revisions update the relevant literature guidance as the adopted statutory guidance will now reflect superseded U.S. GAAP.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-13 SSAP No. 25 SSAP No. 97 (Jake)	Related Parties – Footnote Updates	7 – Agenda Item	No Comment	IP - 11

*Summary:*

On August 10, the Working Group exposed revisions to *SSAP No. 25—Affiliates and Other Related Parties* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to incorporate language to exempt foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction from the look-through provisions included in SSAP No. 25.

*Interested Parties’ Comments:*

Interested parties have no comment on this item.

*Recommendation:*

**NAIC staff recommends that the Working Group adopt the exposed revisions to SSAP No. 97 and SSAP No. 25 to incorporate language to exempt foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction from the look-through provisions included in *SSAP No. 25—Affiliates and Other Related Parties*.**

REVIEW of COMMENTS on EXPOSED ITEMS

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

1. Ref #2022-01: Conceptual Framework Updates
2. Ref #2022-11: Collateral for Loans
3. Ref #2022-12: Review of INT 03-02: Modifications to an Existing Intercompany Pooling Arrangement
4. Ref #2021-25: Leasehold Improvements after Lease Termination

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-01 SSAP No. 5R (Robin)	Conceptual Framework Updates—Liabilities	8 – Agenda Item 9 – Issue Paper	Comments Received	IP - 6

Summary:

This agenda item is reviewing *FASB Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 7, Presentation*, which identifies factors to consider when deciding how items should be displayed on the financial statements, and *Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which updates the definition of an asset and of a liability.

On August 10, 2022, the Statutory Accounting Principles (E) Working Group took the following actions:

1. Adopted, the exposed revisions, to the Preamble and *SSAP No. 4—Assets and Nonadmitted Assets and Issue Paper No. 166—Updates to the Definition of an Asset*, which documents the revisions to SSAP No. 4.
2. Re-exposed the proposed revisions and draft issue paper related to the definition change of a liability in *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets to allow additional time for industry to review the changes in accordance with statutory accounting statements.*

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

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

Interested Parties' Comments:

The Working Group adopted, as final, the exposed revisions to the Preamble and *SSAP No. 4—Assets and Nonadmitted Assets*. The revisions incorporate updates from FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7, Presentation*, which identifies factors to consider when deciding how items should be displayed on the financial statements, and Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which updates the definition of an asset. In

addition, the Working Group adopted *Issue Paper 166—Definition of Assets*, which documents the revisions to SSAP No. 4.

Additionally, the Working Group re-exposed the proposed revisions and draft issue paper related to the definition change of a liability in *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*. This exposure intends to provide additional time for industry to review the changes in accordance with statutory accounting statements.

Interested parties suggest the following language be added to both the liability (which was re-exposed) and asset definition

- The guidance in this statement shall only be applicable to the extent there is not contradictory guidance regarding liabilities addressed in other existing statements.

This will ensure that there will not be any conflicts between the new definition and specific guidance in the SSAP’s.

Recommendation:

**NAIC Staff recommends the Working Group adopt the exposed revisions and incorporate alternative language drafted by Staff (illustrated below) which has a similar approach to the wording proposed by interested parties. This language is proposed for incorporation as a footnote to the asset and liability definitions in both the recently adopted SSAP No. 4, the related Issue Paper No. 166 and to SSAP No. 5R and its related Issue Paper.**

This language is helpful because FASB treats the asset and liability definitions in Concepts Statement No. 8 like the statutory accounting statement of concepts. That is, they are concepts to consider when developing guidance. Accordingly, the update of Concepts Statement No. 8 does not change FASB authoritative literature. By contrast, SAP has treated SSAP No. 4 and SSAP No. 5R which incorporate the definition of an asset and a liability as authoritative foundational statements. FASB noted that some existing authoritative FASB literature is inconsistent with the update to Concepts Statement No. 8. **Therefore, NAIC staff recommends that the Working Group consider incorporating the following, which is similar in intent to the interested parties’ language:**

[The guidance in this statement for \(asset or liability\) recognition is applicable unless another authoritative statement provides more topic specific contradictory guidance. In such cases the topic specific guidance shall apply.](#)

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-11 SSAP No. 21R (Robin)	Collateral for Loans	10 – Agenda Item	Comments Received	IP - 7

Summary:

On August 10, the Working Group exposed the revisions to *SSAP No. 21R—Other Admitted Assets* to clarify that the invested assets pledged as collateral for admitted collateral loans must qualify as admitted invested assets. This agenda item was drafted to address an inconsistency regarding the collateral loan guidance in *SSAP No. 20—Nonadmitted Assets* and SSAP No. 21R. Both *SSAP No. 20—Nonadmitted Assets* and SSAP No. 21R identify the need for adequate collateral that qualifies as an “invested asset.” SSAP No. 20 is explicit that the investment asset collateral must qualify as an admitted asset. Recent discussions with state regulators have highlighted that although SSAP No. 21R references the guidance in SSAP No. 20, that it would be beneficial to also note the need for the collateral to qualify as an admitted invested asset.

*Interested Parties' Comments:*

Interested parties understand the need to align SSAP No. 20 and SSAP No. 21 guidance and agree with the exposed change. We recommend further clarity for one particular collateral type: an equity investment in a joint venture, partnership, or LLC ("equity investment in an LLC"), which would be accounted for under SSAP No. 48 if it were owned directly.

SSAP No. 48 investments qualify as admitted assets when acquired; however, investors are ultimately required to obtain a GAAP audit, subject to a reporting lag on a consistent annual basis in order for the investments to continue to qualify as admitted assets. Interested Parties believe the GAAP audit requirement is primarily driven by the requirement to apply equity method accounting ("EMA") and to value directly held equity investments based on the reporting entity's share of underlying GAAP equity is not applied to collateral loans in SSAP No. 21. SSAP No. 21 specifies that a fair value assessment is required to determine that sufficient collateral exists to support admittance of a collateral loan. In the rare case where the collateral itself is owned outright by the insurer, due to default on the collateral loan and foreclosure on the loan, it is primarily important that the collateral has sufficient fair value such that if it were liquidated by the insurer, it would support the initial investment in the collateral loan. Interested parties note also that the same fair value assessment is already required to support SSAP No. 21, paragraph 4a, which defines impairment rules for collateral loans, using the fair value of collateral as an input to the impairment assessment.

In short, interested parties believe that a fair value assessment is the most relevant valuation information applicable to equity-type collateral. On the other hand, audited statements are the most relevant valuation information for directly held equity-type investments but are not necessarily useful for collateral assets.

To provide additional clarity and consistency with directly acquired SSAP No. 48 investments, we would suggest additional footnote language, as follows:

In cases where an equity investment in a joint venture, partnership or LLC is pledged as collateral in a collateral loan, an adequate fair value assessment (in compliance with SSAP No. 100), is required to support an admitted asset for the purpose of collateral sufficiency. In the event that the loan is foreclosed, ownership of the SSAP No. 48 investment would initially be recognized as an admitted asset, but a GAAP audit must ultimately be obtained on a consistent annual basis to continue to support valuation and admittance of the SSAP No. 48 investment, consistent with requirements for directly acquired investments in such assets.

*Recommendation:*

**NAIC staff recommends that the Working Group discuss the exposed revisions to SSAP No. 21R and the footnote proposed by interested parties. Some regulators have expressed concerns with the footnote noting that they have concerns about having unaudited LLCs, LLC, JV etc. which are pledged as collateral. NAIC staff defers to the Working Group on the action to take at the National Meeting. The Working Group could adopt as exposed, adopt with the footnote, or consider exposure to give more time for regulatory review.**

To provide additional information on the discussion, the interested parties proposed footnote would not require SSAP No. 48 investments used as collateral loans to be supported by an audit until direct ownership. For example, if the loan defaulted, and the reporting entity takes possession of the collateral (SSAP No. 48 investment), an audit would be required for the investment to be admitted. Some regulators have expressed that in their view that SSAP No. 48 investments pledged as collateral that an audit should be required.



Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-12 INT 03-02 (Robin)	Review of INT 03-02: <i>Modification to an Existing Intercompany Pooling Arrangement</i>	11 – Agenda Item	Comments Received	IP - 8

Summary:

On August 10, the Working Group exposed the intent to nullify INT 03-02, as it is inconsistent with SSAP No. 25—*Affiliates and Other Related Parties* guidance regarding economic and non-economic transactions between related parties. The guidance in INT 03-02 can result with, unrecognized gains (dividends) or losses through the using the statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements. Treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions.

This interpretation is from 2003 and although it does not list that it is interpreting *SSAP No. 25—Affiliates and Other Related Parties* the results of the guidance create conflicts with SSAP No. 25. This is because the question in the interpretation is written as if the choice is to either follow reinsurance guidance or to follow related party guidance. Related party guidance applies to all such transactions including reinsurance. The recent changes in the interest rate environment have highlighted that using book value of invested assets can result in the transfer of unrecognized losses or of an unrecognized capital contribution.

Interested Parties' Comments:

The Working Group exposed the intent to nullify Interpretation 03-02: *Modification to an Existing Intercompany Pooling Arrangement* (INT 03-02), because of conflicts between INT 03-02 and *SSAP No. 25—Affiliates and Other Related Parties* guidance regarding economic and non-economic transactions between related parties. The guidance in INT 03-02 can result in unrecognized gains (dividends) or losses through the use of statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements.

Included in the discussion in INT 03-02 is the following:

Further, since modifications to intercompany pooling agreements typically involve the transfer of net liabilities incurred since the inception of the existing pooling agreement (i.e., prior to the effective date of the new agreement), the retroactive reinsurance accounting guidance in paragraphs 33-39 of SSAP No. 62R is applicable. Paragraph 33 states that this special accounting treatment is warranted “due to the potential abuses involving the creation of surplus to policyholders and the distortion of underwriting results...” However, paragraph 36.d. specifically applies to intercompany reinsurance arrangements, and amendments to intercompany reinsurance agreements, since the reinsurance agreement is among companies 100% owned by a common parent.

INT 03-02 notes that the “statutory accounting intent is to avoid surplus gains for the insurance group as a result of implementing a modification to an intercompany pooling arrangement.” As a result, INT 03-02 concludes that the appropriate valuation basis for assets and liabilities transferred among affiliates as part of the modification of an intercompany pooling arrangement is statutory book value. With respect to the intent of paragraph 36.d of SSAP No. 62R, INT 03-02 specifically states: “The presumption of this intent was that there would be no surplus gains to the ceding entity resulting from amendments or modifications to these types of reinsurance agreements.”

We have concerns regarding the proposal to nullify the INT and offer the following comments:

- The discussion in the proposal to nullify INT 03-02 addresses whether intercompany pooling transactions are economic or non-economic transactions. Interested parties note that, with regard to the loss reserves that are moved among entities as part of a change in intercompany pooling, the transferor(s) still has continuing involvement in the reserves (through participation in the pooling arrangement) resulting in a non-economic transaction that is currently recorded as such. Consistent with the movement of the loss reserves, the movement of bonds related to a change in an intercompany pooling arrangement is also treated as a non-economic transaction under the INT.
  - We also note that the transfer of loss reserves at statutory book values in a modification of an intercompany pooling arrangement is consistent with the guidance in SSAP No. 68 regarding statutory mergers.
- Modifications to intercompany pooling arrangements are typically effective retroactive to the beginning of the year. Therefore, the statutory book values of the liabilities at the beginning of the year are used in the transfer of underwriting and claim assets and liabilities. The use of market value for the transfer of bonds in the same transaction would create an inconsistency with the use of historical cost on the transfer of underwriting and claim assets and liabilities and would also create the opportunity for recognizing a gain in surplus, just the opposite of what the INT intended to prevent. Currently, many companies will net the amount of underwriting and claim assets and liabilities with the amount of supporting assets to minimize the movement of invested assets.
- GAAP requires that transfers among entities under common control be reflected at historical cost. The proposed nullification of INT 03-02 would result in accounting that is less conservative than GAAP for bonds with fair values in excess of amortized cost. GAAP treats the transfer of assets and liabilities between entities under common control as non-economic transactions. This same concept is contained in the guidance for intercompany or statutory mergers in SSAP No. 68. While the guidance in SSAP No. 25 is focused on legal entity reporting, the guidance in INT 03-02 is focused on the accounting for the group comprising an intercompany pooling arrangement.
- Intercompany pooling arrangements have the characteristics of a single entity, and in many ways are treated as such. Intercompany pools qualify for combined reporting, upon approval from the domiciliary regulator, for purposes of complying with the NAIC Model Audit Rule and an audit opinion may be obtained on the pool rather than individual legal entities. Additionally, intercompany pools are rated as a group by external rating agencies, the actuarial opinions are prepared on a group basis, and internal controls and governance is usually evaluated on a group rather than individual legal entity basis.
- The generation of internal gains/losses on the transfer of bonds used to settle changes in intercompany pooling arrangements, in the context of a combined group operating as a single entity, would be contrary to the concept of an economic transaction with an independent third party.
  - Since property-casualty companies do not maintain dedicated bond portfolios that are matched to particular property-casualty insurance products, nullification of the INT creates the opportunity to move gross investment assets and cherry-pick the assets used in the transaction to create a gain in surplus.
- If bonds are transferred at market value in order to settle amounts due from/to affiliates as a result of a modification of an intercompany pooling arrangement, any realized investment gains resulting from the transfer would have to be deferred at the common parent reporting entity level until such time as the security either matures or is sold to an outside party by recording a deferred gain and an unrealized loss at every common parent level of reporting within the intercompany pool. For an intercompany pool which files combined audited statutory basis financial statements, realized gains would be eliminated in the presentation of the financial statements of the intercompany pool. This would require the common parent

reporting entities to reverse all gain/loss transactions resulting from the transfer of bonds at market value within the group and establish deferred gain liabilities.

- As previously noted, the exception to retroactive reinsurance accounting in SSAP No. 62R paragraph 36.d specifically applies to intercompany reinsurance arrangements: “The accounting principles for retroactive reinsurance agreements in paragraph 34 shall not apply to the following types of agreements (which shall be accounted for as prospective reinsurance agreements unless otherwise provided in this statement)... Intercompany reinsurance agreements, and any amendments thereto, among companies 100% owned by a common parent or ultimate controlling person *provided there is no gain in surplus as a result of the transaction.*” Under the proposal to nullify the INT, legal entity intercompany pool participants which are not common parent entities will likely recognize a gain upon the transfer of bonds at market value (as payment consideration) in the modification of an intercompany pooling arrangement. A reasonable interpretation of paragraph 36.d of SSAP No. 62R would be that the totality of the intercompany pooling modification transaction should be taken into account when evaluating whether the intercompany transaction results in a surplus gain. As a result, the modification of the intercompany pooling arrangement would result in a gain in surplus and would not qualify for prospective reinsurance accounting. We do not believe this is the intent of the Working Group, nor is it desired by interested parties.
- The majority of bond investments owned by property-casualty insurers are generally held until maturity and are usually comprised of bonds that are rated NAIC 1 or 2. The use of market value for bonds still held within the combined intercompany pool would be inconsistent with the statutory accounting valuation guidance for such bonds.

Interested parties recommend that the Working Group retain INT 03-02. We believe that there are valid reasons for the inconsistency noted by NAIC staff between INT 03-02 and SSAP No. 25 given the unique nature of intercompany reinsurance pooling agreements as noted above. Interested parties also believe that the risk that a company can manipulate economic results by transferring bonds at book value is mitigated by the regulatory scrutiny over modifications to intercompany reinsurance pooling agreements (including the transfer of assets and liabilities that comprise the modification transaction), as changes to such agreements are subject to prior regulatory approval.

Recommendation:

**NAIC staff continues to recommend nullifying *Interpretation 03-02: Modifications to an Existing Intercompany Pooling Arrangement*.** NAIC staff recommends that the Working Group re-expose the intent to nullify INT 03-02 to allow for further discussion. With the re-exposure, the Working Group should also request comments on the effective date.

Staff provides the following regarding some of the key points from industry, which could be considered in the re-exposure period:

1. In the current interest rate environment, the fair value of many bonds is below book value. For example, a bond with an amortized cost of 100 with a fair value of 85. The way INT 03-02 is written a bond with a fair value of 85 could be used to settle an intercompany reinsurance pooling obligation of 100. If the reporting entity paid with cash, they would be required to pay \$100. The actual cash value of obligations when they are extinguished is a relevant measure of the transaction.
2. Using book value for measurement of payments between affiliates can result in either unrecognized of in effect dividend or losses. SSAP No. 25 requires such transfers of assets between affiliates to use fair value. If a subsidiary can pay the parent with assets that have a lower fair value than book value (ex, owes \$100 but pays with a bond of 85), this has a similar effect as an unrecognized capital contribution to the subsidiary. SSAP No. 72 requires a capital contribution to be valued using fair value.

3. Staff agrees that at the ultimate parent level such transfer of assets (in accordance with SSAP No. 25 guidance) may be noneconomic in that the parent continues to hold an interest in the same assets. Therefore, at the parent level, such transfers of assets may result in the deferral of gains. Staff believes that losses would not be deferred at the ultimate parent level.
4. Staff notes that while it may be more expedient to pay intercompany reinsurance pooling transactions with assets, the valuation used should be similar to if the obligation was extinguished with cash. Therefore, an entity can still choose to pay with assets, they just need to be valued consistently with SSAP No. 25 guidance.
5. SSAP No. 62R, paragraph 36d provides an exception to retroactive reinsurance accounting guidance which allows for prospective accounting treatment for intercompany reinsurance among 100% owned affiliated provided there is no gain to the ceding entity. If there is again to the ceding entity, there is guidance in SSAP No. 62R, paragraph 37 which requires a more punitive method of accounting than either prospective or retroactive reinsurance accounting. Therefore, NAIC staff comment is that the statutory accounting objective is to provide different treatment for retroactive reinsurance contracts if there is a gain to the ceding entity. This is another reason that the guidance in INT 03-02 is problematic. The object is to correctly measure the effects of the contract, which drives the accounting. The objective is not to obscure whether there is a gain to the ceding entity, which can happen in the event that the assets used in payment are not measured correctly.
6. Interested parties noted that modifications to intercompany pooling arrangements are typically effective retroactive to the beginning of the year. Staff notes that the payment value when the transaction is settled should be equivalent to the cash value of what is owed on the date of extinguishment of the liability.
7. Many of the interested parties’ comments regarding GAAP use of book value are more relevant to consolidated basis accounting which is not consistent with the legal entity basis of statutory accounting.
8. Interested parties’ comments noted that there is a difference in treatment for intercompany pooling participants who are not 100% owned by a common parent. NAIC staff notes that retroactive pooling agreement changes with participants that are not 100% under common control do not meet the exception to retroactive accounting provided in SSAP No. 62R, paragraph 36d. NAIC staff notes that SSAP No. 62R, paragraph 37 provides guidance for retroactive reinsurance agreements among affiliates where there is a gain to the ceding entity.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2021-25 SSAP No. 19 SSAP No. 73 (Jake)	Leasehold Improvements after Lease Termination	12 – Agenda Item	Comments Received	IP - 3

Summary:

On August 10, the Working Group exposed revisions to SSAP No. 19 and SSAP No. 73 to ensure that the guidance for the leasehold improvements matches the treatment provided in *SSAP No. 40R—Real Estate Investments*. These edits clarify that amortization of leasehold improvements will immediately end when a lease is terminated and will require that any remaining, unamortized leasehold improvement balance be immediately expensed. This includes scenarios where the lease terminates naturally or when the lessee purchases a property it was leasing but **proposes a limited, specific exclusion in SSAP No. 73 that allows leasehold improvements necessary for the functionality of specific health care delivery assets to be excluded in some cases from the purchase cost of the real estate.** It is presumed that the purchase of a property from a third party would normally include the leasehold improvements as part of the full purchase price.

Interested Parties' Comments:

The Working Group exposed this agenda item, incorporating proposed revisions after considering comments from interested parties shown highlighted in italics below. The changes provide an explicit exception to companies that provide direct healthcare. It is limited to situations where the real estate lease agreement has a purchase option that contains language that allows leasehold improvements necessary for the functionality of specific health care delivery assets to be excluded from the purchase cost of the real estate.

SSAP No. 19:

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter of their estimated useful life or the remaining lease term, as defined in SSAP No. 22R. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired. The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity *lessee*. *Such improvements related to the functionality of health care delivery assets shall follow the accounting, reporting and impairment guidance in SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities, and an exception to the application of this guidance to leasehold improvements necessary for the functionality of health care delivery assets is included in SSAP No. 73.* 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 *lessee but excludes situations where the real estate lease agreement has a purchase option that contains language that allows leasehold improvements necessary for the functionality of specific health care delivery assets<sup>1</sup> to be excluded from the purchase cost of the real estate. Upon acquisition, such leasehold improvements necessary for the functionality of healthcare delivery assets shall follow the guidance for health care delivery assets in this statement.* If leased real estate is acquired, recognition of the real estate shall follow the provisions in SSAP No. 40R—*Real Estate Investments*.

<sup>1</sup> The application of this exception is limited to leasehold improvements necessary for the functionality of health care delivery assets that qualified for admittance under SSAP No. 73.

Interested parties continue to agree that, in most cases, unamortized lessee owned leasehold improvements should be immediately expensed if the lease is terminated. However, in the situation where the reporting entity purchases a property that it was previously leasing, immediate expensing may not be appropriate in all circumstances as leasing and purchasing of assets is a complex business activity and takes many forms and structures.

*General Concerns*

The NAIC appears to have based the accounting conclusions on the premise that in all circumstances the purchase price of the leased asset includes the *lessee* purchased and owned leasehold improvements. However, interested parties (who engage in these transactions directly) continue to emphasize that they have not seen this in practice. These transactions, when material, have been audited by external auditors and State Departments of Insurance and no double counting of assets has been identified. It would be helpful to interested parties if the NAIC could share examples where they are seeing double counting of assets in these transactions by reporting entities.

Additionally, the NAIC has noted concerns of entities being able to admit leasehold improvements that were previously non-admitted under SSAP No 19. However, we note there are several instances where an asset can be non-admitted in one period, and subsequently admitted in another upon conforming to the requirements of certain SSAP's (e.g., certain affiliate receivables that were non-admitted due to lack of written agreement as to due date pursuant to SSAP No 25, or certain healthcare receivables that do not immediately conform to the requirements under SSAP No 84, among others). Moving from leasing to owning the underlying asset that the leasehold improvements are attached to changes the overall economics (i.e., the leasehold improvement can now be utilized in a liquidation event given the utility it provides with the building, whereas in a lease situation, given the limited control over the leased facility, the leasehold improvement may not be useful in a liquidation event on a standalone basis and non-admission would be appropriate).

*Healthcare Delivery Assets Exception*

While interested parties appreciate the exception for leasehold improvements that are accounted for in the scope of SSAP No 73 for health care delivery assets, interested parties note that the requirement that contracts include explicit provisions about the exclusion of the leasehold improvements in a purchase situation is not practical and will be onerous particularly for entities that have a high volume of lease activity. Additionally, it is not clear why there would be a difference in accounting treatment between sectors of the insurance industry when the overall economics of leasing is generally the same. This difference adds an unusual layer of complexity.

*Recommendation*

For the reasons noted above and to have guidance that more faithfully represents what is occurring in situations where the underlying leased real estate is purchased, interested parties recommend the following language be considered in both SSAP No 19 and 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. The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity lessee. Such improvements related to the functionality of health care delivery assets shall follow the accounting, reporting and impairment guidance in SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities, and an exception to the application of this guidance to leasehold improvements necessary for the functionality of health care delivery assets is included in SSAP No. 73. If leased real estate is acquired, recognition of the real estate shall follow the provisions in SSAP No. 40R—Real Estate Investments. In situations where the reporting entity lessee can demonstrate through appraisals or other means that the lessee owned leasehold improvements are not included in the purchase price of the

acquired leased real estate, the unamortized leasehold improvements shall be added to the cost basis of the acquired real estate.

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 lessee. ~~but excludes situations where the real estate lease agreement has a purchase option that contains language that allows leasehold improvements necessary for the functionality of specific health care delivery assets<sup>2</sup> to be excluded from the purchase cost of the real estate. Upon acquisition, such leasehold improvements necessary for the functionality of healthcare delivery assets shall follow the guidance for health care delivery assets in this statement.~~ If leased real estate is acquired, recognition of the real estate shall follow the provisions in *SSAP No. 40R—Real Estate Investments*. In situations where the reporting entity lessee can demonstrate through appraisals or other means that the lessee owned leasehold improvements are not included in the purchase price of the acquired leased real estate, the unamortized leasehold improvements shall be added to the cost basis of the acquired real estate.

*Other Matters*

Interested parties want to highlight that there is an editorial modification needed to SSAP No 19, paragraph 9. It references the legacy guidance and needs to be updated to reflect how the lease term is defined in SSAP No 22R. Accordingly, we recommend the following:

SSAP No. 19, paragraph 9:

9. The acquisition cost of depreciable assets, net of salvage, shall be depreciated against net income over the estimated useful lives of the assets in a systematic and rational manner. The acquisition cost of a leasehold improvement shall be amortized against net income over the shorter of its estimated useful life or the ~~original~~ lease term as defined in SSAP 22R ~~excluding options or renewal periods~~. For leasehold improvements capitalized subsequent to inception of the lease, the cost shall be amortized over the shorter of its estimated useful life or the remaining ~~original~~ lease term ~~excluding options or renewal periods~~. Amounts capitalized for leasehold improvements in periods subsequent to the original lease term (i.e., during renewal periods), are amortized utilizing the shorter of the estimated useful life of the asset or the remaining ~~term of the renewal period~~ lease term.

*Recommendation:*

**NAIC staff recommends that the Working Group adopt the exposed revisions clarifying that, except for limited exclusions provided in *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities*, all remaining leasehold improvements shall be immediately expensed at the termination of a lease. NAIC staff also recommend incorporating the consistency edits to SSAP No. 19, paragraph 9, that was suggested by the interested parties, which addresses an item that was missed during a prior agenda item for leasehold improvements. Staff recommend that this revision be included in the adoption as illustrated in the interested parties’ comments above.**

**NAIC staff does not recommend incorporating the other revisions proposed by interested parties. NAIC staff note that in an arm’s length real estate transaction, the seller of the property (with its brokers and representatives) is obligated to get the best sales price possible based on the true condition of the asset,**

**including all enhancements added by the lessee that are fixed to the structure. In a scenario suggested by some of the interested parties' comments where leasehold improvements remain as assets after a lessee has purchased the real estate, the book value of real estate would be the fair market value of the real estate plus the leasehold improvements, which would result in a fundamental overstatement of the value of the assets reported. Additionally, to address the comment on page 12 regarding a concern about the leasehold improvements moving from nonadmitted to admitted because of the purchase of the real estate, NAIC staff believe that this transaction does not change the fact that leasehold improvements are not separate assets that can be used to meet policyholder obligations and should not meet the definition of an admitted asset.**

**The comment letters are included in Attachment 13 (12 pages).**

[https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/Fall - December/Hearing/0-12-2022 - SAPWG Hearing Agenda.docx](https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National%20Meetings/A.%20National%20Meeting%20Materials/2022/Fall%20-%20December/Hearing/0-12-2022%20-%20SAPWG%20Hearing%20Agenda.docx)



Draft: 8/17/22

Statutory Accounting Principles (E) Working Group  
Portland, Oregon  
August 10, 2022

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met in Portland, OR, Aug. 10, 2022. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Sheila Travis (AL); Kim Hudson and Susan Bernard (CA); William Arfanis (CT); Rylynn Brown (DE); Susan Berry (IL); Melissa Gibson (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Melissa Greiner, Matt Milford, and Diana Sherman (PA); Amy Garcia and Jamie Walker (TX); Greg Chew, Doug Stolte, and David Smith (VA); and Amy Malm (WI).

1. Adopted its July 18, May 24, and Spring National Meeting Minutes

The Working Group met July 18 and May 24. During its July 18 meeting, the Working Group exposed proposed reporting changes to Schedule D-1: Long-Term Bonds, which included a proposal for separate schedules for issuer obligations and asset-backed securities (ABS), proposed to be named Schedule D-1-1 and Schedule D-1-2, respectively. The exposure also included granular reporting lines, column additions, and instructional changes to improve consistency and transparency in the information reported.

During its May 24 meeting, the Working Group adopted statutory accounting principle (SAP) clarifications to: 1) *Statement of Statutory Accounting Principles (SSAP) No. 25—Affiliates and Other Related Parties* and *SSAP No. 43R—Loan-Backed and Structured Securities* to clarify the identification and reporting requirements for affiliated transactions and incorporate new reporting codes in various investment schedules to identify investments that involve related parties; and 2) *Interpretation (INT) 22-01: Freddie Mac When-Issued K-Deal (WI Trust) Certificates* to clarify that from that date of origination, investments in the Freddie Mac “When Issued K-Deal” (WI) Program are in scope of SSAP No. 43R. Additionally, the Working Group adopted agenda item 2022-03: Premium Adjustments Allocated to Jurisdictions, which did not result in statutory revisions but expressed support for a corresponding blanks proposal—2022-10BWG—that included instructional changes to Schedule T, the State Page, and Accident and Health Policy Experience Exhibit (AHPEE), clarifying guidance for premium adjustments.

The Working Group also met Aug. 4 in regulator-to-regulator session, pursuant to paragraph 3 (specific companies, entities or individuals) and paragraph 6 (consultations with NAIC staff related to NAIC technical guidance) of the NAIC Policy Statement on Open Meetings to discuss its Summer National Meeting agenda.

Ms. Walker made a motion, seconded by Ms. Malm, to adopt the Working Group’s July 18 (Attachment One-A), May 24 (Attachment One-B), and April 4 (see *NAIC Proceedings – Spring 2022, Accounting Practices and Procedures (E) Task Force, Attachment One*) minutes. The motion passed unanimously.

2. Adopted Non-Contested Positions

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

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

a. Agenda Item 2022-04

Mr. Bruggeman directed the Working Group to agenda item 2022-04: ASU 2021-10, Government Assistance (Attachment One-D). Jim Pinegar (NAIC) stated that this agenda item reviews *Accounting Standard Update (ASU) 2021-10, Government Assistance: Disclosures by Business Entities about Government Assistance*, which increases transparency on certain types of government assistance by increasing disclosures in the financial statements. He stated that due to the rarity of such disclosures, this agenda item proposed SAP clarifications to SSAP No. 24—*Discontinued Operations and Unusual or Infrequent Items*, incorporating limited disclosures from ASU 2021-10. The proposed additions will require identification and the terms and provisions of assistance received.

b. Agenda Item 2022-05

Mr. Bruggeman directed the Working Group to agenda item 2022-05: ASU 2021-09, Leases, Discount Rate for Lessees (Attachment One-E). Jake Stultz (NAIC) stated that this agenda item reviews *ASU 2021-09, Leases (Topic 842), Discount Rate for Lessees That Are Not Public Business Entities*, which states that when the rate implicit in the lease is readily determinable for any individual lease, the lessee should use that rate, rather than a risk-free rate or an incremental borrowing rate, regardless of whether it has made the risk-free rate election. As statutory accounting generally requires that all leases be classified as operating leases, this agenda item proposed SAP clarifications to reject ASU 2021-09 in SSAP No. 22R—*Leases* for statutory accounting.

c. Agenda Item 2022-06

Mr. Bruggeman directed the Working Group to agenda item 2022-06: ASU 2021-07, Compensation – Stock Compensation (Attachment One-F). Mr. Pinegar stated that this agenda item reviews *ASU 2021-07, Compensation – Stock Compensation (Topic 718), Determining the Current Price of an Underlying Share for Equity-Classified Share-Based Awards*, which offers nonpublic companies a practical expedient to one of the inputs necessary—current price input—for option-price modeling. He stated that when equity share options or similar instruments are granted in a share-based payment transaction, the fair value, which is used to determine expense recognition at inception and during any subsequent award modifications, is estimated using an option-pricing model valuation technique. ASU 2021-07 provides a third practical expedient for nonpublic companies, and it is the third practical expedient permitted under U.S. generally accepted accounting principles (GAAP), of which the two other practical expedients are currently permitted under SSAP No. 104R—*Share-Based Payments*. Accordingly, this agenda item proposed SAP clarifications to SSAP No. 104R to incorporate this third new practical expedient.

d. Agenda Item 2022-07

Mr. Bruggeman directed the Working Group to agenda item 2021-07: ASU 2021-08, Business Combinations (Attachment One-G). Mr. Pinegar stated that this agenda item reviews *ASU 2021-08, Business Combinations, Accounting for Contract Assets and Contract Liabilities from Contracts with Customers*, which requires acquiring entities to apply the “Revenue from Contracts with Customers” guidance (Topic 606) when valuing and recognizing contract-related assets and liabilities in a business combination. Prior to the issuance of ASU 2021-08, acquirers would generally recognize items using the fair value on the date of acquisition; however, that approach would generally result in lower liability recognition than required under Topic 606. Mr. Pinegar stated that in keeping with historical precedent, this agenda item proposed SAP clarifications to reject ASU 2021-08 in SSAP No. 47—*Uninsured Plans*. However, as ASU 2021-08 is related to business combinations, the agenda item also proposes to reject ASU 2021-08 in SSAP No. 68—*Business Combinations and Goodwill*, noting that rejection does not impact the determination of U.S. GAAP book value in an acquired entity.

3. Reviewed Comments on Exposed Items – Minimal Discussion

a. Agenda Item 2021-20

Mr. Bruggeman directed the Working Group to agenda item 2021-20: Effective Derivatives – ASU 2017-12. Julie Gann (NAIC) stated that during the 2021 Fall National Meeting, the Working Group exposed an agenda item that summarized the key changes detailed in *ASU 2017-12: Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities* with a request for comments on the extent revisions were needed in *SSAP No. 86—Derivatives*. She stated that ASU 2017-12 was originally reviewed in 2017; however, the Working Group only adopted certain disclosure provisions with the intent to review the full ASU subsequently. During the Spring National Meeting, the Working Group exposed additional guidance from ASU 2017-12, proposing a new SSAP No. 86, Exhibit A on assessing hedge effectiveness, which would replace the current Exhibit A and Exhibit B. Ms. Gann stated that these proposed revisions would align U.S. GAAP guidance with statutory accounting so there would be consistency in the determination of hedge effectiveness. In addition, the exposure included revisions to what is permitted as excluded components and explicit measurement methods for each type of excluded component. She stated that the proposed revisions would be considered an adoption, with modification, from U.S. GAAP on the hedge effectiveness guidance from ASU 2017-12, as statutory specific measurement guidance is needed for excluded components due to the different measurement concepts between U.S. GAAP and SAP. She stated that NAIC staff recommended adoption of the exposed revisions to SSAP No. 86, along with guidance to detail an effective date of Jan. 1, 2023, with early adoption permitted, and the guidance adopted from U.S. GAAP. She stated that companies that elect to early adopt would have different financial results for year-end 2022 from those that adopt in 2023; however, most companies are anticipated to early adopt, and the 2023 time frame is only for companies that need additional time for system changes. In addition, it was recommended that the Working Group sponsor a blanks proposal to incorporate new disclosures and electronic column reporting fields in Schedule DB for year-end 2023. However, as the new data-captured elements will not be available until 2023, any company electing to adopt these provisions in 2022 will be required to complete the disclosures in narrative form. She stated that as the modifications to SSAP No. 86 are new SAP concepts, NAIC staff recommend drafting an issue paper to document the revisions captured in this agenda item, as well as other derivative revisions from the review of ASU 2017-12, as certain elements from the ASU are still pending statutory accounting review.

Mr. Hudson made a motion, seconded by Mr. Kasinow, to adopt the exposed new SAP concept revisions to SSAP No. 86, incorporating the Jan. 1, 2023, effective date, with early adoption permitted, and relevant literature language proposed by NAIC staff. The motion included direction to sponsor a blanks proposal and draft an issue paper to document the revisions (Attachments One-H, One-I, and One-J). The motion passed unanimously.

b. Agenda Item 2022-02

Mr. Bruggeman directed the Working Group to agenda item 2022-02: SSAP No. 48 – Alternative Valuation of Minority Ownership Interests. Mr. Pinegar stated that this agenda item reviews the audited U.S. tax equity exception provided in *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*. He stated that this agenda item arose trying to address questions regarding at which level the audited U.S. tax basis should apply, as there was ambiguity on whether the insurer’s audit would suffice or if the audit should reside at the investee level. He stated that informal comments from a representative of the American Institute of Certified Public Accountants (AICPA) indicated that they were not aware of anyone using the audited U.S. tax basis method, which is permitted as an exception if audited U.S. GAAP basis financial statements were not available. They further indicated that they were not aware of anyone issuing U.S. tax basis equity audits. Mr. Pinegar stated that this agenda item proposed two options for consideration. The first option sought input as to whether the audited U.S. tax basis exception was being used, and if not, whether it should be removed as a permissible exception to audited

U.S. GAAP basis in SSAP No. 48. The second option proposed an SAP clarification that if the audited U.S. tax basis exception is retained, the audit is required at the investee (investment) level. He stated that in response to comments received from interested parties, which indicated that insurers are using the audited U.S. GAAP basis exception, NAIC staff recommended the retention of the audited U.S. tax equity exception in SSAP No. 48 but also clarification that the audit is required at the investee level.

Mr. Clark made a motion, seconded by Mr. Chew, to adopt the exposed SAP clarification to retain the U.S. tax equity exception permitted in SSAP No. 48 but also to clarify that the audit is required to occur at the investee level (Attachment One-K). The motion passed unanimously.

#### 4. Reviewed Comments on Exposed Items

##### a. Agenda Item 2022-01

Mr. Bruggeman directed the Working Group to agenda item 2022-01: Conceptual Framework – Updates. Mr. Pinegar stated that this agenda item reviews Financial Accounting Standards Board (FASB) Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements* (Chapter 4) and Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7, Presentation* (Chapter 7) for their impact on statutory accounting. He stated that the final topic reviewed Chapter 7 and proposed a minor SAP clarification to the Preamble, updating a paragraph reference to *Statement of Financial Accounting Concept 5*, which was superseded by Chapter 7. He stated that Chapter 7 describes what information should be included in the financial statements and how appropriate presentation can contribute to the objective of financial reporting. However, Chapter 7 concepts were not expected to modify current guidance, other than to update references to superseded accounting concepts.

Mr. Pinegar stated that Chapter 4 introduced revised definitions for the terms “asset” and “liability,” simplifying their descriptions and redefining their essential characteristics. He stated that the historical definitions no longer include the term “probable” or the phrase “as the result of past transactions or events,” citing that the rationale for their removal has been documented in the agenda item and the related issue papers. He stated that as statutory accounting references these definitions, this agenda item proposed SAP clarifications to SSAP No. 4—*Assets and Nonadmitted Assets* and SSAP No. 5R—*Liabilities, Contingencies and Impairments of Assets* to reflect the FASB’s updated definitions. He stated that in addition, the Working Group exposed two issue papers, each articulating the changes for SSAP No. 4 and SSAP No. 5R, the FASB’s rationale for the changes, and discussion as to why the updates are proposed to be SAP clarifications in nature. He stated that while interested parties did not have any comments on the asset definitional change, or its related issue paper, they did offer comments on the recommended changes to the definitional change of a liability. He stated that interested parties recommended an SSAP-by-SSAP review to ensure that there would not be any unintended consequences, specifically the requirement to now recognize a liability for an item that had not previously been recognized as such. He stated that in response, NAIC staff are of the opinion that combined with the concept of conservatism as detailed in the Preamble, an item meeting the definition of a liability, either under the current or new proposed definition, should likely be reported as a liability for statutory accounting. If there are specific circumstances or instruments that do not warrant recognition as a liability, those should be identified by industry with a request for an individual evaluation by the Working Group. To permit time for a further assessment by industry before considering adoption of the exposed revisions, Mr. Pinegar stated that NAIC staff would recommend a re-exposure of the proposed liability revisions and its related issue paper.

Mr. Bruggeman stated that as statutory accounting integrates these terms at the standard level, they have a higher authority level than U.S. GAAP, as they only reference the terms in concept statements; thus, there is a

differentiation in the accounting hierarchy. In response to interested parties requesting an SSAP-by-SSAP review, he said he would be supportive of a re-exposure of the liability portion of the agenda item so interested parties can present specific instruments or items of consideration. Michael M. Monahan (American Council of Life Insurers—ACLI) stated that interested parties support the re-exposure so they can review for specific instances that may warrant the Working Group’s review.

Mr. Hudson made a motion, seconded by Ms. Walker, to adopt the exposed SAP clarifications to the Preamble and the updated definition of an asset in SSAP No. 4 and its related issue paper, *Statutory Issue Paper No. 166—Updates to the Definition of an Asset* (Attachments One-L and One-M). The motion passed unanimously.

In a separate action, Mr. Hudson made a motion, seconded by Ms. Walker, to re-expose the proposed definition change of a liability in SSAP No. 5R and its related issue paper. The motion passed unanimously.

#### 5. Considered Maintenance Agenda – Pending Listing – Exposures

Mr. Hudson made a motion, seconded by Ms. Malm, to move agenda items 2022-09 through 2022-13 to the active listing and expose all items for a public comment period ending Oct. 7. The motion passed unanimously.

##### a. Agenda Item 2022-09

Mr. Bruggeman directed the Working Group to agenda item 2022-09: ASU 2022-01: Fair Value Hedging – Portfolio Layer Method. Ms. Gann stated that ASU 2017-12 incorporated a “last-of-layer” method to make portfolio fair value hedge accounting more accessible for specific assets. Under a last-of-layer approach, for a closed portfolio of prepayable financial assets or one or more beneficial interests secured by a portfolio of payable financial instruments, entities were allowed to hedge a stated amount of the assets or assets in a closed portfolio that is anticipated to be outstanding for the designated hedge period. However, since the issuance of ASU 2017-12, the FASB has issued another update in *ASU 2022-01, Fair Value Hedging – Portfolio Layer Method* to expand the last-of-layer approach for additional instruments. Ms. Gann stated that this agenda item proposed new SAP concepts to incorporate portfolio layer method hedging for statutory accounting. She stated that this guidance would be limited to recognized assets, which is consistent with U.S. GAAP. In addition, this agenda item would permit partial term hedging, a method that permits entities to enter fair value hedges of interest rate risk for only a portion of the term of the hedged financial instrument. She stated that while this is proposed to be allowed for statutory accounting, it is proposed to be limited to recognized assets. While U.S. GAAP permit this approach for both assets and liabilities, if permitted for statutory accounting, partial term hedges for liabilities may reduce the carrying cost of the liability when in fact the liability has not been extinguished. Ms. Gann stated that industry suggested the difference to U.S. GAAP to permit the partial term hedging approach to be incorporated for statutory accounting for recognized assets. Subsequent consideration to expand the partial term approach to liabilities could occur as part of a broader topic to review how basis adjustments are reflected under the existing derivative guidance. Ms. Gann stated that the proposed revisions would introduce additional new SAP concepts into SSAP No. 86, and if adopted, they would be integrated into the issue paper being drafted to encompass all revisions to SSAP No. 86.

##### b. Agenda Item 2022-10

Mr. Bruggeman directed the Working Group to agenda item 2022-10: ASU 2022-02: Troubled Debt Restructuring and Vintage Disclosures. Ms. Gann stated that this agenda item reviews *ASU 2022-02: Troubled Debt Restructurings and Vintage Disclosures*, which effectively eliminated prior U.S. GAAP guidance for troubled debt restructurings in support of using an allowance for credit losses pursuant to *ASU 2016-13: Measurement of Credit Losses on Financial Instruments*. She stated that this agenda item proposes rejecting ASU 2022-03 in SSAP No.

36—*Troubled Debt Restructuring* to maintain the current guidance. She stated that although the guidance is retained, the exposure includes revisions in SSAP No. 36 to detail U.S. GAAP versus SAP differences for the accounting of troubled debt restructurings for creditors, and the SSAP would no longer converge with authoritative U.S. GAAP guidance.

c. Agenda Item 2022-11

Mr. Bruggeman directed the Working Group to agenda item 2022-11: Collateral for Loans. Robin Marcotte (NAIC) stated that this agenda item proposes revisions to *SSAP No. 21R—Other Admitted Assets* to clarify that the invested assets pledged as collateral for admitted collateral loans must qualify as admitted assets. She noted that the proposed revisions would address consistency differences between *SSAP No. 20—Nonadmitted Assets* and *SSAP No. 21R*.

d. Agenda Item 2022-12

Mr. Bruggeman directed the Working Group to agenda item 2022-12: Review of INT 03-02: Modification to an Existing Intercompany Pooling Arrangement. Ms. Marcotte stated that this agenda item proposes to nullify *INT 03-02: Modification to an Existing Intercompany Pooling Arrangement*, as it contains historical guidance that conflicts with *SSAP No. 25*. She stated that INT 03-02 directs certain transfers, including economic transfers, between affiliates to be recorded at book value, rather than fair value, as is directed in *SSAP No. 25*. Mr. Bruggeman stated that INTs are typically issued for specific situations, and while this INT was issued in 2003, the rationale for having this accounting direction has likely lapsed, and review of INT 03-02 is warranted.

e. Agenda Item 2022-13

Mr. Bruggeman directed the Working Group to agenda item 2022-13: Related Parties – Footnote Updates. Mr. Stultz stated that this agenda item was drafted in response to comments received on agenda item 2021-21: Related Party Reporting, which was adopted by the Working Group on May 24. During that meeting, interested parties suggested extending the exemption to foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction, which are within the scope of *SSAP No. 30R—Unaffiliated Common Stock*. Mr. Stultz stated that in response to comments received, the Working Group directed NAIC staff to draft an agenda item to propose footnote revisions to *SSAP No. 25* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, which would make these items consistent with *SSAP No. 30R*.

6. Considered Maintenance Agenda – Active Listing

a. Agenda Item 2021-25

Mr. Bruggeman directed the Working Group to agenda item 2021-25: Leasehold Improvements After Lease Termination. Mr. Stultz stated that this agenda item proposed SAP clarifications to *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities* to address questions about the treatment of leasehold improvements in situations where a leased property is purchased by the lessee during the lease term. He stated that the revisions propose to clarify that in any scenario in which a lease terminates early, all remaining leasehold improvements shall be immediately expensed, even if the lessee purchases the leased property. This proposed guidance was initially exposed at the 2021 Fall National Meeting, from which interested parties provided comments requesting consideration of an exception in specific circumstances. Mr. Stultz stated that in response, the Working Group

directed staff to further work with interested parties on this guidance. He stated that NAIC staff have updated the proposed language to allow companies that provide direct health care to exclude situations where the real estate lease agreement has a purchase option that contains language that allows leasehold improvements necessary for the functionality of specific health care delivery assets to be excluded from the purchase price of the real estate. In these limited scenarios, after purchase, the leasehold improvements necessary for the functionality of health care delivery assets would follow existing guidance for health care delivery assets in SSAP No. 73.

Mr. Hudson made a motion, seconded by Ms. Travis, to expose agenda item 2021-25 for a public comment period ending Oct. 7. The motion passed unanimously.

b. Agenda Item 2019-21

Mr. Bruggeman directed the Working Group to agenda item 2019-21: Proposed Bond Definition. Ms. Gann stated that this agenda item reflects efforts between industry and state insurance regulators to principally define a bond for reporting on Schedule D-1. She stated that this agenda contains several items for exposure, summarized as follows:

- An updated principles-based bond definition, which has been revised to reflect limited changes as directed by the Working Group during its July 18 meeting.
- An updated issue paper, which reflects the overall discussion from the Working Group's July 18 meeting, as well as noted edits to the guidance. For example, the draft issue paper includes discussion on feeder funds and how the assessment of these funds, for reporting purposes, should focus on the substance of the underlying investments in determining bond classification.
- Proposed revisions to *SSAP No. 26R—Bonds* and *SSAP No. 43R* to incorporate the principles-based bond definition in authoritative accounting guidance. *SSAP No. 26R* is proposed to contain the principal bond definition; however, *SSAP No. 43R* contains several proposed revisions, including a name change to "Asset Backed Securities."

Ms. Gann stated that this agenda item also has a current exposure of proposed reporting changes to Schedule D-1 and related instruction revisions. She stated that although the current items reflect the bulk of the anticipated edits for the principles-based bond definition, additional revisions will be necessary, specifically to restrict ABS from the scope of *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* and other various references in *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. Mr. Bruggeman stated that NAIC staff have spent considerable time evaluating the proposed modifications, including the option to combine *SSAP No. 26R* and *SSAP No. 43R* into one *SSAP*. However, due to distinct differences, maintaining two separate *SSAPs* appears to be the best approach. In addition, due to the extent of the revisions, and the blanks deadlines, the earliest these revisions are likely to be in effect is Jan. 1, 2025; although, the potential still exists for Jan. 1, 2024. Mr. Bruggeman reminded the Working Group that these revisions are focused on accounting and reporting changes, and elements pertaining to NAIC designations or risk-based capital (RBC) charges would be addressed by the respective groups. In a response to an inquiry from Mr. Monahan, Mr. Bruggeman stated that the comment deadline is Oct. 7; however, due to the extent of the revisions, an extension could be requested, if needed.

Ms. Weaver made a motion, seconded by Mr. Clark, to expose agenda item 2019-21, which includes the updated principle-based bond definition, updated issue paper, and proposed revisions to SSAP No. 26R and SSAP No. 43R for a public comment period ending Oct. 7. The motion passed unanimously.

7. Discussed Other Matters

a. Review of U.S. GAAP Exposures

Ms. Marcotte stated that there were two current FASB exposures; however, NAIC staff recommend reviewing the final ASUs under the SAP Maintenance Process, as detailed in *Appendix F—Policy Statements*. Ms. Gann stated that NAIC staff are monitoring the Inflation Reduction Act of 2022 for any potential impact to insurers, specifically its impact on deferred tax assets/liabilities and subsequent events for financial reporting purposes. Mr. Monahan stated that industry is also monitoring the Inflation Reduction Act of 2022 closely, as it will likely affect several insurers. Jonathan Rodgers (National Association of Mutual Insurance Companies—NAMIC) stated that NAMIC is attempting, either through legislation or an interpretation from the U.S. Department of the Treasury (Treasury Department), that the financial statements of record, which are used to determine a minimum tax per the act, should be statutory statements, rather than U.S. GAAP financial statements. He stated that if changes are needed in *SSAP No. 101—Income Taxes* because of this legislation, NAMIC would request an effective date to occur no earlier than the fourth quarter of 2023.

b. Update for Life Actuarial (A) Task Force Coordination

Ms. Marcotte stated that the Working Group was provided with a listing of the amendments made to the *Valuation Manual* by the Life Actuarial (A) Task Force since the 2021 Summer National Meeting. She stated that there were not any items identified that require Working Group action (Attachment One-N).

c. Received a Referral from the Macroprudential (E) Working Group

Mr. Bruggeman stated that the Working Group has received a referral from the Macroprudential (E) Working Group (Attachment One-O), which includes its work plan (*see NAIC Proceedings – Summer 2022, Financial Stability (E) Task Force, Attachment One-B*). He stated that the referral has several items, some of which are in progress.

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

[https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2022/fall - december/hearing/1 - 8.10.22 sapwgmin.docx](https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national%20meetings/a.%20national%20meeting%20materials/2022/fall-december/hearing/1-8.10.22%20sapwgmin.docx)



Draft: 10/17/22

Statutory Accounting Principles (E) Working Group  
E-Vote  
October 6, 2022

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded Oct. 6, 2022. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Sheila Travis (AL); Kim Hudson (CA); Rylynn Brown (DE); Eric Moser (IL); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Melissa Greiner (PA); Jamie Walker (TX); David Smith (VA); and Amy Malm (WI).

1. Exposed Interpretations

The Working Group conducted an e-vote to consider exposure of two interpretations that were in response to the Inflation Reduction Act, which is effective for tax years 2023 and after. The Inflation Reduction Act has a corporate alternative minimum tax (CAMT). Under the existing statutory accounting guidance, an entity that knows it is subject to the new CAMT must consider the impact on the statutory valuation allowance and the admissibility of deferred tax assets in the period of enactment.

The interested parties provided a comment letter with industry requests regarding the Inflation Reduction Act (Attachment One-A). The two interpretations that were considered for exposure were as follows:

- a. *INT 22-02: Third Quarter 2022 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax.* This interpretation does not require financial reporting changes for third quarter 2022 because a reasonable estimate cannot be made. It requires disclosure and allows a subsequent event exception. INT 22-02 has a comment deadline of Oct. 14.
- b. *INT 22-03: Inflation Reduction Act - Corporate Alternative Minimum Tax –* This interpretation addresses fourth quarter 2022 and interim 2023 reporting. It requires reporting when reasonable estimates can be made. It provides some subsequent event exceptions regarding the CAMT to allow estimates to be updated as information becomes available. Companies subject to the CAMT are required to have their estimates recognized fully by year-end 2023. Disclosures are also provided. INT 22-03 has a comment deadline of Oct. 28.

Mr. Hudson made a motion, seconded by Ms. Walker, to expose INT 22-02 and INT 22-03. The motion passed unanimously.

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

[https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/Fall - December/Hearing/2 - 10.6.22 SAPWGmin.docx](https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2022/Fall-December/Hearing/2-10.6.22SAPWGmin.docx)

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Draft: 11/1/22

Statutory Accounting Principles (E) Working Group  
Virtual Meeting  
October 24, 2022

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met Oct. 24, 2022. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Blase Abreo (AL); Kim Hudson (CA); William Arfanis and Michael Estabrook (CT); Rylynn Brown (DE); Eric Moser and Cindy Andersen (IL); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett and Pat Gosselin (NH); Bob Kasinow (NY); Melissa Greiner and Diana Sherman (PA); Jamie Walker (TX); Doug Stolte and David Smith (VA); and Kristin Forsberg (WI).

1. Adopted INT 22-02

The Working Group held a public hearing to review comments (Attachment One-XX) received on the Oct. 6 exposure of *Interpretation (INT) 22-02: Third Quarter 2022 Reporting of the Inflation Reduction Act*.

Bruggeman directed the Working Group to *INT 22-02: Third Quarter 2022 Reporting of the Inflation Reduction Act*. Marcotte noted that INT 22-02 was one of two interpretations the Working Group exposed in response to the federal Inflation Reduction Act, which was adopted into law on Aug. 16 and is effective for tax years 2023 and after. She stated the Inflation Reduction Act has a corporate alternative minimum tax (CAMT). Under existing statutory accounting guidance, an entity that has determined it is subject to the new CAMT must consider the impact on the statutory valuation allowance and the admissibility of deferred tax assets in the period of enactment, which is when President Joe Biden signed the Act into law. With the existing guidance, unless exceptions are made, the Aug. 16 enactment date would require reporting entity assessments for the third quarter of 2022. She stated that INT 22-02 has been drafted to provide an exception under existing guidance and not require financial reporting changes for the third quarter of 2022 because a reasonable estimate likely cannot be made. INT 22-02 proposes disclosure and allows a subsequent event reporting exception.

Marcotte noted that INT 22-02 provides an overview of the CAMT, which imposes a minimum corporate tax of 15% of the corporation's (or group of entities under common control filing a consolidated tax return) "adjusted financial statement income" for the tax year, reduced by corporate alternative minimum foreign tax credit. She stated that the CAMT will only apply to corporations (determined on a consolidated tax filing basis) with average adjusted financial statement income in excess of \$1 billion for the three prior tax years. This threshold is reduced to \$100 million in the case of certain foreign-parented corporations. She stated that a corporation's adjusted financial statement income is the amount of net income or loss the corporation reports on its applicable financial statement. The applicable financial statement income is based on book income that may be generally accepted accounting principles (GAAP), International Financial Reporting Standards (IFRS), or regulatory reporting based on a hierarchy. The CAMT amount is then compared to the normal taxable amount, and the taxpayer pays the higher of the two calculations.

Marcotte stated that several details regarding the implementation of the CAMT are pending development of guidance from the U.S. Department of the Treasury (Treasury Department). She stated that the exposed INT 22-02 ultimately provides exceptions to existing statutory accounting provisions, indicating that financial reporting changes are not required for the third quarter of 2022 because a reasonable estimate cannot be made and provides exceptions to subsequent event reporting. She stated that the exposed INT 22-02 requires disclosure by

all reporting entities on whether they anticipate being subject to the CAMT. She noted that the interpretation is temporary and would be automatically nullified on Dec. 1, 2022.

Marcotte noted that interested parties' Oct. 14 comments on the exposure provided proposed clarifications for the disclosures in paragraph 13.b. She stated that the exposed disclosure focused on if the reporting entity had determined if it would be subject to the CAMT in 2023. The interested parties' proposed clarifications focused on two issues, the first noting that the reporting entity or a controlled group of corporations of which the reporting entity is a member could make the tax determinations because the CAMT is based on all the members filing in the consolidated tax return. She stated the second item that interested parties recommended was changing the wording "subject to the CAMT" to "liable for the CAMT." She noted that the proposed clarifications were more explicit that the CAMT is calculated based on multiple reporting entities if a reporting entity files a consolidated tax return and more explicit regarding a reporting entity's expectations of CAMT payment in 2023. With this discussion, she stated that NAIC staff recommend that the Working Group consider adopting the exposed interpretation with the edits to paragraph 13.b. proposed by interested parties. She noted that in accordance with the *NAIC Policy Statement on Maintenance of Statutory Accounting Principles* that the Working Group needed to adopt the interpretation with a two-thirds majority of the minimum of 67% of the members present.

Bruggeman stated that the intent is that reporting entities are not required to estimate the potential 2023 CAMT liability for the third quarter of 2022. He noted that because of the federal rules-making process, there are numerous rules that will not be available until well into 2023. Therefore, it made sense to have disclosure for the third quarter of 2022 reporting.

Rose Albrizio (Equitable), representing interested parties, stated support for accepting their recommended edits. She stated that replacing "subject to" with "liable for" brought more clarity to the disclosure because an applicable corporation means that it must do the CAMT calculation; it does not always mean that the reporting entity or group of entities will pay the CAMT tax. She noted that a taxpayer will not pay the CAMT unless the calculated CAMT amount exceeds the regular tax liability. Albrizio stated that interested parties recommend using the term "liable for" to provide a clearer disclosure.

Bruggeman stated that he is OK with the "liable for" language, but identifying applicable corporations may be useful. He stated that entities that are liable for an amount will at some point have to estimate it. He stated that the initial thought process was that even if a reporting entity did not know if it were liable, the reporting entity may have identified if it were an applicable corporation such that its adjusted financial statement income may necessitate the comparison of CAMT to normal tax. He also noted that an entity may be part of a group that is subject to the CAMT calculation, and it is possible that a specific member may not have to pay additional CAMT amounts.

Albrizio noted that for the currently exposed *INT 22-03: Inflation Reduction Act – Corporate Alternative Minimum Tax*, the interested parties expect to have more comments on some of the more detailed nuances of applicable and liable disclosures. She noted that the CAMT calculation is computed on the consolidated tax return but that there are other considerations regarding if a particular individual reporting entity is required to pay an additional CAMT amount.

Bruggeman noted appreciation for the interested parties' comments. He stated he understands that there may be differences between reporting entities which are subject to the calculation and those that may be liable for the payment. He noted that he anticipates some of the comments on INT 22-02 may be relevant for the current exposure of INT 22-03.

Bruggeman also noted that as a state insurance regulator, he would not be surprised to see some new filings regarding tax sharing agreements to clarify the obligations under the CAMT. He noted that the previous alternative minimum tax used the minimum taxable amount, and the new CAMT uses a consolidated book number as the starting point; that is, the CAMT is using book income (GAAP, IFRS, or statutory accounting principles [SAP]) with adjustments. Therefore, the prior link to taxable income in the old alternative minimum tax does not exist in the CAMT. He stated that determining the amount payable and other aspects of the calculations will be more complex in consolidated groups that include non-insurance entities.

Hudson made a motion, seconded by Arfanis, to adopt INT 22-02 (Attachment One-XX) with the revisions recommended by interested parties. The motion passed unanimously (which met the policy statement requirement of a two-thirds majority of the minimum of 67% of the members present).

Bruggeman noted that NAIC staff have requested direction regarding updates to the similar disclosures in INT 22-03, which is currently exposed until Oct. 28. Marcotte stated that NAIC staff request Working Group direction on if the disclosure in the exposed INT 22-03 should be expanded to separately capture applicable corporation (an entity whose adjusted financial statement income is above the threshold and, therefore, is subject to the calculation that compares CAMT to normal tax) and liable corporation (an entity that expects to pay the CAMT for 2023). Bruggeman summarized that the difference is asking if the consolidated tax return adjusted financial statement income is high enough (i.e., over \$1 billion) as a separate question from if a reporting entity expects to pay the CAMT. Bruggeman noted that would be valuable information if a reasonable estimate can be made. Clark stated that he would like to see a separate disclosure regarding whether a reporting entity is an applicable corporation in INT 22-03. As there were no objections by Working Group members, NAIC staff were directed to work with industry regarding updates to the disclosures in INT 22-03. Bruggeman noted that the Working Group will consider the INT 22-03 during its Nov. 16 meeting, which will primarily focus on the bond project.

Marcotte stated that a memorandum regarding the adoption of third quarter of 2022 disclosures would be forwarded to the Blanks (E) Working Group for discussion during its Nov. 17 meeting.

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

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2022/Fall-December/Hearing/3-10-24-22-SAPWGmin.docx>

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Draft: 11/23/22

Statutory Accounting Principles (E) Working Group  
Virtual Meeting  
November 16, 2022

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met Nov. 16, 2022. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Sheila Travis (AL); Kim Hudson and Susan Bernard (CA); William Arfanis (CT); Rylynn Brown and Tom Hudson (DE); Cindy Andersen and Eric Moser (IL); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Joan Riddell (NY); Melissa Greiner and Diana Sherman (PA); Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI).

The Working Group held a public hearing to review comments (Attachments One-A1 through One-A4).

1. Discussed and Exposed the Proposed Bond Definition

Bruggeman directed the Working Group to agenda item 2019-21: Proposed Bond Definition, noting that comments were received on the July 18 exposed reporting changes and the Aug. 18 exposed accounting changes.

Julie Gann (NAIC) stated that there were three attachments in the materials for discussion that include documents revised from the exposure, including a revised *Statement of Statutory Accounting Principle (SSAP) No. 26R—Bonds*, revised *SSAP No. 43R—Loan-Backed and Structured Securities*, and a new document that proposes revisions to other SSAPs. She stated that NAIC staff recommend exposing these documents for comment. She stated that a revised issue paper was not provided and that NAIC staff are working to update the document for possible exposure at the Fall National Meeting.

Gann stated that the documents for statutory accounting and reporting revisions were exposed for comment in July and August. Comments were received from Fermat Capital (Fermat), the Industry Lease-Backed Securities Working Group, and interested parties. Gann summarized the comments received as follows:

- The Fermat comment letter requested that the Working Group use the Bond Project to clarify requirements for working capital finance investments (WCFI), with comments that these investments meet the definition of an issuer credit obligation in scope of SSAP No. 26R and should be reported on Schedule D, Part 1, as bonds. Gann stated that NAIC staff's recommendation to this comment is to incorporate revisions to paragraph 4 of SSAP No. 26R to exclude investments that are specifically identified within other SSAPs. Gann provided examples including structured settlements that are in scope of *SSAP No. 21R—Other Admitted Assets*, surplus notes that are in scope of *SSAP No. 41R—Surplus Notes*, and working capital finance notes in scope of *SSAP No. 105R—Working Capital Finance Investments*.
- The Industry Lease-Backed Securities Working Group's comment letter requested the inclusion of a new example to clarify that there is a class of asset-backed securities (ABS) where the ABS issuer does not actually own the underlying collateral, but rather has a security interest through loan documents, which provides recourse to the collateral in the event of default. Gann stated that NAIC staff are recommending revising Example 2 of SSAP No. 26R to address the dynamic raised in the comment letter. Gann stated that a new example was not warranted, but she believes that incorporating the concepts within the existing

example addresses the concerns. She also indicated that the loan-to-value indicated in SSAP No. 26R, paragraph 7, needs to be changed from 70% to 100% prior to exposure of the document.

- John Garrison (Industry Lease-Backed Securities Working Group) stated support for accepting the concepts in their letter and the proposed recommended edits. Garrison stated that the proposed modifications capture the concepts noted in their comment letter and would support inclusion of these changes in the revised SSAP No. 26R.
  - Mike Reis (Northwestern Mutual), representing interested parties, offered support to the concept brought up by the Industry Lease-Backed Securities Working Group and the modifications to Example 2 in SSAP No. 26R.
  - Clark stated that a footnote was also added to SSAP No. 26R as a result of Garrison's comments. The footnote is related to one of the points raised, which is that throughout the definition, assets owned by the issuer are discussed. In some instances, these assets are not technically owned, but the rights to the assets have effectively been assigned to the creditor. The intention was to be inclusive of all assets that the creditor has recourse to, and the footnote was added to explicitly state this concept.
- Interested parties provided comments on all of the exposed documents. They also provided comments on the bond definition, which was not presented as a revised document. NAIC staff have not made revisions or provided the bond definition specifically because the edits are reflected in the SSAPs as the authoritative guidance or for historical documentation in the issue paper. Interested parties also commented on the issue paper's language regarding feeder funds. Gann stated that NAIC staff and Clark have worked with industry to refine the feeder fund language and that it is not available today. The document will be presented at the Fall National Meeting with a request for exposure.
  - NAIC staff have proposed new terms to be included within the glossary for SSAP No. 26R to reflect the concepts of the bond definition. Gann stated that interested parties indicated that the new glossary terms are not needed as they are within the standard. They also identified that some of the legacy terms within the glossary no longer need to be retained. Gann stated support for the proposal although the definition for bank loans should be retained. She stated that NAIC staff have made revisions to SSAP No. 26R to remove the glossary and to include the definition of bank loans within a new footnote.
  - Interested parties also provided comments with regard to the income recognition detail that was added to SSAP No. 43R. They also requested clarification on the assessment of cash flows and changes in cash-flow projections. Gann stated that industry and Clark have worked with NAIC staff to refine the proposed changes. Gann stated that the key changes from the prior exposure pertain to the use of U.S. generally accepted accounting principles (GAAP) language in determining the ability to use a prospective method, which would be a high credit quality distinction, and how the assessment is completed at the time of the initial acquisition. She stated that clarification was made to indicate that if there is an adverse change in expected cash flows and the investment is impaired, meaning that fair value is less than amortized cost, an other-than-temporary impairment (OTTI) shall be recognized.



- Interested parties identified the need for transition language. NAIC staff agreed and added additional transitional language to both of the revised documents. Gann provided a high-level summary of the additional transitional language added to SSAP No. 26R and SSAP No. 43R.
- Interested parties provided comments on the need for additional exposure. NAIC staff agreed with the request to expose for a public comment period ending Feb. 10, 2023.
- Gann discussed additional changes to SSAP No. 26R related to the need to have the bond definition in a centralized location. She stated that prior exposures had the bond definition in both SSAP No. 26R and SSAP No. 43R. Gann stated that with the revised documents, the entire bond definition is now located in SSAP No. 26R and that securities that qualify as ABS under the bond definition will move to SSAP No. 43R for the measurement and reporting guidance.
- Interested parties provided comments concerning embedded derivatives. Gann provided a summary of the comments and stated that the full text of interested parties' comments was included in Attachment A. She stated that NAIC staff worked with industry and Clark to provide revisions, detailed in the agenda and SSAP No. 26R, that were more explicit that the performance variations that restrict bond classification are intended to reflect non-debt variables. She stated that the guidance is not intended to restrict situations that are commonly related to debt instruments, such as vanilla inflation or benchmark interest rate adjustments such as with U.S. Treasury Inflation Indexed Securities (TIPs) or Secured Overnight Financing Rate (SOFR) linked coupons.

Bruggeman stated there was concern of being able to meet a Jan. 1, 2024, deadline to implement the proposed changes considering vendor and NAIC staff need to implement the changes. He stated that, given this concern, he directed NAIC staff to incorporate a Jan.1, 2025, effective date in order to provide time to implement the changes.

Reis expressed appreciation to both NAIC staff and the Iowa Insurance Division staff for working with interested parties on these issues. He stated that interested parties support the changes made. Reis stated that interested parties agree that the Jan. 1, 2024, implementation date would be too soon. He stated that interested parties will focus their next exposure comments on fatal flaws, consistency, language, and readability issues, and that the main concepts have been ironed out. Reis discussed two specific items, one of which was the embedded derivative language Gann discussed. He stated that interested parties do not want to mirror Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) extensive language and guidance and want to spend the requisite time to get this right. He said this is a big issue and will be a focus of interested parties as they want to ensure there are no unintended consequences. Reis stated the second point is related to securities that do not meet the bond definition language in SSAP No. 26R, paragraph 3.d., and may potentially go on Schedule BA, Other Long-Term Invested Assets. He stated that these are generally good investments. Reis provided an example of an environmental, social, or government (ESG) bond that may be caught in this language and receive a risk-based capital (RBC) charge that is not commensurate with the risk. He stated that interested parties are asking that these types of investments that do not meet the bond definition, and are moved to Schedule BA, are reviewed to ensure that they receive the appropriate RBC charge.

Bruggeman directed NAIC staff to add Reis' comment concerning ESG bonds to the list of issues to discuss with the NAIC Risk-Based Capital Investment Risk and Evaluation (E) Working Group in order to make sure all parties are in agreement.

Clark stated support for Bruggeman's comment and indicated that in facilitating discussion with the RBC group, it would be helpful to group assets expected not to qualify under the bond definition into categories, to the extent that there are particular asset types expected to fall out. Input from industry on what those categories are will likely be necessary. He stated that the embedded derivative topic is the largest outstanding issue that requires substantive discussion. Clark stated that under U.S. GAAP, different accounting and measurement guidance applies to different types of financial instruments. Recognizing that multiple financial instruments could be combined in order to avoid the accounting and reporting methodology that would otherwise apply, GAAP adopts a concept whereby features that are not clearly and closely related to each other must be bifurcated and accounted for separately. However, due to the complexity of doing this in practice, many companies elect to carry the entire contract at fair value. He stated that under statutory accounting, there may be additional incentives to combine instruments given the reliance of the capital framework on accounting classification, such that non-bond risk/return can receive bond capital treatment. So, with the proposed bond definition, he stated that the intent is to develop a principle that appropriately safeguards against non-bond risks being characterized as bond risks, ideally, without bringing in the unnecessary complexity of the U.S. GAAP embedded derivative guidance. Clark highlighted the inclusion of this concept as a specific component for the Working Group to consider and provide any feedback they may have on it. He stated that when this issue initially came up several years ago with structured notes and principal protected notes (PPNs), there were some safeguards established at that time. He stated that for structured notes, if the reference variable component could result in a loss of principal, then it was treated as a derivative under *SSAP No. 86—Derivatives*. Clark stated that the new guidance would go further where there is a non-debt variable component and require those to move to SSAP No. 21R and Schedule BA.

Gann stated that there is another document up for exposure with regard to accounting guidance referred to as Proposed Revisions to Other SSAPs. She stated that NAIC staff reviewed each SSAP in the NAIC *Accounting Practices and Procedures Manual (AP&P Manual)* to identify any references to loan-backed securities, names that needed to be revised, or additional references to bonds. She stated that revisions have been proposed to update references and guidance under the bond definition. Gann stated that this document also includes revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to exclude ABS from being in scope of the cash equivalent or short-term guidance. Gann stated the document also includes proposed revisions to SSAP No. 21R to specify accounting and reporting guidance for debt securities that do not qualify as bonds.

Gann discussed interested parties' comments related to the reporting revisions exposed in July 2022. She stated that the revisions identified reporting lines and the descriptions of what is included in the reporting lines. She discussed the split to Schedule D, which will now have two Parts: 1) Schedule D-1-1 for issuer credit obligations; and 2) Schedule D-1-2 for ABS. Gann stated that comments were received from interested parties and are detailed in the Hearing Agenda. She stated NAIC staff are, for the most part, supportive of the comments received. Gann stated that revised documents were not available for this meeting and that NAIC staff will present these at the Fall National Meeting. She stated that at the Fall National Meeting, the documents will go beyond what has currently been presented for the instructions and Schedule D and will encompass a review of the entire annual statement and reporting instructions for all areas that may be affected by the updated bond definition or new reporting structure.

Gann went on to discuss some of the comments received from interested parties provided in the Hearing Agenda. She identified one comment that may require discussion was related to a revision recommending deletion of a new column for current overcollateralization percentage proposed strictly for ABS. Industry identified that it would be operationally challenging to include that information for ABS every time they file Schedule D-1-2. She stated agreement that it would be operationally challenging and identified that column was originally considered for the sub-schedule that was considered before the current split schedule proposal. Gann stated that the original

intent was for the column to be limited to specific SBS structures and that with the new proposal, it was being included for all ABS. She stated that NAIC staff are seeking input on whether this column should be retained, retained, and restricted to certain types of ABS or deleted.

Bruggeman inquired, and Gann confirmed, that summary lines will be included in the proposed Schedule D–1–2. He stated concern that the proposed revisions would only capture the data intended and not data for non-relevant ABS, with the goal of not having to ask for supplemental data from filers. Bruggeman directed NAIC staff to leave in the proposed revisions for now, with revisions to limit the column to specific ABS.

Tip Tipton (Thrivent), representing interested parties, thanked NAIC staff and state insurance regulators for collaborating with industry on the proposed reporting changes, and he stated that they have a good product moving forward. He highlighted one issue, Item 10, and asked for Angelica Tamayo-Sanchez (New York Life) to comment.

Tamayo-Sanchez stated that the concern with the principle-based definition in the assessment of credit enhancement is supposed to be done at the origination of the investment. This is because there could be things that start happening with the deal itself, such as a default, where companies are taking impairment, or the underlying collateral could change. She stated it would be operationally difficult to keep assessing the securities every quarter. Tamayo-Sanchez stated the reaction of interested parties is that although asset managers are reviewing the portfolio from a credit perspective, interested parties are not sure that the calculation to determine whether a security is a bond would be done at every reporting period. She stated that more data would be needed to determine what calculations are actually done regarding the over-collateralization in ABS and how that data would be fed into systems that put Schedule D together.

Clark stated that the intent is not to determine what qualifies as a bond as that is done at origination. The reporting field under discussion is more of a data element to be used in the financial analysis on the state insurance regulator side and only apply to specific subgroups. He stated that for those that do not meet the meaningful cash flow practical expedient, meaning there is a larger residual collateral exposure, they are relying on refinancing or sale. So, it was viewed that for those groupings, this data element, of obtaining updated loan-to-values, would be a useful input into the analysis process and not to determine whether it is a bond each quarter. Clark stated that he appreciates the comments if this data point is not something that is operationally achievable. He stated that it would be similar to the data maintained for commercial mortgage loans (CMLs) and residential mortgage loans (RMLs) used in the RBC calculation, and this is where they are looking for feedback as to what is the operational feasibility if applied to a smaller subset of the population.

Bruggeman stated the timing does not need to be every quarter, although state insurance regulators would like it quarterly for analysis purposes and to keep things consistent throughout the year with regard to systems. If it is not achievable every quarter, the Working Group would like to hear about it, and it may only be part of the annual filing.

Gann stated that NAIC staff's recommended actions are to expose the updated revisions to SSAP No. 26R, SSAP No. 43R, and the proposed revisions to other SSAPs for a public comment period ending Feb. 10, 2023.

Clark made a motion, seconded by Malm, to expose the revisions to 2019-12: Proposed Bond Definition, with a comment period ending Feb. 10, 2023. The motion passed unanimously.

## 2. Discussed INT 22-03 Third and Fourth Quarter 2022 Reporting of the Inflation Reduction Act

Robin Marcotte (NAIC) stated that on Oct. 6, the Working Group exposed *Interpretation (INT) 22-02: Third Quarter 2022 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax* to provide exceptions to *SSAP No. 9—Subsequent Events* and *SSAP No. 101—Income Taxes* in response to the federal Inflation Reduction Act for third-quarter 2022 and exposed *INT-22-03: Inflation Reduction Act – Corporate Alternative Minimum Tax* to address fourth-quarter 2022 and interim 2023 reporting. On Oct. 24, the Working Group adopted INT 22-02, which included disclosures and provided that reasonable estimates and effects of the corporate alternative minimum tax (CAMT) could not be made for third-quarter 2022. She noted that the CAMT is not effective as a tax until 2023 tax years.

Marcotte provided a summary of the exposures included in agenda item INT 22-03, as well as a summary of comments received from interested parties (Attachment One-A3). She stated that interested parties provided a fairly extensive comment letter on INT 22-03 and noted items that needed to be addressed for 2023. She noted that interested parties requested that instead of finalizing INT 22-03, that INT 22-02 be extended from third-quarter 2022 to include year-end 2022. She stated that NAIC staff recommend extending the previously adopted INT 22-02 to include the Dec. 31, 2022, financial statements. She noted that as detailed in the exposures, the CAMT is effective for 2023 tax years. Therefore, not recognizing the impacts of the CAMT for 2022 reporting would only affect the statutory valuation allowance and possibly the calculations regarding the admissibility of certain deferred tax assets. She stated that there are multiple items within the federal Inflation Reduction Act and that several U.S. Treasury regulations are pending development. She stated that in addition to the extension of INT 22-02 for year-end 2022 reporting, an additional disclosure for year-end 2022 was also recommended, which would identify applicable corporations that are required to perform the calculations to determine if the corporation of the controlled group of corporations for which the reporting entity is a member might owe the CAMT. She noted that this disclosure does not require a CAMT estimated result of the calculation, but only seeks to identify companies filing a consolidated return with an adjusted financial statement income that is expected to require the CAMT calculation. She noted that the meeting materials also propose a nullification date of March 15, 2023, because the INT is not proposed to apply to first-quarter 2023 reporting.

Rose Albrizio (Equitable), representing interested parties, stated appreciation for consideration of extending the period through year-end 2022. She noted that the interested parties' comment letter was meant to highlight some of the issues supporting extension of INT 22-02 through year-end. She stated that additional guidance is needed for 2023 and noted that interested parties have been working on proposed edits to INT 22-03 to address the tax accounting issues for 2023 reporting, which could be used for permanent guidance. She stated that interested parties have had an initial discussion with NAIC staff and are planning to discuss this again with NAIC staff following the Fall National Meeting. She stated that if INT 22-02 was extended through March 31, 2023, it would increase the possibility of the U.S. Department of the Treasury (Treasury Department) providing guidance. However, extending the INT 22-02 will not provide the guidance needed on issues specific to insurance companies (e.g., allocation of the CAMT that is calculated on a total corporate basis to individual company financial statements).

Bruggeman expressed support for extending INT 22-02 to year-end 2022, which is consistent with the NAIC staff recommendation. He also inquired if the Working Group was interested in an extension of INT 22-02 for first-quarter 2023 reporting. He noted that the year-end 2022 filing date is March 1 and that the end of the first-quarter reporting is March 31.

Kim Hudson stated support for extending through year-end 2022. He stated that theoretically it would be better for the Working Group to re-evaluate the guidance during the first quarter 2023. However, he noted a concern

regarding timing issues regarding the ability of the Working Group to evaluate and adopt first-quarter 2023 guidance.

Weaver stated support for extending through year-end 2022 and into first-quarter 2023. Bruggeman asked Kim Hudson if he preferred a year-end 2022 or first-quarter 2023 extension. Hudson noted that because of the timing issues, he preferred an extension through first-quarter 2023.

Albrizio stated that interested parties will be actively working on this topic. She stated that in relation to the allocations process, this will also require the updating of tax-sharing arrangements.

Bruggeman directed NAIC staff to adjust the language in INT 22-03 to be extended to include first-quarter 2023. He stated that the Working Group could continue discussion at the Fall National Meeting.

Kim Hudson made a motion, seconded by Weaver, to expose the revisions to *INT 22-02: Third Quarter 2022 through First Quarter 2023 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax*, which extend the INT to apply to year-end 2022 and first-quarter 2023 with the proposed additional disclosure regarding applicable entities, with a public comment period ending Dec. 1, 2022. Marcotte inquired regarding the nullification date, and the Working Group was also directed to draft language noting that INT 22-02 would be automatically nullified on June 15, 2023. The motion passed unanimously. Bruggeman noted that the exposure would be discussed at the Fall National Meeting.

Marcotte stated that there will be a longer process to look at SSAP No. 101 and its implementation guide due to the previous removal of the alternative minimum tax guidance in 2019.

### 3. Discussion of Other Matters – Negative IMR

Reis provided comments related to the American Council of Life Insurers (ACLI) submitted comment letter (Attachment One-A4) regarding its request related to the allowance (admission) of a negative interest maintenance reserve (IMR) balance in statutory accounting. He provided a summary of the comment letter, including the rationale for the development of IMR. Reis stated that if a company were to sell all of its bonds in a falling interest rate environment, it would recognize significant interest-related realized gains. This would show increased financial strength through increased surplus and would be inappropriate as the company would now have a lower yielding portfolio but show higher surplus. Therefore, the surplus does not show the entire picture in this scenario, especially where the liability is not going to change under statutory accounting. Reis stated that when IMR was developed, it was recognized that it should work both ways, as recognizing losses in a rising interest rate environment would show decreased financial strength through decreased surplus. He stated that IMR was adopted in 1992 when industry was in the middle of a decade-long declining interest rate environment, so it was only adopted for realized gains. Reis stated that at the time, the realized losses were a negative component and should have theoretically been recognized. However, after remaining on the AVR/IMR (E) Working Group's agenda for another 10 years, the Working Group was ultimately disbanded with no action being taken.

Reis stated that the ACLI hopes the NAIC can resume discussion of the allowance of negative IMR so that industry does not look inappropriately weaker in a period of rising interest rates, which are actually good for the industry. He stated that the ACLI would like to discuss this topic further with the Working Group at the Fall National Meeting, as the disallowance of a negative IMR would inappropriately show the decreased financial strength or, worse, incentivize companies to make inappropriate asset/liability management decisions with both bond investments and derivatives that hedge those bond investments. He stated that this affects decisions today, even if the

negative IMR balance is not negative for all companies. He stated that the ACLI hopes the Working Group will take at least temporary action on this issue.

Bruggeman stated that it is the sale of bonds with a realized loss in this case that actually generates the negative IMR and that the increase in interest rates may be the reason for the sales but has no bearing on the IMR calculation. He stated that the Life Actuarial (A) Task Force is looking into this issue and that the Working Group must work together with the Task Force to make sure it does not get ahead on the issues. Bruggeman stated that he is not sure the Working Group can have an effective discussion at the Fall National Meeting with the short time frame. Bruggeman stated that companies that are approaching this situation should contact their domestic state insurance regulator to inquire about the potential for a permitted practice.

Reis stated that the ACLI is supportive of the Task Force looking into this issue and the appropriate utilization of negative IMR within asset adequacy testing (AAT). He stated that it should only be included in asset adequacy if it is an admitted asset. Reis noted, in relation to the concept of companies not selling bonds, that this method may lead to a mismatch between assets and liabilities.

Bruggeman stated that he understands there are situations where a company needs to sell bonds or that it makes sense to sell bonds. He stated his point was that companies should discuss with their domestic state insurance regulators to explain why the company wants to sell bonds since every situation may be different. Bruggeman suggested exposing the ACLI letter and directed NAIC staff to put together a discussion to potentially have an exposure at the Fall National Meeting.

Malm inquired about NAIC staff compiling data to provide the Working Group and state insurance regulators information on the movement of IMR since year-end 2021 to third-quarter 2022. She expressed support for coordination between the Working Group and the Task Force on this issue.

Gann stated that NAIC staff will put together an agenda item for discussion and exposure at the Fall National Meeting. Reis stated that the ACLI is ready to take questions from NAIC staff or state insurance regulators.

Mike Monahan (ACLI) stated that AAT is a pass/fail, so it may not be the whole solution. He inquired who drafted the memorandum included in the meeting materials from NAIC staff to the Task Force. Gann stated that the memorandum was drafted by Scott O'Neal (NAIC), support staff for the Task Force.

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

[https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2022/fall - december/hearing/4 - 11.16.22 sapwgmin.docx](https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national%20meetings/a.%20national%20meeting%20materials/2022/fall-december/hearing/4-11.16.22%20sapwgmin.docx)

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

**Issue: ASU 2022-01 – Fair Value Hedging – Portfolio Layer Method**

**Check (applicable entity):**

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

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

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

- Expands the last-of-layer method that permitted only one hedged layer to allow multiple hedged layers of a single closed portfolio. This resulted in a name change from last-of-layer to “portfolio layer method.”
- Expands the scope to include nonprepayable financial assets.
- Specifies that eligible hedging instruments in a single-layer hedge may include spot-starting or forward-starting constant notional swaps, or spot or forward-starting amortizing-notional swaps and that the number of hedged layers (that is single or multiple) corresponds with the number of hedges designated.
- Provides additional guidance on the accounting for and disclosure of hedge basis adjustments that are applicable to the portfolio layer method whether a single hedged layer or multiple hedged layers are designated.
- Specifies how hedge basis adjustments should be considered when determining credit losses (impairment) for the assets included in the closed portfolio.

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

Initial staff assessments on the U.S. GAAP guidance considered potential issues with how hedge basis adjustments are reflected, as U.S. GAAP prevents basis adjustments directly to assets hedged in a portfolio. However, after discussing with industry, and analyzing how the differences in measurement / recognition between U.S. GAAP and SAP impact this assessment, the basis adjustment impact for portfolio layer method hedges will only occur at the time of dedesignation. This is because SAP generally uses an amortized cost approach for effective hedges (if the

hedged item is valued at amortized cost), and the derivative mirrors that measurement method. Under U.S. GAAP, where they both use a fair value method, basis adjustments occur frequently to reflect the change in fair value. With the SAP measurement approach, fair value hedge basis adjustments only occur at hedge termination or at dedesignation. As such, this is not a key SAP impact.

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

Partial Term Hedging:

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

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.

Key elements pertaining to portfolio layer method hedging under U.S. GAAP:

- For a closed portfolio of financial assets or one or more beneficial interests secured by a portfolio of financial instruments, an entity may designate as the hedged item or items a hedged layer or layers if the following criteria are met: *(Note – The FASB was asked to consider expanding the scope to include liabilities (specifically, insurance liabilities), and the FASB elected not to expand the portfolio layer method to include hedges of liabilities.)*
  - As part of the initial hedge documentation, an analysis is completed and documented to support the entity's expectation that the hedged item or items (that is, the hedged layer or layers in aggregate) is anticipated to be outstanding for the designated hedge period. That analysis shall incorporate the



- entity's current expectations of prepayments, defaults, and other factors affecting the timing and amount of cash flows associated with the closed portfolio.
- For purposes of its analysis, the entity assumes that as prepayments, defaults, and other factors affecting the timing and amount of cash flows occur, they first will be applied to the portion of the closed portfolio that is not hedged.
  - The entity applies the partial-term hedging guidance to the assets or beneficial interests used to support the entity's expectation. An asset that matures on a hedged layer's assumed maturity date meets this requirement.
- After a closed portfolio is established, an entity may designate new hedging relationships associated with the closed portfolio without dedesignating any existing hedging relationships associated with the closed portfolio if the criteria are met for those newly designated hedging relationships.
  - For one or more existing hedged layer or layers that are designated under the portfolio layer method, the gain or loss (that is, the change in fair value) on the hedged item attributable to the hedged risk shall not adjust the carrying value of the individual beneficial interest or individual assets in or removed from the closed portfolio. Instead, that amount shall be maintained on a closed portfolio basis and recognized currently in earnings.
  - If the hedged item is a hedged layer designated in a portfolio layer method hedge on a closed portfolio and the closed portfolio includes only available-for-sale debt securities, the entire gain or loss (that is, the change in fair value) on the hedged item attributable to the hedged risk shall be recognized in earnings rather than in other comprehensive income to offset the gain or loss on the hedging instrument. If the closed portfolio includes available-for-sale debt securities and assets that are not available-for-sale debt securities, an entity shall determine the portion of the change in fair value on the hedged item attributable to the hedged risk associated with the available-for-sale debt securities using a systematic and rational method. That amount shall be recognized in earnings rather than in other comprehensive income. An entity shall not adjust the carrying amount of the individual available-for-sale debt securities included in the closed portfolio.
  - For each closed portfolio with one or more hedging relationships designated and accounted for under the portfolio layer method, an entity shall perform and document at each effectiveness assessment date an analysis that supports the entity's expectation that the hedged layer or layers in aggregate is still anticipated to be outstanding for the designated hedge period. That analysis shall incorporate the entity's current expectations of prepayments, defaults, and other factors affecting the timing and amount of cash flows associated with the closed portfolio using a method consistent with the method used to perform the analysis at initial hedge documentation.
  - An adjustment that is maintained on a closed portfolio basis in a portfolio layer method hedge in accordance shall be amortized to earnings. Amortization shall begin no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged. The entity shall fully amortize that adjustment by the hedged item's assumed maturity date.
  - An asset or liability that has been designated as being hedged remains subject to the applicable requirements for assessing impairment or credit losses for that type of asset or for recognizing an increased obligation for that type of liability. A portfolio layer method basis adjustment that is maintained on a closed portfolio basis for an existing hedge shall not be considered when assessing the individual assets or individual beneficial interest included in the closed portfolio for impairment or credit losses or when assessing a portfolio of assets for impairment or credit losses. An entity may not apply this guidance by analogy to other components of amortized cost basis. Because the hedging instrument is recognized separately as an asset or liability, its fair value or expected cash flows shall not be considered in applying those impairment or credit loss requirements to the hedged asset or liability.

- For a fair value hedge of interest rate risk in which the hedged item is designated for a partial term, an entity may measure the change in the fair value of the hedged item attributable to interest rate risk using an assumed term that begins when the first hedged cash flow begins to accrue and ends at the end of the designated hedge period. The assumed issuance of the hedged item occurs on the date that the first hedged cash flow begins to accrue. The assumed maturity of the hedged item occurs at the end of the designated hedge period. Additionally, an entity may have one or more separately designated partial-term hedging relationships outstanding at the same time for the same debt instrument (for example, 2 outstanding hedging relationships for consecutive interest cash flows in Years 1–3 and consecutive interest cash flows in Years 5–7 of a 10-year debt instrument).
- An entity may elect to discontinue (or partially discontinue) hedge accounting prospectively for all or a portion of the hedged layer for one or more hedging relationships associated with the closed portfolio at any time if a breach has not occurred and a breach is not anticipated. If multiple hedged layers are associated with the closed portfolio, the entity may voluntarily elect to dedesignate (or partially dedesignate) any hedges associated with that closed portfolio.
- For one or more hedging relationships designated under the portfolio layer method, an entity shall discontinue (or partially discontinue) hedge accounting in the following circumstances:
  - If the entity cannot support on a subsequent testing date that the hedged layer or layers are anticipated to be outstanding for the designated hedge period (that is, a breach is anticipated), it shall discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item that is no longer anticipated to be outstanding for the designated hedge period.
  - If on a subsequent testing date the outstanding amount of the closed portfolio of financial assets or one or more beneficial interests is less than the hedged layer or layers (that is, a breach has occurred), the entity shall discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item that is no longer outstanding.
- In the event of either an anticipated breach or a breach that has occurred, if multiple hedged layers are associated with a closed portfolio, an entity shall determine which hedge or hedges to discontinue (or partially discontinue) in accordance with an accounting policy election. That accounting policy election shall specify a systematic and rational approach to determining which hedge or hedges to discontinue (or partially discontinue). An entity shall establish its accounting policy no later than when it first anticipates a breach or when a breach has occurred (whichever comes first). After an entity establishes its accounting policy, it shall consistently apply its accounting policy to all portfolio layer method breaches (anticipated and occurred).
- If a portfolio layer method hedging relationship is discontinued (or partially discontinued) in a voluntary dedesignation or in anticipation of a breach, the basis adjustment associated with the dedesignated amount as of the discontinuation date shall be allocated to the remaining individual assets in the closed portfolio that supported the dedesignated hedged layer using a systematic and rational method. An entity shall amortize those amounts over a period that is consistent with the amortization of other discounts or premiums associated with the respective assets.
- For a portfolio layer method hedging relationship that is discontinued because a breach has occurred, as of the discontinuation date an entity shall:

- Determine the portion of the basis adjustment associated with the amount of the hedged layer that exceeds the closed portfolio (that is, the portion of the basis adjustment associated with the breach) using a systematic and rational method and immediately recognize that amount in interest income
- Disclose the information specified for the breach.
- A closed portfolio may simultaneously have a layer or layers that have been breached and a layer or layers that it anticipates will be breached. In that case, an entity shall apply the guidance in this paragraph for the breach or breaches that have occurred and the guidance for the anticipated breach or breaches.
- New disclosures that include:
  - Amortized cost basis of closed portfolios of financial assets or beneficial interests
  - Amount that represents the hedged layers
  - Basis adjustments associated with the hedged layers
  - Hedge basis adjustment recognized in current-period interest income because of a breach.
  - Circumstances that led to a breach.

### Existing Authoritative Literature:

#### **SSAP No. 86—Derivatives**

Establishes statutory accounting guidance for derivative instruments and hedging, income generation and replication (synthetic asset) transactions.

Guidance for portfolio hedges is limited to fair value hedges as follows:

26. Fair value hedges qualify for hedge accounting if all of the following criteria are met:
- d. The hedged item is specifically identified as either all or a specific portion of a recognized asset or liability or of an unrecognized firm commitment. The hedged item is a single asset or liability (or a specific portion thereof) or is a portfolio of similar assets or a portfolio of similar liabilities (or a specific portion thereof);
  - e. If similar assets or similar liabilities are aggregated and hedged as a portfolio, the individual assets or individual liabilities must share the risk exposure for which they are designated as being hedged. The change in fair value attributable to the hedged risk for each individual item in a hedged portfolio must be expected to respond in a generally proportionate manner to the overall change in fair value of the aggregate portfolio attributable to the hedged risk; and

Under existing guidance, hedges identified as ‘portfolio’ hedges that did not qualify within the limited parameters in paragraph 26 did not qualify as hedging and were not permitted “hedge accounting” treatment in the statutory financial statements. Without hedge accounting, the hedging instruments are required to be reported at fair value, with fluctuations in fair value gains and losses recognized through surplus.

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

**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 2021-20: Effective Derivatives – ASU 2017-12 is considering other aspects pending from ASU 2017-12, primarily hedge effectiveness assessments, inclusion of guidance for excluded components and the measurement of excluded components.

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

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

***Recommendation:***

NAIC staff has been working with industry representatives on ASU 2022-01 for portfolio hedges, as well as on the U.S. guidance for partial term derivatives issued in ASU 2017-12. With these efforts, industry has provided NAIC staff suggested edits to incorporate key aspects of the U.S. GAAP guidance for portfolio hedges and partial-term hedges into SSAP No. 86. NAIC staff recommends that the Working Group classify this agenda item as a New SAP Concept and expose the proposed edits for comment. It is also recommended that the Working Group direct NAIC staff to prepare one issue paper with all recent derivative revisions.

**Summary of Revisions Proposed in this Agenda Item – Portfolio Layer Method and Partial Term:**

- SSAP No. 86: Revisions are proposed to paragraph 26 (fair value hedges) to detail criteria for portfolio and partial-term hedges. A small disclosure edit is proposed to paragraph 62 and guidance for reporting when the hedge is discontinued is proposed for inclusion in Exhibit C.

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

- Exhibit A – Assessment of Hedge Effectiveness: Limited revisions to paragraphs 17-18 to mirror updated U.S. GAAP guidance and a new section (beginning with paragraph 46) for specific hedge assessment guidance on the portfolio layer method.

**Staff Review Completed by:** Julie Gann - NAIC Staff, April 2022

**Proposed Edits to SSAP No. 86:**

**Fair Value Hedges (Note- subparagraphs 26a-c are not affected and are omitted for brevity)**

26. Fair value hedges qualify for hedge accounting if all of the following criteria are met:

- d. The hedged item is specifically identified as either all, ~~or~~ a specific portion, or the partial term of a recognized asset, or all or a specific portion of ~~or~~ a recognized liability or of an unrecognized firm commitment. The hedged item is a single asset or liability (or a specific portion or partial term thereof) or is a portfolio of similar assets or a portfolio of similar liabilities (or a specific portion thereof) or a closed portfolio of assets (pursuant to paragraph 26f and Exhibit A, paragraph 46) where assumed layer or layers is anticipated to be outstanding (or a specific portion thereof)<sup>1</sup>. For a partial term hedge of one or more consecutive selected contractual cash flows where the hedged item begins when the first hedge cash flow begins to accrue and ends at the end of the designation hedge period, the assumed maturity of the hedged item occurs at the end of the designated hedge period; (ASC 815-25-35-13B Partial Term Hedging.)
- e. If similar assets or similar liabilities are aggregated and hedged as a portfolio, the individual assets or individual liabilities must share the risk exposure for which they are designated as being hedged. The change in fair value attributable to the hedged risk for each individual item in a hedged portfolio must be expected to respond in a generally proportionate manner to the overall change in fair value of the aggregate portfolio attributable to the hedged risk; and
- f. For a closed portfolio of financial assets or one or more beneficial interests secured by a portfolio of financial instruments, an entity may designate as the hedged item or items a hedged layer or layers (this designation is referred to throughout as the “portfolio layer method” (detailed in Exhibit A). (ASC 815-20-25-12A Portfolio Layer Method)
- ~~f.g.~~ If the hedged item is a financial asset or liability, a recognized loan servicing right, or a nonfinancial firm commitment with financial components, the designated risk being hedged is:
  - i. The risk of changes in the overall fair value of the entire hedged item;
  - ii. The risk of changes in its fair value attributable to changes in benchmark interest rate;
  - iii. The risk of changes in its fair value attributable to changes in the related foreign currency exchange rates; or
  - iv. The risk of changes in its fair value attributable to both changes in the obligor’s creditworthiness and changes in the spread over the benchmark interest rate with respect to the related financial asset’s or liability’s credit sector at inception of the hedge (referred to as credit risk).

If the risk designated as being hedged is not the risk in paragraph 26.f.i., two or more of the other risks (benchmark interest rate risk, foreign currency exchange risk, and credit risk) may simultaneously be designated as being hedged.

The benchmark interest rate being hedged in a hedge of interest rate risk must be specifically identified as part of the designation and documentation at the inception of the hedging relationship. In calculating the change in the hedged item’s fair value attributable to changes in the benchmark interest rate, the estimated coupon cash flows used in calculating fair value ~~shall~~ must be based on either ~~all of the full~~ contractual cash flows ~~of the entire hedged item or the benchmark rate~~

<sup>1</sup> For clarity, partial-term hedges and portfolio hedges addressed in paragraph 26.f. are limited to the situations in which the hedged item(s) is a recognized asset or a closed portfolio of financial assets. These hedging accounting methods are not permitted to hedge liabilities.

component of the contractual coupon cash flows of the hedged item determined at hedge inception. An entity may designate a fair value hedge of interest rate risk in which the hedged item is a prepayment instrument. The entity may consider only how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity (for example, an entity may consider only how change in the benchmark interest rate affect an obligor's decision to call a debt instrument when it has the right to do so.) The entity need not consider other factors that would affect this decision (for example, credit risk) when assessing hedge effectiveness. (ASU 815-25-35-13 & 815-20-25-6B)~~Excluding some of the hedged item's contractual cash flows (for example, the portion of the interest coupon in excess of the benchmark interest rate) from the calculation is not permitted.~~<sup>2</sup>-An entity may not simply designate prepayment risk as the risk being hedged for a financial asset. However, it can designate the option component of a prepayable instrument as the hedged item in a fair value hedge of the entity's exposure to changes in the fair value of that "prepayment" option, perhaps thereby achieving the objective of its desire to hedge prepayment risk. The effect of an embedded derivative of the same risk class must be considered in designating a hedge of an individual risk. For example, the effect of an embedded prepayment option must be considered in designating a hedge of benchmark interest rate risk.

#### Disclosure Requirements

62. Reporting entities shall disclose the following for all derivative contracts used:
- a. General disclosures:
    - vii. The net gain or loss recognized in unrealized gains or losses during the period ending period resulting from derivatives that no longer qualify for hedge accounting. For portfolio layer method hedges, disclose circumstances that led to the breach. (ASC 815-10-50-5C.)

**Staff Note: The shaded section reflects revised guidance adopted with agenda item 2021-20.**

#### Relevant Literature

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

<sup>2</sup>~~The first sentence of paragraph 26.d. that specifically permits the hedged item to be identified as either all or a specific portion of a recognized asset or liability or of an unrecognized firm commitment is not affected by the provisions in this subparagraph.~~

This statement rejects *FSP FIN 39-1, Amendments of FASB Interpretation No. 39, and ASU 2014-03, Derivatives and Hedging – Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps – Simplified Hedge Accounting Approach.*

65. This statement adopts, with modification, certain revisions to ASC 815-20 included in ASU 2017-12. Remaining provisions of ASU 2017-12 will be subsequently assessed for statutory accounting and shall not be considered adopted for statutory accounting until that assessment is complete.
- a. Revisions effective January 1, 2019 with early adoption permitted, are limited to specific provisions, and related transition guidance, pertaining to the documentation and assessment of hedge effectiveness and only includes: 1) provisions allowing more time to perform the initial quantitative hedge effectiveness assessment; 2) provisions allowing subsequent assessments of hedge effectiveness to be performed qualitatively if certain conditions are met; and 3) revisions regarding use of the critical terms and short-cut methods for assessing hedge effectiveness.
  - b. Revisions effective January 1, 2023, with early adoption permitted, are limited to the criteria for initial and subsequent hedge effectiveness detailed in the FASB Accounting Standards Codification (ASC) paragraphs 815-20-25-72 through 815-20-35-20, as modified through the issuance of ASU 2017-12. This adoption reflects statutory modifications to specify that the accounting and reporting of hedging instruments, including excluded components of the instruments, shall follow statutory specific guidance detailed in the statement. The intent of this guidance is to clarify that the determination of whether a hedging instrument qualifies as an effective hedge shall converge with U.S. GAAP, but that the measurement method shall continue to follow statutory specific provisions. The adoption of the referenced ASC paragraphs only extends to revisions incorporated through ASU 2017-12; therefore, any subsequent U.S. GAAP edits would require statutory accounting consideration before considered adopted.
  - c. Revisions effective \_\_\_\_\_, with early adoption permitted, are limited to the criteria for the portfolio layer method detailed in ASU 2022-01, criteria to only consider how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity date in 815-20-25-6B, adding option in calculating the change in the hedged item's fair value attributed to changes in the benchmark interest rate based on the benchmark rate components of the contractual cash flows detailed in FASB ASC 815-25-35-13, and the partial-term hedging method detailed in FASB ASC 815-25-35-13B. The adoption of the partial term hedging method reflects statutory modifications that limits its use only when the hedged item is a recognized asset. This is different than U.S. GAAP, which permits the partial term method for hedged liabilities. The statutory limitation is established to prevent interim basis adjustments to hedged liabilities that could present a reduction of reported liabilities on the financial statements when the actual liability has not been reduced. Reconsideration of this statutory limitation may occur after a broader project to consider how derivative basis adjustments to hedged liabilities shall be reflected in the financial statements.

### Effective Date and Transition

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

- a. Revisions adopted to paragraph 64 to reject FSP FIN 39-1 is effective January 1, 2013, for companies that have previously reported a position in the balance sheet that was net of counterparty

agreements. (Companies that have previously reported derivative instruments and/or related collateral gross shall not be impacted by these revisions.)

- b. Revisions adopted in paragraph 16 clarify the reporting for amounts received/paid to adjust variation margin until the derivative contract has ended and are effective January 1, 2018, on a prospective basis, for reporting entities that have previously considered these amounts to reflect settlement or realized gains/losses. (Companies that have previously reported variation margin changes in line with the revisions shall not be impacted by these revisions.)
- c. Revisions to incorporate limited provisions from ASU 2017-12 pertaining to the documentation of hedge effectiveness (detailed in paragraph 65) are effective January 1, 2019, with early adoption permitted for year-end 2018. However, if the reporting entity is a U.S. GAAP filer, the reporting entity may only elect early adoption if the entity has also elected early adoption of ASU 2017-12 for year-end 2018.
- d. Revisions adopted April 2019 to explicitly include structured notes in scope of this statement are effective December 31, 2019. Revisions adopted July 2020 to define “derivative premium,” require gross reporting of derivatives without the impact of financing premiums and require separate recognition of premiums payable and premiums receivable, are effective January 1, 2021.
- e. Revisions adopted August 2022 that adopt with modification the criteria for initial and subsequent hedge effectiveness detailed in the FASB ASC paragraphs 815-20-25-72 through 815-20-35-20, as modified through the issuance of ASU 2017-12 and that incorporate statutory accounting revisions for the accounting and reporting of excluded components are effective January 1, 2023, with early adoption permitted. These revisions shall be applied prospectively for all new and existing hedges. Entities shall detail the adoption of this guidance as a change in accounting principle pursuant to *SSAP No. 3—Accounting Changes and Corrections of Errors*.
- f. [Revisions adopted \[REDACTED\] that adopt U.S. GAAP guidance for the portfolio layer method, U.S. GAAP guidance to only consider how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity, U.S. GAAP guidance adding option in calculating the change in the hedged item’s fair value attributed to changes in the benchmark interest rate based on the benchmark rate component of the contractual coupon cash flows, that and adopt with modification U.S. GAAP guidance for partial term hedging are effective \[REDACTED\], with early adoption permitted. These revisions shall be applied prospectively to qualifying new hedges. \(Staff Note – Asking industry on the need to permit dedesignation / redesignation of existing hedges.\)](#)

### **Proposed Edits to Exhibit C – Interest Rate Hedging**

- 2d. Gain/Loss on Termination of a swap, collar or forward accounted for under hedge accounting (includes closing, exercise, maturity, and expiry):
  - i. Exercise—The remaining book value of the derivative shall become an adjustment to the cost or proceeds of the hedged item(s) received or disposed of individually or in aggregate;
  - ii. Sale, maturity, expiry, or other closing transaction of a derivative which is an effective hedge—Any gain or loss on the transaction, except for excluded components, will adjust the basis (or proceeds) of the hedged item(s) individually or in aggregate. [If a portfolio layer method hedging relationship is discontinued \(or partially discontinued\) in a voluntary dedesignation or in anticipation of a breach, the basis adjustment associated with the dedesignated amount as of the discontinuation date shall be allocated to the remaining](#)



individual assets in the closed portfolio that supported the dedesignated hedged layer using a systematic and rational method. Alternatively, if the item being hedged is subject to IMR, the gain or loss on the terminated hedging derivative may be realized and shall be subject to IMR upon termination. (ASU 815-25-40-9)

- iii. Gain/loss on termination of derivatives will be recognized currently in net income (realized gain/loss) to the extent they ceased to be effective hedges.
- iv. Upon the redesignation of a derivative from a currently effective hedging relationship-
  - (a) with an item(s) carried at amortized cost to another effective hedging relationship with an item(s) carried at amortized cost, the derivative shall continue to be recorded at amortized cost and no gain or loss on the derivative shall be recognized.
  - (b) with an item(s) carried at amortized cost or fair value to an effective relationship with an item(s) carried at fair value, the accounting for the derivative shall be consistent with (ii) above.
  - (c) with an item(s) carried at fair value to an effective relationship with an item(s) carried at amortized cost, the accounting for the derivative shall be consistent with (ii) above.

#### Exhibit A – Assessment of Effectiveness

17. All of the following conditions apply to both fair value hedges and cash flow hedges: *(815-20-25-104)*
- e. The interest-bearing asset or liability is not prepayable, that is, able to be settled by either party before its scheduled maturity, or the assumed maturity date if the hedged item is measured as a partial-term hedge of interest rate risk in which the assumed maturity of the hedged items occur on the date in which the last hedged cash flow is due and payable ends at the end of the designated hedge period. in accordance with paragraph 815-25-35-13B, with the following qualifications:
    - i. This criterion does not apply to an interest-bearing asset or liability that is prepayable solely due to an embedded call option (put option) if the hedging instrument is a compound derivative composed of an interest rate swap and a mirror-image call option (put option).
    - ii. The call option embedded in the interest rate swap is considered a mirror image of the call option embedded in the hedged item if all of the following conditions are met:
18. All of the following incremental conditions apply to fair value hedges only: *(815-20-25-105 & 815-25-35-13B)*
- a. The expiration date of the interest rate swap matches the maturity date of the interest-bearing asset or liability or the assumed maturity date if the hedged item is measured as a partial-term hedge of interest rate risk in which the assumed maturity of the hedged items ends at the end of the designated hedge period occur on the date in which the last hedged cash flow is due and payable in accordance with paragraph 815-25-35-13B.

Portfolio Layer Method (Note – New paragraphs at the end of Exhibit A.)

46. For a closed portfolio of financial assets or one or more beneficial interests secured by a portfolio of financial instruments, an entity may designate as the hedged item or items a hedged layer or layers (this designation is referred to throughout as the “portfolio layer method.”) (ASU 815-20-25-12A)

- a. As part of the initial hedge documentation, an analysis is completed and documented to support the entity’s expectation that the hedged item or items (that is, the hedged layer or layers in aggregate) is anticipated to be outstanding for the designated hedge period. That analysis shall incorporate the entity’s current expectations of prepayments, defaults, and other factors affecting the timing and amount of cash flows associated with the closed portfolio.
- b. For purposes of its analysis in paragraph 46.a., the entity assumes that as prepayments, defaults, and other factors affecting the timing and amount of cash flows occur, they first will be applied to the portion of the closed portfolio that is not hedged; and
- c. The entity applies the partial-term hedging guidance to the assets or beneficial interest used to support the entity’s expectation in paragraph 46.a. An asset that matures on a hedged layer’s assumed maturity date meets this requirement.

47. After a closed portfolio is established in accordance with paragraph 46, and entity may designate new hedging relationships associated with the closed portfolio without dedesignating any existing hedging relationships associated with the closed portfolio if the criteria of paragraph 46 are met for those newly designated hedging relationships. (ASU 815-20-25-12B)

48. For the portfolio layer method if both of the following conditions exist, the quantitative test described for similar assets (shared risk exposure) may be performed qualitatively on a hedge-by-hedge basis and only at hedge inception:

- a. The hedged item is a hedged layer in a portfolio layer hedge and designated in accordance with paragraph 26.f. of SSAP No. 86.
- b. An entity measures the change in fair value of the hedged item based on the benchmark rate component of the contractual coupon cash flows.

Using the benchmark rate component of the contractual coupon cash flows when all assets have the same assumed maturity date and prepayment risk does not affect the measurement of the hedged item results in all hedged items having the same benchmark rate component coupon cash flows. (ASU 815-20-55-14A)

49. For one or more hedging relationships designated under the portfolio layer method, an entity shall discontinue (or partially discontinue) hedge accounting in the following circumstances: (ASU 815-25-40-8)

- a. If the entity cannot support on a subsequent testing date that the hedged layer or layers are anticipated to be outstanding for the designated hedge (that is, a breach is anticipated), it shall discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item that is no longer anticipated to be outstanding for the designated hedge period.
- b. If on a subsequent testing date the outstanding amount of the closed portfolio of financial assets or one or more beneficial interests is less than the hedged layer or layers (that is, a breach has occurred), the entity shall discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item that is no longer outstanding.

50. In the event of either an anticipated breach (as described in paragraph 49.a.) or a breach that has occurred (as described in paragraph 49.b.) for portfolio layer method, if multiple hedged layers are associated with a closed

portfolio, an entity shall determine which hedge or hedges to discontinue (or partially discontinue) in accordance with an accounting policy election. That accounting policy election shall specify a systematic and rational approach to determining which hedge or hedges to discontinue (or partially discontinue). An entity shall establish its accounting policy no later than when it first anticipates a breach or when a breach has occurred (whichever comes first). After an entity establishes its accounting policy, it shall consistently apply its accounting policy to all portfolio layer method breaches (anticipated and occurred). (ASU 815-25-40-8A)

**In the issue paper, the U.S. GAAP references not pulled into Exhibit will also be updated as follows:**

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

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

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2022/Fall-December/Hearing/5-22-09-ASU2022-01-PortfolioHedges.docx>

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

**Issue: ASU 2022-02 – Troubled Debt Restructurings and Vintage Disclosures**

**Check (applicable entity):**

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

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

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

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

Although consideration of ASU 2016-13 is still pending statutory accounting review, from initial assessments and industry outreach, a full adoption of the CECL standard is not likely to be supported. This is because 1) insurers more commonly hold assets at amortized cost under SAP and at fair value (as available for sale) under U.S. GAAP – so the CECL model would significantly impact the measurement method under SAP, but not under U.S. GAAP, and 2) the asset-valuation reserve (AVR), a statutory accounting guidance applicable to life and fraternal insurers, establishes a reserve to offset potential credit-related investment losses on most investment categories. With ASU 2016-13 applicable to small public and non-public U.S. GAAP filers as of Jan. 1, 2023, NAIC staff are currently soliciting input from industry on key CECL impacts to assess for statutory accounting purposes. Once that information is received, a further review will occur on ASU 2016-13 to determine the extent that CECL concepts should be reflected within statutory accounting principles.

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

With ASU 2022-02, expanded disclosures on commitments and modified loans have been incorporated. Although some of the general concepts within the following U.S. GAAP disclosures are captured in SSAP No. 36, paragraph 23, the following U.S. GAAP disclosures are more specific than what was previously incorporated:

1. Disclose if the creditor has a commitment to lend additional funds to debtors experiencing financial difficulty for which the creditor has modified the terms of the receivables in the form of principal forgiveness, an interest rate reduction, and other-than-insignificant payment delay, or a term extension in the current reporting period (ASU 310-10-50-36). (Note – This is similar to a prior GAAP disclosure for TDRs and reflected in concept within SSAP No. 36, paragraph 23.b.)
2. In addition to disclosures about the type and magnitude of certain modifications of receivables made to debtors experiencing financial difficulty (summarized in paragraphs 3-5 below), the financial effect of those modifications and the degree of success of the modification in mitigating potential credit losses, an entity shall consider providing information that helps financial statement users understand significant changes in the type of magnitude of modifications, including those modifications that, for example, were caused by a major credit event, even if the modifications would not require the disclosures detailed below.) (ASU 310-10-50-38)
3. For each period in which a statement of income is presented, an entity shall disclose the following information related to modifications of receivables that are in the form of principal forgiveness, an interest rate reduction, an other-than insignificant payment delay, or a term extension (or a combination thereof) made to debtors experiencing financial difficulty during the reporting period. (ASU 310-10-50-42)
  - a. By class of financing receivable, qualitative and quantitative information about:
    - i. The types of modifications utilized by an entity, including the total period-end amortized cost basis of the modified receivables and the percentage of modifications of receivables made to debtors experiencing financial difficulty relative to the total period-end amortized cost basis of receivables in the class of financing receivable.
    - ii. The financial effect of the modification by type of modification, which shall provide information about the changes to the contractual terms as a result of the modification and shall include the incremental effect of principal forgiveness on the amortized cost basis of the modified receivables, as applicable, or the reduction in weighted-average interest rates (versus a range) for interest rate reductions.
    - iii. Receivable performance in the 12 months after a modification of a receivable made to a debtor experiencing financial difficulty.

- b. By portfolio segment, qualitative information about how those modifications and the debtors' subsequent performance are factored into determining the allowance for credit losses.
4. Receivables made be modified in more than one manner. An entity that modifies the same receivable in more than one manner shall provide disclosures sufficient for users to understand the different types of combinations of modifications provided to borrowers. For example, a receivable may be modified to provide both principal forgiveness and an interest rate reduction. In that case, an entity shall disclose the period-end amortized cost basis of that receivable in a separate category that reflects that a combination of mortification types has been granted. If another receivable was modified to provide both an interest rate reduction and a term extension, the period-end amortized cost basis of that receivable shall be presented in a different category. Multiple separate combinations categories may be necessary if significant. The same receivable's period-end amortized cost basis shall not be presented in multiple categories. (310-10-50-43)
  5. For each period in which a statement of income is presented, an entity shall disclose the following information about financing receivables that had a payment default during the period and had been modified in the form of principal forgiveness, an interest rate reduction, an other-than-insignificant payment delay, or a term extension (or a combination thereof) within the previous 12 months preceding the payment default when the debtor was experiencing financial difficulty at the time of the modification. (310-10-50-44)
    - a. By class of financing receivable, qualitative and quantitative information about those defaulted financing receivables, including the following:
      - i. The type of contractual change the modification provided.
      - ii. The amount of financing receivables that defaulted, including the period-end amortized cost basis for financing receivables that defaulted.
    - b. By portfolio segment, qualitative information about how those defaults are factored into determining the allowance for credit losses.

Per the ASU, the disclosures in paragraphs 3, 4 and 5 shall be provided regardless of whether a modification of a receivable to a debtor experiencing financial difficulty results in a new loan. (ASU 310-10-50-41)

In addition to the TDR for creditors guidance, ASU 2022-02 also incorporates and revises "vintage" disclosures for gross write-offs for public business entities involving financing receivables and net investment in leases. These disclosures were originally captured as part of the CECL guidance in ASU 2016-13 for all entities, and the revisions modify and restrict the disclosures to public business entities:

- When disclosing credit quality indicators of financing receivables and net investment in leases, a public business entity shall present the amortized cost basis within each credit quality indicator by year of origination (that is, vintage year). For purchased financing receivables and net investment in leases, an entity shall use the initial date of issuance to determine the year of origination, not the date of acquisition. For origination years before the fifth annual period, a public business entity may present the amortized cost basis of financing receivables and net investments in leases in the aggregate. For interim-period disclosures, the current year-to-date originations in the current reporting period are considered to the current-period originations. (326-20-50-6)
- A public business entity shall present the gross write-offs recorded in the current period, on a current year-to-date basis, for financing receivables and net investments in leases by origination year. For origination years before the fifth annual period, a public business entity may present the gross write-offs in the current period for financing receivables and net investments in leases in aggregate. The requirement to present the

amortized cost basis within each credit quality indicator by year of origination is not required for an entity that is not a public business entity. (326-20-50-6A)

### Existing Authoritative Literature:

#### **SSAP No. 36—Troubled Debt Restructuring**

A troubled debt restructuring is defined as a debt restructuring whereby 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 grant. Guidance in SSAP No. 36, adopted from U.S. GAAP for creditors, details the following:

- Determining whether a creditor has granted a concession
- Determining whether a debtor is experiencing financial difficulties
- Determining whether a restructuring results in a delay in payment that is insignificant
- Accounting by creditors
- Disclosure for creditors.

Key excerpts from the guidance in SSAP No. 36:

#### **Accounting by Creditors**

17. A creditor shall account for a troubled debt restructuring according to the type of the restructuring (receipt of assets in full satisfaction, modification of terms, combination of types). Generally, troubled debt restructuring involving the transfer of assets shall be accounted for at the fair value of the assets received. Troubled debt restructuring involving modification of terms shall be accounted for at fair value (as determined by acceptable appraisal methodologies) in accordance with *SSAP No. 100R—Fair Value*. If the restructured loan is collateral dependent, fair value shall be the fair value of the collateral. If the restructured loan is not collateral dependent, fair value shall be determined in accordance with SSAP No. 100R. If the determined fair value of the loan is less than the recorded investment in the loan (including accrued interest, net deferred loan fees or costs, and unamortized premium or discount), a new cost basis shall be established at the fair value with the difference being recorded as a realized loss in the statement of operations. After the troubled debt restructuring, a creditor shall account for the assets consistent with the statutory guidance for such assets.

18. A creditor shall account for assets, including foreclosed property and equity interests in corporations, joint ventures, or partnerships, received in satisfaction of the loan at their fair value (as determined by acceptable appraisal methodologies) at the time of restructuring or at the book value of the loan if lower. If the fair value is less than the book value, the required writedown shall be recognized as a realized capital loss. The creditor shall reclassify the asset from loans to the appropriate asset account, such as real estate or other invested assets, at the time that the creditor obtains clear title to the asset except for mortgage loans which shall follow the guidance in paragraph 18 of SSAP No. 37. After the troubled debt restructuring, a creditor shall account for the assets received in satisfaction of the loan consistent with the statutory guidance for similar assets.

19. Any fees received in connection with a modification of terms of a troubled debt restructuring shall be applied as a reduction of the recorded investment in the loan. All costs associated with the restructuring, including direct loan origination costs, shall be charged to expense as incurred.

#### **Disclosure by Creditors**

23. A creditor shall disclose in the financial statements the information captured in paragraphs 23.a., 23.b. and 23.c. about troubled debt restructuring as of the date of each balance sheet presented. Disclosures captured from paragraphs 23.d. and 23.e. are required in the statutory audited financial statements only:

- a. As of the date of each statement of financial position presented, the recorded investment in the loans for which impairment has been recognized in accordance with this statement



- and the related realized capital loss. (For mortgage loans, the disclosures in SSAP No. 37 shall also be completed.)
- b. The amount of commitments, if any, to lend additional funds to debtors owing receivables whose terms have been modified in troubled debt restructuring
  - c. The creditor's income recognition policy for interest income on an impaired loan
  - d. For troubled debt restructurings that occurred during the annual reporting period, aggregated by type of instrument, qualitative and quantitative information on (1) how the items were modified and (2) the financial effects of the modifications
  - e. If restructured within the previous 12 months and there has been a payment default during that period, disclose qualitative and quantitative information about the defaulted instruments, aggregated by type of instrument, including: (1) type of instruments that defaulted and (2) the amount of recorded investments for which default occurred
24. Refer to the Preamble for further discussion regarding disclosure requirements.
25. This statement is not intended to modify the requirement for life and health insurers to complete the annual statement exhibit disclosing long-term mortgage loans in good standing with restructured terms.

#### Relevant Literature

26. This statement adopts with modification *FASB Statement No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings* (FAS 15) to specify that creditors shall reclassify assets obtained in a troubled debt restructuring from loans to the appropriate asset account at the time the creditor obtains clear title to the asset, except for mortgage loans which shall be reclassified at the beginning of the redemption period unless it is probable that the mortgage loan will be redeemed and with modification to require that gains and losses from extinguishment of debt be reported as capital gains or losses, and charged to operations. In August 2012, this statement was revised to adopt paragraphs 310-40-15-13 through 310-40-15-18 and 310-40-15-20 of the FASB Codification incorporated through *FASB ASU 2011-02, A Creditors Determination of Whether a Restructuring Is a Troubled Debt Restructuring*. Also in August 2012, this statement adopted with modification the disclosure requirements included in paragraphs 310-10-50-33 through 310-10-50-34 of the FASB Codification originally incorporated from *ASU 2010-20, Receivables (Topic 310), Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, deferred by *ASU 2011-01, Receivables (Topic 310), Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20* and reinstated through *ASU 2011-02*. These disclosure requirements have been modified to be applicable for all troubled debt restructurings within the scope of SSAP No. 36, rather than limited to troubled debt restructurings of "financing receivables." The revisions adopted in August 2012 from *ASU 2011-02* and *ASU 2010-20* are effective January 1, 2013, with early application permitted.
27. This statement adopts paragraphs 9, 22, and 25 of *FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan* (FAS 114). Paragraphs 6.d., 13 and 21 of FAS 114 are rejected. *FASB Statement No. 118, Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures* is adopted as it relates to troubled debt restructuring.
28. This statement adopts *FASB Technical Bulletin 81-6, Applicability of Statement 15 to Debtors in Bankruptcy Situations* and *FASB Technical Bulletin 80-2, Classification of Debt Restructuring by Debtors and Creditors*. It also adopts *FASB Emerging Issue Task Force No. 87-18, Use of Zero Coupon Bonds in a Troubled Debt Restructuring*, *FASB Emerging Issue Task Force No. 87-19, Substituted Debtors in a Troubled Debt Restructuring*, *FASB Emerging Issue Task Force No. 89-15, Accounting for a Modification of Debt Terms When the Debtor is Experiencing Financial Difficulties* consistent with the modifications to FAS 15 discussed in this statement, *FASB Emerging Issues Task Force No. 96-22, Applicability of the Disclosures Required by FASB Statement No. 114 When a Loan Is Restructured in a Troubled Debt Restructuring into Two (or More) Loans* and *FASB EITF 02-4: Determining Whether a Debtor's Modification or Exchange of Debt Instruments is Within the Scope of FASB Statement No. 15*.

29. Although *FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases* (FAS 91) was rejected in *SSAP No. 26R—Bonds*, this statement is consistent with paragraph 14 of *FAS No. 91*.

30. This statement rejects *FASB Emerging Issues Task Force No. 94-8, Accounting for Conversion of a Loan into a Security in a Troubled Debt Restructuring* and *FASB Technical Bulletin 94-1, Application of Statement 115 to Debt Securities Restructured in a Troubled Debt Restructuring*.

**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 2020, in response to the COVID pandemic, the Statutory Accounting Principles (E) Working Group issued two interpretations providing limited time exceptions for troubled debt restructurings. INT 20-07, believed most widely used, provided limited-time practical expedients in determining whether restructured payments are considered insignificant. Both interpretations automatically expired on Jan. 2, 2022.

- INT 20-03: Troubled Debt Restructurings Due to COVID-19
- INT 20-07: Troubled Debt Restructuring of Certain Debt Investments Due to COVID-19

In 2016, with the issuance of ASU 2016-13, the Working Group began discussions on the CECL standard for statutory accounting. Although a number of preliminary discussions occurred, discussions halted as the effective date of U.S. GAAP standard (as well as other standards) was delayed in response to the COVID-19 pandemic. ASU 2016-13 is now effective January 2023 for smaller reporting public entities and nonpublic companies. When discussions were ongoing, a comment letter received from interested parties dated July 9, 2018, recommended that the NAIC retain the existing credit impairment guidance in statutory accounting principles. The discussion on ASU 2016-13 for statutory accounting is expected to resume in 2022.

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

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

**Recommendation:**

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

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

**Staff Review Completed by:** Julie Gann - NAIC Staff, April 2022

[https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/Maintenance/Active Form A's/2022/22-XX - ASU 2022-02 - TDR CECL - With Edits.docx](https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/Maintenance/Active%20Form%20A's/2022/22-XX-ASU%2022-02-TDR%20CECL-With%20Edits.docx)

## Proposed Revisions to SSAP No. 36:

### Relevant Literature

26. This statement rejects ASU 2022-02, *Troubled Debt Restructurings and Vintage Disclosures* and the U.S. GAAP guidance within the Accounting Standards Codification for troubled debt restructurings for creditors. This ASU is rejected as the U.S. GAAP guidance for troubled debt restructuring by creditors has been significantly modified to eliminate the separate recognition of losses from restructurings as losses are captured within the allowance for credit losses valuation account established pursuant to ASU 2016-13, *Financial Instruments – Credit Losses*. As statutory accounting has not adopted ASU 2016-13, the prior troubled debt restructuring adopted from U.S GAAP in effect prior to ASU 2016-13 and ASU 2022-02 has been retained. With the rejection of ASU 2022-02, reporting entities shall continue to apply the prior concepts within SSAP No. 36 when assessing and classifying modifications as troubled debt restructurings. These retained concepts do not permit entities to consider troubled debt restructurings as new loans and therefore do not permit immediate recognition of unamortized fees, costs, or prepayment penalties as interest income at the time of restructuring. Additionally, fees received by a reporting entity from a restructuring shall continue to reduce the recorded investment and all costs incurred by a reporting entity with the restructuring shall continue to be charged to expense as incurred.

27. Although the statutory accounting guidance for troubled debt restructurings for creditors no longer reflects authoritative guidance from U.S. GAAP, the guidance in SSAP No. 36 reflects the following superseded U.S. GAAP guidance as follows:

- a. Adopted with modification FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings* (FAS 15) to specify that creditors shall reclassify assets obtained in a troubled debt restructuring from loans to the appropriate asset account at the time the creditor obtains clear title to the asset, except for mortgage loans which shall be reclassified at the beginning of the redemption period unless it is probable that the mortgage loan will be redeemed and with modification to require that gains and losses from extinguishment of debt be reported as capital gains or losses, and charged to operations.
- b. Adopted paragraphs 310-40-15-13 through 310-40-15-18 and 310-40-15-20 of the FASB Codification incorporated through FASB ASU 2011-02, *A Creditors Determination of Whether a Restructuring Is a Troubled Debt Restructuring*
- c. Adopted with modification the disclosure requirements included in paragraphs 310-10-50-33 through 310-10-50-34 of the FASB Codification originally incorporated from ASU 2010-20, *Receivables (Topic 310), Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, deferred by ASU 2011-01, *Receivables (Topic 310), Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20* and reinstated through ASU 2011-02. These disclosure requirements were modified to be applicable for all troubled debt restructurings within the scope of SSAP No. 36, rather than limited to troubled debt restructurings of “financing receivables.”
- d. Adopted paragraphs 9, 22, and 25 of FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan* (FAS 114). Adopted FASB Statement No. 118, *Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures* as it relates to troubled debt restructuring.
- e. Adopts FASB Technical Bulletin 81-6, *Applicability of Statement 15 to Debtors in Bankruptcy Situations* and FASB Technical Bulletin 80-2, *Classification of Debt Restructuring by Debtors and Creditors*, FASB Emerging Issue Task Force No. 87-18, *Use of Zero Coupon Bonds in a Troubled Debt Restructuring*, FASB Emerging Issue Task Force No. 87-19, *Substituted Debtors in a Troubled Debt Restructuring*, FASB Emerging Issue Task Force No. 89-15, *Accounting for a Modification of Debt Terms When the Debtor is Experiencing Financial Difficulties* consistent with the modifications to FAS 15, FASB Emerging Issues Task Force No. 96-22, *Applicability of the Disclosures Required by FASB*

*Statement No. 114 When a Loan Is Restructured in a Troubled Debt Restructuring into Two (or More) Loans and FASB EITF 02-4: Determining Whether a Debtor's Modification or Exchange of Debt Instruments is Within the Scope of FASB Statement No. 15.*

- f. This statement is consistent with paragraph 14 of FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases (FAS 91), but FAS 91 was rejected in SSAP No. 26R

28. For historical reference purposes, the following superseded U.S. GAAP guidance was previously rejected within this statement:

- a. Paragraph 6.d., 13 and 21 of FAS 114.
- b. FASB Emerging Issues Task Force No. 94-8, Accounting for Conversion of a Loan into a Security in a Troubled Debt Restructuring and FASB Technical Bulletin 94-1, Application of Statement 115 to Debt Securities Restructured in a Troubled Debt Restructuring.

~~26. This statement adopts with modification FASB Statement No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings (FAS 15) to specify that creditors shall reclassify assets obtained in a troubled debt restructuring from loans to the appropriate asset account at the time the creditor obtains clear title to the asset, except for mortgage loans which shall be reclassified at the beginning of the redemption period unless it is probable that the mortgage loan will be redeemed and with modification to require that gains and losses from extinguishment of debt be reported as capital gains or losses, and charged to operations. In August 2012, this statement was revised to adopt paragraphs 310-40-15-13 through 310-40-15-18 and 310-40-15-20 of the FASB Codification incorporated through FASB ASU 2011-02, A Creditors Determination of Whether a Restructuring Is a Troubled Debt Restructuring. Also in August 2012, this statement adopted with modification the disclosure requirements included in paragraphs 310-10-50-33 through 310-10-50-34 of the FASB Codification originally incorporated from ASU 2010-20, Receivables (Topic 310), Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses, deferred by ASU 2011-01, Receivables (Topic 310), Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20 and reinstated through ASU 2011-02. These disclosure requirements have been modified to be applicable for all troubled debt restructurings within the scope of SSAP No. 36, rather than limited to troubled debt restructurings of "financing receivables." The revisions adopted in August 2012 from ASU 2011-02 and ASU 2010-20 are effective January 1, 2013, with early application permitted.~~

~~27. This statement adopts paragraphs 9, 22, and 25 of FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan (FAS 114). Paragraphs 6.d., 13 and 21 of FAS 114 are rejected. FASB Statement No. 118, Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures is adopted as it relates to troubled debt restructuring.~~

~~28. This statement adopts FASB Technical Bulletin 81-6, Applicability of Statement 15 to Debtors in Bankruptcy Situations and FASB Technical Bulletin 80-2, Classification of Debt Restructuring by Debtors and Creditors. It also adopts FASB Emerging Issue Task Force No. 87-18, Use of Zero Coupon Bonds in a Troubled Debt Restructuring, FASB Emerging Issue Task Force No. 87-19, Substituted Debtors in a Troubled Debt Restructuring, FASB Emerging Issue Task Force No. 89-15, Accounting for a Modification of Debt Terms When the Debtor is Experiencing Financial Difficulties consistent with the modifications to FAS 15 discussed in this statement, FASB Emerging Issues Task Force No. 96-22, Applicability of the Disclosures Required by FASB Statement No. 114 When a Loan Is Restructured in a Troubled Debt Restructuring into Two (or More) Loans and FASB EITF 02-4: Determining Whether a Debtor's Modification or Exchange of Debt Instruments is Within the Scope of FASB Statement No. 15.~~

~~29. Although FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases (FAS 91) was rejected in SSAP No. 26R—Bonds, this statement is consistent with paragraph 14 of FAS No. 91.~~

~~30. This statement rejects FASB Emerging Issues Task Force No. 94-8, Accounting for Conversion of a Loan into a Security in a Troubled Debt Restructuring and FASB Technical Bulletin 94-1, Application of Statement 115 to Debt Securities Restructured in a Troubled Debt Restructuring.~~

### **Effective Date and Transition**

~~34.29.~~ ~~34.~~ This statement is effective for years beginning January 1, 2001. The provisions of this statement shall be applied to all troubled debt restructurings entered into on or after January 1, 2001. The adoption of FASB EITF 02-4: Determining Whether a Debtor's Modification or Exchange of Debt Instruments is within the Scope of FASB Statement No. 15 was incorporated from INT 03-12 and effective December 7, 2003. [The revisions adopted in August 2012 from ASU 2011-02 and ASU 2010-20 are effective January 1, 2013, with early application permitted.](#)

### **Comments Requested – Is additional disclosure information desired on troubled debt restructurings?**

As detailed in the summary of new GAAP guidance, disclosures are expanded to allocate TDRs by type of modification – such as principal forgiveness, interest rate reduction, other-than-insignificant payment delay or term extension. Also under the new U.S. GAAP guidance, TDR disclosures are aggregated based on type of modification, and if more than one modification occurs, then a new category is reported to aggregate info for all contracts that have similar modifications. (So, modifications that encompass both principal forgiveness and interest rate reductions would be aggregated in a separate category, and modifications that include interest rate reductions and term extensions would be aggregated in a separate category.)

Below are the current disclosures and data-template for statutory financials. As shown, the data captured is limited.

#### **Disclosure by Creditors**

23. A creditor shall disclose in the financial statements the information captured in paragraphs 23.a., 23.b. and 23.c. about troubled debt restructuring as of the date of each balance sheet presented. Disclosures captured from paragraphs 23.d. and 23.e. are required in the statutory audited financial statements only:

- a. As of the date of each statement of financial position presented, the recorded investment in the loans for which impairment has been recognized in accordance with this statement and the related realized capital loss. (For mortgage loans, the disclosures in SSAP No. 37 shall also be completed.)
- b. The amount of commitments, if any, to lend additional funds to debtors owing receivables whose terms have been modified in troubled debt restructuring
- c. The creditor's income recognition policy for interest income on an impaired loan
- d. For troubled debt restructurings that occurred during the annual reporting period, aggregated by type of instrument, qualitative and quantitative information on (1) how the items were modified and (2) the financial effects of the modifications
- e. If restructured within the previous 12 months and there has been a payment default during that period, disclose qualitative and quantitative information about the defaulted instruments, aggregated by type of instrument, including: (1) type of instruments that defaulted and (2) the amount of recorded investments for which default occurred

<b>Note 5B.</b>	<b>Debt Restructuring</b>	Current Year	Prior Year
(1)	The total recorded investment in restructured loans, as of year-end	\$ _____	_____
(2)	The realized capital losses related to these loans	\$ _____	_____
(3)	Total contractual commitments to extend credit to debtors owing receivables whose terms have been modified in troubled debt restructurings	\$ _____	_____

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2022/Fall-December/Hearing/6-22-10-ASU2022-02-TDRCECL.docx>

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

**Issue: Related Parties – Footnote Updates**

**Check (applicable entity):**

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Description of Issue:** At its May 24, 2022, meeting, the Statutory Accounting Principles (E) Working Group adopted agenda item 2021-21 – Related Party Reporting. That agenda item encompassed two main goals:

1. Clarified the reporting of affiliate transactions within existing reporting lines in the investment schedules, while remaining 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. Incorporated new reporting requirements for investment transactions with related parties. This agenda item added a new column to annual statement reporting schedules: B – Mortgage Loans, D – Long-Term Bonds, DB – Derivatives, BA – Other Long-Term Invested Assets, DA – Short-Term Investments, E2 – Cash Equivalents, and DL – Securities Lending Collateral Assets where the reporting entity must select a code that best describes the related party relationship within the investment.

When agenda item 2021-21 was exposed for the final time on April 4, 2022, a footnote was added to *SSAP No. 25*, paragraph 9 that states “Consistent with *SSAP No. 97*, footnote 1, 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.” Among the comments received from interested parties after the April 4 exposure was a suggestion to extend the exemption to foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction, which are within the scope of *SSAP No. 30R—Unaffiliated Common Stock*.

As part of the adoption of agenda item 2021-21 at the May 24 meeting, NAIC staff were directed by the Working Group to make revisions to include foreign open-end funds *SSAP No. 25* and *SSAP No. 97* in the footnotes.

**Existing Authoritative Literature:**

***SSAP No. 25—Affiliates and Other Related Parties*** (paragraph and footnote originally adopted on the May 24, 2022, Working Group call.)

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<sup>FN</sup>, indirect control shall be presumed to exist unless the presumption of control can be overcome as detailed in paragraph 7. If direct or indirect control exists,

whether through voting securities, contracts, common management or otherwise, the arrangement is considered affiliated under paragraph 5. Consistent with paragraph 8, a disclaimer of affiliation does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

FN—Consistent with SSAP No. 97, footnote 1, 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.

***SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities***

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<sup>FN</sup>.

FN—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.

**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.

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.



On May 24, 2022, the Working Group adopted agenda item 2021-21 – Related Party Reporting, which encompassed two main goals:

- Clarified the reporting of affiliate transactions within existing reporting lines in the investment schedules, while remaining consistent with the definition of an “affiliate” pursuant to Model #440, SSAP No. 25 and SSAP No. 97.
- Incorporated new reporting requirements for investment transactions with related parties. This agenda item added a new column to annual statement reporting schedules: B – Mortgage Loans, D – Long-Term Bonds, DB – Derivatives, BA – Other Long-Term Invested Assets, DA – Short-Term Investments, E2 – Cash Equivalents, and DL – Securities Lending Collateral Assets where the reporting entity must select a code that best describes the related party relationship within the investment.

**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 a SAP clarification, and expose revisions to SSAP No. 25 and SSAP No. 97 to incorporate language to exempt foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction from the look-through provisions included in SSAP No. 25.

**Proposed edits 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<sup>FN</sup>, indirect control shall be presumed to exist unless the presumption of control can be overcome as detailed in paragraph 7. If direct or indirect control exists, whether through voting securities, contracts, common management or otherwise, the arrangement is considered affiliated under paragraph 5. Consistent with paragraph 8, a disclaimer of affiliation does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

FN—Consistent with SSAP No. 97, footnote 1, investments in an exchange traded fund (ETF), ~~or~~ a mutual fund (as defined by the SEC) or a foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction 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 or foreign open-end investment fund unless ownership of the ~~ETF fund~~ actually results in “control” with the power to direct or cause the direction of management of an underlying company. ETFs, ~~and~~ mutual funds and foreign open-end investment funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws or the applicable foreign jurisdictions laws.

**Proposed edits to SSAP No. 97:**

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<sup>FN</sup>.

FN—Investments in an exchange traded fund (ETF), ~~or~~ a mutual fund (as defined by the SEC) or a foreign open-end investment fund governed and authorized in accordance with regulations established by the applicable foreign jurisdiction 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 or foreign open-end investment fund unless ownership of the ~~fund~~ETF actually results in “control” with the power to direct or cause the direction of management of an underlying company. ETFs, ~~and~~ mutual funds and foreign open-end investment funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws or the applicable foreign jurisdictions laws. ETFs, ~~and~~ mutual funds and foreign open-end investment funds held by a reporting entity shall be reported as common stock, unless the ~~fund~~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 foreign open-end investment funds or to adjust the value of SCAs as a result of investments in ETFs, ~~or~~ mutual funds or foreign open-end investment funds.

**Staff Review Completed by:** Jake Stultz – NAIC Staff, July 2022

**Status:**

On August 10, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 25 and SSAP No. 97 to incorporate language to exempt foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction from the look-through provisions included in SSAP No. 25 and SSAP No. 97.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2022/Fall-December/Hearing/7-22-13-RelatedPartyFootnoteRev.docx>

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

**Issue: Conceptual Framework – Updates**

**Check (applicable entity):**

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Description of Issue:** In December 2021, the Financial Accounting Standards Board (FASB) issued two new chapters of its conceptual framework. The conceptual framework is a body of interrelated objectives and fundamentals that provides the FASB with a foundation for setting standards and concepts to consider when it resolves questions or develops/modifies accounting and reporting guidance.

It is important to note that the Statements of Financial Accounting Concepts are not authoritative and do not establish new or change existing U.S. GAAP. Per the FASB chair, these concepts are “a tool for the Board to use in setting standards that improve the understandability of information entities provide to existing and potential investors, lenders, donors, and other resource providers.”

This agenda item reviews and summarizes each of the two newly issued concept chapters and reviews their potential impact on statutory accounting. Again, while the conceptual framework statements are not authoritative, they are the guiding principles for standard setting and these new updates have superseded chapters currently referenced in the *Accounting Practices and Procedures Manual (AP&P Manual)*. In addition, and most notably, in the case of one of these chapters, FASB changed certain key fundamental definitions, specifically the definition of an asset and a liability, which have historically been mirrored by statutory accounting.

**Update 1:**

FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements* introduced updated definitions of certain key elements used in financial reporting – the definition of an asset and liability. The chapter states that assets and liabilities have conceptual and definitional primacy because assets and liabilities (and changes in those elements) are foundational to all the other items reported in the financial statements. To correctly identify and represent an asset or liability is the beginning basis for all financial reporting and due to their importance, updates to both financial statement elements have been adopted. A summary of each, comparing the historical and current definitions, is provided below:

**Changes regarding the definition of an ASSET:**

- **Historical definition:** a probable future economic benefit obtained or controlled by a particular entity as a result of past transactions or events.
- **Historical Characteristics: Three essential characteristics:**
  1. it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows,
  2. a particular enterprise can obtain the benefit and control others' access to it, and
  3. the transaction or other event giving rise to the enterprise's right to or control of the benefit has already occurred.
- **New Definition:** a present right of an entity to an economic benefit.

➤ **Current Characteristics: Two essential characteristics:**

1. it is a present right, and
2. the right is to an economic benefit.

The combination of these two characteristics allows an entity to obtain the economic benefit and control others' access to the benefit. A present right of an entity to an economic benefit entitles the entity to the economic benefit and the ability to restrict others' access to the benefit to which the entity is entitled. For clarity, an "economic benefit" represents services or other items of economic value and generally result in net cash inflows to the entity.

**Commentary regarding definitional changes:**

The current definition of an asset no longer includes the term *probable* or the phrases *future economic benefit* and *past transactions or events*. The FASB concluded that the term *probable* has historically been misunderstood as implying that a future benefit must be probable to a certain threshold before the definition of an asset was met. Thus, if the probability of a future benefit was low, an asset could not be recognized. FASB also struck the phrase *future economic benefit* as this phrase often was interpreted that the asset must represent a certain future economic benefit (such as eventual cash inflows), however with this update, FASB clarified that the asset represents the rights to the benefit, not the actual benefit itself – nor the probability of realization.

Finally, FASB struck the phrase as the result of *past transactions or events*. It was concluded that if the asset represents a *present right*, by default, the right must have occurred as the result of a past transaction or event and thus this phraseology was deemed redundant and unnecessary.

Changes regarding **the definition of a LIABILITY:**

- **Historical definition:** are [certain or] probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.
- **Historical Characteristics: Three essential characteristics:**
  1. it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand,
  2. the duty or responsibility obligates a particular enterprise, leaving it little or no discretion to avoid the future sacrifice, and
  3. the transaction or other event obligating the enterprise has already happened.
- **New Definition:** a present obligation of an entity to transfer an economic benefit.
- **Current Characteristics: Two essential characteristics:**
  1. it is a present obligation, and
  2. the obligation requires an entity to transfer or otherwise provide economic benefit to others. (For the purposes of this characteristic, *transfer* is typically used to describe obligations to pay cash or convey assets, while the term *provide* is used to describe obligations to provide services or stand by to do so).

**Commentary regarding definitional changes:**

The current definition of a liability no longer includes the term *probable* or the phrase *in the future as a result of past transactions or events*. The FASB concluded that the term *probable* has historically been understood as implying that a future obligation must meet a probability to a certain threshold before the definition of a liability was met. Thus, if the probability of a future transfer of an asset (or the requirement to provide a service) was low,

a liability would likely not be recognized. In removing the term *probable* (and replacing it with “present obligation”), FASB concluded that in almost all situations, the presence of an obligation will be apparent. It stated that most present obligations are legally enforceable, including obligations arising from binding contracts, agreements, statutes, or other legal or contractual means. Chapter 4 also discusses the prevalence of certain business risks and how to assess if they result in the recognition of a liability. It concluded that while certain businesses pose risk of future events occurring that will cause them to transfer an economic benefit (an asset), the risk itself does not represent a present obligation because exposure to a potential negative consequence does not constitute a present obligation.

However, FASB also stated situations lacking clear legal or contractual evidence of a present obligation may pose particular challenges that may make it difficult to discern whether a present obligation exists. In these settings, the FASB stated that constructive obligations or other noncontractual obligations are created by circumstance rather than by explicit agreement. In the absence of an explicit agreement, sufficient information to distinguish a present obligation is likely only available at the specific standards level. Thus, the FASB concluded that the specific facts and circumstances at the standards level (or in the case of statutory accounting, at the SAP level) must be utilized to determine whether the entity has created a constructive obligation and must recognize a liability.

FASB also struck the phrase as the result of *past transactions or events*. It was concluded that if the liability represents a *present right*, by default, the right must have occurred as the result of a past transaction or event and thus this phraseology was deemed redundant and unnecessary.

#### **Update 2:**

FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7, Presentation* identifies factors that the FASB will consider when deciding **how** items should be displayed on the financial statements. Chapter 7 describes the information to be included in the financial statements and how appropriate presentation can contribute to the objective of financial reporting – to communicate financial information about an entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources (goods and services) to the entity. These decisions typically involve buying or selling of goods/services or holding equity and debt instruments as well as providing or settling loans or other forms of credit. This chapter articulates that the financial statements meet a “general purpose” and should not be considered to meet all purposes for possible users – and thus a common set of conceptual standards is appropriate.

Chapter 7 also describes the importance of financial statement notes, or supplementary information so that financial statement users are provided with a more complete picture of an entity’s accounting policy or any particular unique circumstance or event. In terms of general reporting, the conceptual statement relays that a distinction between nonhomogeneous items should be depicted in the financial statements with different reporting line items and subtotals and that the information should be provided based on recognition and measurement standards. In essence, reporting should be sufficiently aggregated, but not aggregated to a level in which the information is too consolidated for general use and understanding. Once reported, then any significant accounting policy or circumstance would further be defined with accompanying notes.

The chapter broadly states that to meet the objectives of financial reporting, line items should be distinct based on the information being provided – as the information should distinguish between various types of transactions/events and should assist users in their estimates in the amounts and timing of future cash flows or the entity’s ability to provide other economic value. The financial statements should depict the results of different types of transactions, including changes in events or other circumstances that may vary the frequency or predictability of performance based on many items, including changes in economic conditions.

In summary, while Chapter 7 does supersede sections of *Statement of Financial Accounting Concept 5*, it did not result in fundamental changes to the principal concepts of financial reporting. The chapter articulates the need for complete financial reporting, describes the interconnectedness of a ‘complete set of financial statements’ and relays the importance of these documents as the information in the financial statements is the primary (and typically the

sole) source for analyzing current and potential future performance of an organization and its ability to meet its long-term financial objectives. At a high level, the chapter discusses what information should broadly be categorized as revenues, expenses, gains, and losses and to the extent equity is impacted by operations as well as changes in owners' equity through investments or distributions.

In terms of the impact to statutory accounting, the updated concepts in this chapter are not expected to modify current guidance, other than to update references to superseded accounting concepts.

#### Existing Authoritative Literature:

**NAIC Staff Note** – the Preamble contains reference to certain concept statements in footnotes 2 and 4 and have been bolded below for ease of identification. It is important to note that while these footnotes currently reference superseded conceptual statements, the conceptual statements noted do not represent adopted guidance - they are noted as reference for overarching guiding principles regarding financial reporting.

#### Preamble

#### IV. Statutory Accounting Principles Statement of Concepts

25. This document states the fundamental concepts on which statutory financial accounting and reporting standards are based. These concepts provide a framework to guide the National Association of Insurance Commissioners (NAIC) in the continued development and maintenance of statutory accounting principles ("SAP" or "statutory basis") and, as such, these concepts and principles constitute an accounting basis for the preparation and issuance of statutory financial statements by insurance companies in the absence of state statutes and/or regulations.

26. The NAIC and state insurance departments are primarily concerned with statutory accounting principles that differ from GAAP reflective of the varying objectives of regulation. Recodification of areas where SAP and GAAP are parallel is an inefficient use of limited resources.

27. SAP utilizes the framework established by GAAP. **FN2** This document integrates that framework with objectives exclusive to statutory accounting. The NAIC's guidance on SAP is comprehensive for those principles that differ from GAAP based on the concepts of statutory accounting outlined herein. Those GAAP pronouncements that are not applicable to insurance companies will not be adopted by the NAIC. For those principles that do not differ from GAAP, the NAIC must specifically adopt those GAAP Pronouncements to be included in statutory accounting. GAAP Pronouncements do not become part of SAP until and unless adopted by the NAIC.

28. The body of statutory accounting principles is prescribed in the statutory hierarchy of accounting guidance. This hierarchy provides the framework for judging the presentation of statutory financial statements in conformance with statutory accounting principles.

29. Statutory requirements vary from state to state. While it is desirable to minimize these variations, to the extent that they exist it is the objective of NAIC statutory accounting principles to provide the standard against which the exceptions will be measured and disclosed if material.

**FN 2 - The GAAP framework applicable to insurance accounting is set forth in *Statements of Financial Accounting Concepts One, Two, Five, and Six*. These documents, promulgated by the Financial Accounting Standards Board, set forth the objectives and concepts which are used in developing accounting and reporting standards.**

#### V. Statutory Hierarchy

42. The following Hierarchy is not intended to preempt state legislative and regulatory authority.

**Level 1**

*SSAPs, including U.S. GAAP reference material to the extent adopted by the NAIC from the FASB Accounting Standards Codification (FASB Codification or GAAP guidance)*

**Level 2**

*Consensus positions of the Emerging Accounting Issues (E) Working Group as adopted by the NAIC (INTs adopted before 2016)*

*Interpretations of existing SSAPs as adopted by the Statutory Accounting Principles (E) Working Group (INTs adopted in 2016 or beyond)*

**Level 3**

*NAIC Annual Statement Instructions*

*Purposes and Procedures Manual of the NAIC Investment Analysis Office*

**Level 4**

*Statutory Accounting Principles Preamble and Statement of Concepts FN4*

**Level 5**

*Sources of nonauthoritative GAAP accounting guidance and literature, including: (a) practices that are widely recognized and prevalent either generally or in the industry, (b) FASB Concept Statements, (c) AICPA guidance not included in FASB Codification, (d) International Financial Reporting Standards, (e) Pronouncements of professional associations or regulatory agencies, (f) Technical Information Service Inquiries and Replies included in the AICPA Technical Practice Aids, and (g) Accounting textbooks, handbooks and articles*

43. If the accounting treatment of a transaction or event is not specified by the SSAPs, preparers, regulators and auditors of statutory financial statements should consider whether the accounting treatment is specified by another source of established statutory accounting principles. If an established statutory accounting principle from one or more sources in Level 2 or 3 is relevant to the circumstances, the preparer, regulator or auditor should apply such principle. If there is a conflict between statutory accounting principles from one or more sources in Level 2 or 3, the preparer, regulator or auditor should follow the treatment specified by the source in the higher level—that is, follow Level 2 treatment over Level 3. Revisions to guidance in accordance with additions or revisions to the NAIC statutory hierarchy should be accounted for as a change in accounting principle in accordance with SSAP No. 3—*Accounting Changes and Corrections of Errors*.

44. Because of developments such as new legislation or the evolution of a new type of business transaction, there sometimes are no established statutory accounting principles for reporting a specific transaction or event. In those instances, it might be possible to report the event or transaction on the basis of its substance by selecting a statutory accounting principle that appears appropriate when applied in a manner similar to the application of an established statutory principle to an analogous transaction or event. In the absence of a SSAP or another source of established statutory accounting principles, the preparer, regulator or auditor of statutory financial statements may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes the Statutory Accounting Principles Statement of Concepts and GAAP reference material and accounting literature identified in Level 5. The appropriateness of other accounting literature depends on its relevance to the particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, the Statutory Accounting Principles Statement of Concepts would be more authoritative than any other sources of accounting literature. Similarly, FASB Concepts Statements would normally be more influential than other sources of nonauthoritative GAAP pronouncements.

**FN 4 - The Statutory Accounting Principles Statement of Concepts incorporates by reference FASB Concepts Statements One, Two, Five and Six to the extent they do not conflict with the concepts**

outlined in the statement. However, for purposes of applying this hierarchy the FASB Concepts Statements shall be included in Level 5 and only those concepts unique to statutory accounting as stated in the statement are included in Level 4.

#### SSAP No. 4—Assets and Nonadmitted Assets

**NAIC Staff Note** – this SAP contains the definition of the financial statement element of an **Asset**. Relevant items have been bolded below for ease of identification.

2. For purposes of statutory accounting, **an asset shall be defined as: probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.** These assets shall then be evaluated to determine whether they are admitted. The criteria used is outlined in paragraph 3.

3. As stated in the Statement of Concepts, "The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third-party interests should not be recognized on the balance sheet," and are, therefore, considered nonadmitted. For purposes of statutory accounting principles, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2, which is accorded limited or no value in statutory reporting, and is one which is:

- a. Specifically identified within the *Accounting Practices and Procedures Manual* as a nonadmitted asset; or
- b. Not specifically identified as an admitted asset within the *Accounting Practices and Procedures Manual*.

If an asset meets one of these criteria, the asset shall be reported as a nonadmitted asset and charged against surplus unless otherwise specifically addressed within the *Accounting Practices and Procedures Manual*. The asset shall be depreciated or amortized against net income as the estimated economic benefit expires. In accordance with the reporting entity's written capitalization policy, amounts less than a predefined threshold of furniture, fixtures, equipment, or supplies, shall be expensed when purchased.

4. Transactions which do not give rise to assets as defined in paragraph 2 shall be charged to operations in the period the transactions occur. Those transactions which result in amounts which may meet the definition of assets, but are specifically identified within the *Accounting Practices and Procedures Manual* as not giving rise to assets (e.g., policy acquisition costs), shall also be charged to operations in the period the transactions occur.

5. The reporting entity shall maintain a capitalization policy containing the predefined thresholds for each asset class to be made available for the department(s) of insurance.

**FN1 - FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.**

**FN2 -** If assets of an insurance entity are pledged or otherwise restricted by the action of a related party, the assets are not under the exclusive control of the insurance entity and are not available to satisfy policyholder obligations due to these encumbrances or other third-party interests. Thus, pursuant to



paragraph 2(c), such assets shall not be recognized as an admitted asset on the balance sheet. Additional guidance for assets pledged as collateral is included in INT 01-31.

### **SSAP No. 5—Liabilities, Contingencies and Impairments of Assets**

**NAIC Staff Note** – this SAP contains the definition of the financial statement element of a **Liability**. Relevant items have been bolded below for ease of identification.

**2. A liability is defined as certain or probable FN1 future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).**

**3. A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable FN1 future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened.** This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statements when incurred.

**4. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies.**

**FN1 - FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.**

**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):** While slightly different, the updated FASB asset & liability definitions do closer align with IFRS definitions. While IFRS retains the phrase “as a result of past events,” it also explicitly retains the term “control,” which is now implicit with the FASB updates. The elimination of the explicit term “control” was a deliberate action of the FASB as they noted that the notion of control has been historically misunderstood (control is to the right that gives rise to the economic benefit rather than to the economic benefits themselves). For reference *IFRS Chapter 4 – The Elements of Financial Statements*, defines an **asset** as a present economic resource controlled by the entity as a result of past events; with the economic resource representing a right that has the potential to produce economic benefits. Additionally, the chapter defines a **liability** as a present obligation of an entity to transfer an economic resource as a result of past events.

**Staff Recommendation:** NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to the Preamble, *SSAP No. 4—Assets and Nonadmitted Assets* and *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*, as illustrated below and in the issue papers, to incorporate updates from *Chapter 4, Elements of Financial Statements* and *Chapter 7, Presentation of the FASB’s Conceptual Framework for Financial Reporting*.

**Proposed edits to the Preamble:** proposed modifications reflect updates for superseded FASB Financial Accounting Concepts.

#### IV. Statutory Accounting Principles Statement of Concepts

25. This document states the fundamental concepts on which statutory financial accounting and reporting standards are based. These concepts provide a framework to guide the National Association of Insurance Commissioners (NAIC) in the continued development and maintenance of statutory accounting principles (“SAP” or “statutory basis”) and, as such, these concepts and principles constitute an accounting basis for the preparation and issuance of statutory financial statements by insurance companies in the absence of state statutes and/or regulations.

26. The NAIC and state insurance departments are primarily concerned with statutory accounting principles that differ from GAAP reflective of the varying objectives of regulation. Recodification of areas where SAP and GAAP are parallel is an inefficient use of limited resources.

27. SAP utilizes the framework established by GAAP. **FN2** This document integrates that framework with objectives exclusive to statutory accounting. The NAIC’s guidance on SAP is comprehensive for those principles that differ from GAAP based on the concepts of statutory accounting outlined herein. Those GAAP pronouncements that are not applicable to insurance companies will not be adopted by the NAIC. For those principles that do not differ from GAAP, the NAIC must specifically adopt those GAAP Pronouncements to be included in statutory accounting. GAAP Pronouncements do not become part of SAP until and unless adopted by the NAIC.

28. The body of statutory accounting principles is prescribed in the statutory hierarchy of accounting guidance. This hierarchy provides the framework for judging the presentation of statutory financial statements in conformance with statutory accounting principles.

29. Statutory requirements vary from state to state. While it is desirable to minimize these variations, to the extent that they exist it is the objective of NAIC statutory accounting principles to provide the standard against which the exceptions will be measured and disclosed if material.

**FN 2** - The GAAP framework applicable to insurance accounting is set forth in *Statements of Financial Accounting Concepts ~~One, Two, Five, and Six~~Eight*. These documents, promulgated by the Financial Accounting Standards Board, set forth the objectives and concepts which are used in developing accounting and reporting standards.

#### V. Statutory Hierarchy

42. The following Hierarchy is not intended to preempt state legislative and regulatory authority.

##### Level 1

*SSAPs, including U.S. GAAP reference material to the extent adopted by the NAIC from the FASB Accounting Standards Codification (FASB Codification or GAAP guidance)*

##### Level 2

*Consensus positions of the Emerging Accounting Issues (E) Working Group as adopted by the NAIC (INTs adopted before 2016)*

*Interpretations of existing SSAPs as adopted by the Statutory Accounting Principles (E) Working Group (INTs adopted in 2016 or beyond)*

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**Level 4**

*Statutory Accounting Principles Preamble and Statement of Concepts FN4*

**Level 5**

*Sources of nonauthoritative GAAP accounting guidance and literature, including: (a) practices that are widely recognized and prevalent either generally or in the industry, (b) FASB Concept Statements, (c) AICPA guidance not included in FASB Codification, (d) International Financial Reporting Standards, (e) Pronouncements of professional associations or regulatory agencies, (f) Technical Information Service Inquiries and Replies included in the AICPA Technical Practice Aids, and (g) Accounting textbooks, handbooks and articles*

**FN 4** - The Statutory Accounting Principles Statement of Concepts incorporates by reference FASB Concepts Statements ~~One, Two,~~ Five and ~~Six~~Eight to the extent they do not conflict with the concepts outlined in the statement. However, for purposes of applying this hierarchy the FASB Concepts Statements shall be included in Level 5 and only those concepts unique to statutory accounting as stated in the statement are included in Level 4.

**Proposed edits SSAP No. 4—Assets and Nonadmitted Assets:** proposed modifications reflect an updated definition of the term **Asset** – to match the newly issued definition in FASB Statement of Financial Accounting Concepts No. 8

2. For purposes of statutory accounting, an asset shall be defined as: a present right of an entity to an economic benefit. ~~probable FN1 future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.~~ An asset has ~~two~~three essential characteristics: (a) it is a present right ~~embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows,~~ and (b) the right is to an economic benefit. ~~a particular entity can obtain the benefit and control others' access to it FN1 FN2, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.~~ These assets shall then be evaluated to determine whether they are admitted. The criteria used is outlined in paragraph 3.

3. As stated in the Statement of Concepts, "The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third-party interests should not be recognized on the balance sheet," and are, therefore, considered nonadmitted. For purposes of statutory accounting principles, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2, which is accorded limited or no value in statutory reporting, and is one which is:

- a. Specifically identified within the *Accounting Practices and Procedures Manual* as a nonadmitted asset; or
- b. Not specifically identified as an admitted asset within the *Accounting Practices and Procedures Manual*.

If an asset meets one of these criteria, the asset shall be reported as a nonadmitted asset and charged against surplus unless otherwise specifically addressed within the *Accounting Practices and Procedures Manual*. The asset shall be depreciated or amortized against net income as the estimated economic benefit expires. In accordance with the reporting entity's written capitalization policy, amounts less than a predefined threshold of furniture, fixtures, equipment, or supplies, shall be expensed when purchased.

4. Transactions which do not give rise to assets as defined in paragraph 2 shall be charged to operations in the period the transactions occur. Those transactions which result in amounts which may meet the definition of assets, but are specifically identified within the *Accounting Practices and Procedures Manual* as not giving rise to assets (e.g., policy acquisition costs), shall also be charged to operations in the period the transactions occur.

5. The reporting entity shall maintain a capitalization policy containing the predefined thresholds for each asset class to be made available for the department(s) of insurance.

**FN1** - *FASB Statement of Financial Accounting Concepts No. 86, Elements of Financial Statements*, states that the combination of these two characteristics allows an entity to obtain the economic benefit and control others' access to the benefit. A present right of an entity to an economic benefit entitles the entity to the economic benefit and the ability to restrict others' access to the benefit to which the entity is entitled. ; Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

**FN2** - If assets of an insurance entity are pledged or otherwise restricted by the action of a related party, the assets are not under the exclusive control of the insurance entity and are not available to satisfy policyholder obligations due to these encumbrances or other third-party interests. Thus, pursuant to paragraph 2(c), such assets shall not be recognized as an admitted asset on the balance sheet. Additional guidance for assets pledged as collateral is included in INT 01-31.

#### Relevant Literature

9. This statement incorporates the definition of an asset from ~~adopts~~ *FASB Statement of Financial Accounting Concepts No. 86, Chapter 4, Elements of Financial Statements*, paragraphs E16-E18~~25-33~~.

#### References

##### Relevant Issue Papers

*Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*

*Issue Paper No. 119—Capitalization Policy, An Amendment to SSAP Nos. 4, 19, 29, 73, 79 and 82*

*Issue Paper No. 166—Updates to the Definition of an Asset*

**SSAP No. 5—Liabilities, Contingencies and Impairments of Assets:** proposed modifications reflect an updated definition of the term **Liability** – to match the newly issued definition in *FASB Statement of Financial Accounting Concepts No. 8*

2. A liability is defined as a present obligation of an entity to transfer an economic benefit. ~~certain or probable FN1 future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).~~

3. A liability has ~~three~~two essential characteristics: (a) it is a present obligation ~~embodies a present duty or responsibility to one or more other entities that entails settlement by probable FN1 future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, and~~ (b) the obligation requires an entity to transfer or otherwise provide economic benefit to others ~~duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and~~ (c) ~~the transaction or other event obligating the entity has already happened.~~ This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and

reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statements when incurred.

4. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies.

~~FN1—FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.~~

### Relevant Literature

39. This statement adopts *FASB Statement No. 5, Accounting for Contingencies* (FAS 5), *FASB Statement 114, Accounting by Creditors for Impairment of a Loan* only as it amends in part FAS 5 ~~and paragraphs 35 and 36 of FASB Statement of Financial Accounting Concepts No. 6—Elements of Financial Statements~~. *FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss, An Interpretation of FASB Statement No. 5* (FIN No. 14) is adopted with the modification to accrue the loss amount as the midpoint of the range rather than the minimum as discussed in paragraph 3 of FIN No. 14. This statement adopts with modification *ASU 2013-04, Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date* with the same statutory modification adopted for FIN 14. [This statement incorporates the definition of a liability from FASB Statement of Financial Accounting Concepts No. 8, Chapter 4, Elements of Financial Statements, paragraphs E37 and E38.](#)

### References

#### Relevant Issue Papers

*Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*

*Issue Paper No. 20—Gain Contingencies*

*Issue Paper No. 135—Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*

[Issue Paper No. 166—Updates to the Definition of an Asset](#)

#### *Recommendation:*

**NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to the Preamble, *SSAP No. 4—Assets and Nonadmitted Assets* and *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*, as illustrated in the agenda item and in the draft issue papers, to incorporate updates from *Chapter 4, Elements of Financial Statements* and *Chapter 7, Presentation of the FASB's Conceptual Framework for Financial Reporting*.**

**Staff Review Completed by:** Jim Pinegar—NAIC Staff, January – 2022

#### **Status:**

On April 4, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to the Preamble, *SSAP No. 4—Assets and*

*Nonadmitted Assets* and *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets* to incorporate 1) updates from FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7, Presentation* which identifies factors to consider when deciding how items should be displayed on the financial statements, and 2) Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which updates the definitions of an asset and a liability. The Working Group also exposed two draft issue papers for historical documentation of these SAP clarifications.

On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to the Preamble and *SSAP No. 4—Assets and Nonadmitted Assets*. The revisions incorporate updates from FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7, Presentation*, which identifies factors to consider when deciding how items should be displayed on the financial statements, and Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which updates the definition of an asset. In addition, the Working Group adopted *Issue Paper No. 166—Updates to the Definition of an Asset*, which documents the revisions to *SSAP No. 4*.

Additionally, on August 10, 2022, the Working Group re-exposed the proposed revisions and draft issue paper related to the definition change of a liability in *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*. This exposure intends to provide additional time for industry to review the changes in accordance with statutory accounting statements. These revisions are also shown above under the *SSAP No. 5R* heading.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2022/Fall-December/Hearing/8-22-01ConceptualFramework.docx>

# Statutory Issue Paper No. 16X

## Updates to the Definition of a Liability

### STATUS

Exposure Draft – August 10, 2022

Original and Current Authoritative Guidance: SSAP No. 5R

Type of Issue:  
Common Area

### SUMMARY OF ISSUE

1. This issue paper documents the SAP clarification revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*. The intent of the revisions is to align current statutory accounting guidance, specifically the definition of a “liability,” with the term utilized by the Financial Accounting Standards Board (FASB).

### SUMMARY CONCLUSION

2. The statutory accounting principle clarifications to SSAP No. 5R (illustrated in Exhibit A), reflect that for the purposes of statutory accounting, a liability shall be defined as: a present obligation of an entity to transfer an economic benefit. A liability has two essential characteristics: (1) it is a present obligation, and (2) the obligation requires an entity to transfer or otherwise provide economic benefit to others. For the purposes of these characteristics, *transfer* is typically used to describe obligations to pay cash or convey assets, while the term *provide* is used to describe obligations to provide services or stand by to do so. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity’s financial statements when incurred.

3. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies. (The definition and recognition requirements of loss contingencies under SSAP No. 5R are not proposed to be revised and will continue as statutory accounting guidance.)

### DISCUSSION

4. In December 2021, FASB issued *Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which introduced updated definitions of certain key elements used in financial reporting – most notably updating the fundamental definition of a liability. Through the FASB’s adoption of Concept Statement No. 8, the original Concept Statement No. 6 has been superseded. As statutory accounting currently reflects FASB’s historical definition, this issue paper is to review the prior concept definition (currently utilized by statutory accounting) and compare it to FASB’s updated concept definition and assess whether the revised concept definition shall be reflected in statutory accounting.

5. FASB concept statements do not reflect authoritative U.S. GAAP guidance. Rather concept statements are intended to set forth objectives and fundamental concepts that will be the basis for development of financial accounting and reporting guidance. The term “liability” is not captured or defined in the FASB Accounting Standards Codification (which is the source of authoritative U.S. GAAP.) Furthermore, although the concept statement is intended to be used as a guide in establishing authoritative

U.S. GAAP, the FASB is not restricted to the concepts when developing guidance, and the FASB may issue U.S. GAAP which may be inconsistent with the objectives and fundamental concepts set forth in Concept Statements. A change in a FASB Concept Statement does not 1) require a change in existing U.S. GAAP, 2) amend, modify or interpret the Accounting Standards Codification, or 3) justify either changing existing generally accepted accounting and reporting practices or interpreting the Accounting Standards Codification based on personal interpretations of the objectives and concepts in the concepts statement.

6. Under the prior FASB concept statement, which was reflected in SSAP No. 5R, a liability was defined as a probable future sacrifice of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of past transactions or events. In addition, the historical definition possessed three essential characteristics in that (1) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (2) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (3) the transaction or other event obligating the entity has already happened.

7. Pursuant to the prior concept statement, and as incorporated in SSAP No. 5R, *probable*, as referenced both in the definition and essential characters, was used in a usual general meaning, rather than in a specific accounting or technical sense and referred to which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

8. With the new FASB conceptual framework chapter, a liability is now defined as a present obligation of an entity to transfer an economic benefit. In addition, the current definition has two essential characteristics in that the liability is (1) a present obligation, and (2) the obligation requires an entity to transfer or otherwise provide economic benefits to others.

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

10. However, the FASB also stated that situations lacking clear legal or contractual evidence of a present obligation may pose particular challenges that may make it difficult to discern whether a present obligation exists. In these settings, the FASB stated that constructive obligations or other noncontractual obligations are created by circumstance rather than by explicit agreement. In the absence of an explicit agreement, sufficient information to distinguish a present obligation is likely only available at the specific standards level. Thus, the FASB concluded that the specific facts and circumstances at the standards level (or in the case of statutory accounting, at the SSAP level) must be utilized to determine whether the entity has created a constructive obligation and must recognize a liability.

11. The FASB also struck the phrase *as the result of past transactions or events*. With this action, the FASB clarified that if the liability represents a *present obligation*, by default, the obligation must have occurred as the result of a past transaction or event and thus this phraseology was deemed redundant and unnecessary.



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

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

14. The remaining concepts and guidance articulated in SSAP No. 5R (e.g., contingencies, impairments, guarantees, etc.) were not proposed for revision and thus are not further discussed in this issue paper.

### **Actions of the Statutory Accounting Principles (E) Working Group**

15. During the Spring 2022 National Meeting, the Working Group is exposed this issue paper for public comment.

16. During the Summer 2022 National Meeting, the Working Group is re-exposed this issue paper for public comment.

## **RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE**

### **Statutory Accounting**

17. Relevant excerpts of SSAP No. 5R, paragraphs 2-3 regarding the definition of a liability accounting are as follows:

2. A liability is defined as certain or probable<sup>1</sup> future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).

3. A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable<sup>1</sup> future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits,

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<sup>1</sup> *FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements*, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in *FASB Statement 5, Accounting for Contingencies*, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statements when incurred.

### Generally Accepted Accounting Principles

17. Relevant paragraphs from *Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements* have been included below:

#### Liabilities

E37. A liability is a present obligation of an entity to transfer an economic benefit

#### Characteristics of Liabilities

E38. A liability has the following two essential characteristics: a. It is a present obligation. b. The obligation requires an entity to transfer or otherwise provide economic benefits to others.<sup>2</sup>

E39. Liabilities commonly have features that help identify them. For example, many liabilities require the obligated entity to pay cash to one or more identified other entities. Liabilities may not require an entity to pay cash but may require the entity to convey other assets, provide services, or transfer other economic benefits or to be ready to do so. Liabilities are based on a foundation of legal rights and duties.

E40. Entities routinely incur liabilities in exchange transactions to acquire the funds, goods, and services they need to operate. For example, borrowing cash (acquiring funds) obligates an entity to repay the amount borrowed, acquiring assets on credit obligates an entity to pay for the assets, and selling products with a warranty or guarantee obligates an entity to either pay cash or repair or replace any products that prove defective. Often, obligations incurred in exchange transactions are contractual based on written or oral agreements to pay cash or to provide goods or services to specified or determinable entities on demand at specified or determinable dates or on the occurrence of specified events.

#### Present obligation

E41. A liability requires that an entity be obligated to perform or act in a certain manner. In most cases it is apparent that liabilities are legally enforceable. Legally enforceable obligations include those arising from binding contracts, agreements, rules, statutes, or other requirements that would be upheld by a judicial system or government. Judicial systems vary in type and form, and the term judicial systems includes any such system that would enforce laws, statutes, and regulations. In the context most relevant to financial reporting, an obligation is any condition that binds an entity to some performance or action. In a financial reporting context, something is binding on an entity if it requires performance. Performance is what the entity is required to do to satisfy the obligation.

E42. Many obligations that qualify as liabilities stem from contracts and other agreements that are enforceable by courts or from governmental actions that have the force of law. Agreements, contracts, or statutory requirements often will specify or imply how an obligation was incurred and when and how the obligation is to be settled. For example, borrowing and lease agreements specify the amount of charges and the dates when the payments are due. The absence of a specified maturity date or event to require settlement may cast doubt that an obligation exists.

E43. Liabilities necessarily involve other parties, society, or law. The identity of the other party or recipient need not be known to the obligated entity before the time of settlement. An obligation of an entity to itself cannot be a liability. For example, in the absence of external requirements an

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<sup>2</sup> This chapter continues the practice of describing liabilities as an obligation either to transfer or to provide economic benefits. For example, the term transfer has typically been used to describe obligations to pay cash or convey assets, and the term provide has typically been used to describe obligations to perform services or stand ready to do so.

entity is not obligated to repair the roof of its building or maintain its plant and equipment. Although those actions may be wise business moves, the entity may forgo or defer such activities because there is no present obligation to perform the activity.

E44. Certain obligations require nonreciprocal transfers from an entity to one or more other entities. Such obligations include taxes imposed by governments, donations pledged to charitable entities, and cash dividends declared but not yet paid.

E45. To have a liability, an entity must have a present obligation, that is, the obligation exists at the financial statement date. The settlement date of the liability may occur in the future, but the obligation must be present at the financial statement date. Transactions or other events or circumstances expected to occur in the future do not in and of themselves give rise to obligations today.

E46. An intention to purchase an item, for example, an asset, does not in and of itself create a liability. However, a contractual obligation that requires an entity to pay more than the fair value of the asset at the transaction date may create a liability before the asset is received, reflecting what the entity might have to pay to undo the unfavorable contract.

E47. Business risks result from the conduct of an entity's business activities. A business risk is not a present obligation, though at some point in the future an event may occur that creates a present obligation. Some businesses have the potential of carrying out activities and creating present obligations as a result of those activities. However, no present obligation exists even if it is virtually certain that an obligating event will occur, though at present no such event has occurred. The essence of distinguishing business risks from liabilities is determining the point in time when an entity has a present obligation.

E48. Some business risks result from an entity's transactions, for example, selling goods in overseas markets might expose an entity to the risk of future cash flow fluctuations because of changes in foreign exchange rates. Other business risks result from an entity's operating environment, for example, operating in a highly specialized industry might expose an entity to the risk that it will be unable to attract sufficient skilled staff to sustain its operating activities. Those risks are not liabilities.

E49. To be presently obligated, an entity must be bound, either legally or in some other way, to perform or act in a certain way. Most liabilities are legally enforceable, including those arising from contracts, agreements, rules, and statutes. An entity also can become obligated by other means that would be expected to be upheld by a judicial process. However, the existence of a present obligation may be less clear in those circumstances.

E50. Some liabilities rest on constructive obligations, including some that arise in exchange transactions. A constructive obligation is created, inferred, or construed from the facts in a particular situation rather than contracted by agreement with another entity or imposed by government. An entity may become constructively obligated through customary business practice. In the normal course of business, an entity conducting certain activities may not create a clear contractual obligation but may nonetheless cause the entity to become presently obligated. For example, policies and practices for sales returns and those for warranties in the absence of a contract may create a present obligation because the pattern of behavior may create an enforceable claim for performance that would be upheld in the ultimate conclusion of a judiciary process.

E51. An entity's past behavior also may give rise to a present obligation. Repeated engagement in a certain behavior may obligate the entity to perform or act in a certain way on the basis of that pattern of behavior. For example, the entity may create a constructive obligation to employees for vacation pay or year-end bonuses by paying them every year even though it is not contractually bound to do so and has not announced a policy to do so.

18. The most notable changes regarding the definition of a liability included removal of the term *probable* and the phrase *as a result of past transactions or events*. Rationale for these changes were documented in *Chapter 4, Elements of Financial Statements* commentary as follows:

BC4.11. The definitions of both an asset and a liability in Concepts Statement 6 include the term *probable* and the phrases *future economic benefit* and *past transactions or events*. The term *probable* in the definitions in Concepts Statement 6 has been misunderstood as implying that a future economic benefit or a future sacrifice of economic benefit must be probable to a certain threshold before the definition of an asset or a liability is met. In other words, if the probability of future economic benefit is low, the asset definition is not met under that interpretation. A similar interpretation could be made for liabilities. The footnotes to the Concepts Statement 6 definition of assets and liabilities also were not helpful in clarifying the application of the term *probable* as used in the definitions of assets and liabilities. Accordingly, the Board decided to eliminate that term from the definitions of both assets and liabilities.

BC4.12. The term *future* in the definitions in Concepts Statement 6 focused on identifying a future flow of economic benefits to demonstrate that an asset exists or identifying a future transfer of economic benefits to demonstrate that a liability exists. The definitions in Concepts Statement 6 were often misunderstood as meaning that the asset (liability) is the ultimate future inflow (outflow). For example, in the instance of trade receivables, the definition in Concepts Statement 6 could be misunderstood to indicate that the asset is the successful collection of the receivable in the future. When applied appropriately, however, the definition would conclude that the asset is the present right to collection. Similar misunderstandings occurred in applying the liability definition. As a result, the Board concluded that a focus on the term *present* would appropriately shift the focus from identifying a future occurrence. Therefore, the Board decided to include the term *present right* to demonstrate that an asset exists and emphasize the term *present obligation* to demonstrate that a liability exists.

BC4.13. The definitions of assets and liabilities in Concepts Statement 6 both include the phrase *past transactions or events*. The Board concluded that if an entity has a present right or a present obligation, one can reasonably assume that it was obtained from some past transaction or event. Therefore, that phrase is considered redundant and has been eliminated from the definitions.

19. The other significant change to the definition of a liability included changing *future sacrifices* to a *present obligation*. Rationale for these changes were documented in *Chapter 4, Elements of Financial Statements* commentary as follows:

BC4.25. The term *present obligation* is included in the definition of a liability, both in this chapter and in Concepts Statement 6. Because the application of the liability definition under Concepts Statement 6 did not give sufficient emphasis to the term *present obligation*, the definition in this chapter more appropriately emphasizes that term. Assessing whether a present obligation exists is the primary criterion in the definition of a liability in this chapter. The primacy of the term *present obligation* is made more evident through the removal of many of the problematic terms in the definition of a liability in Concepts Statement 6, as discussed in paragraphs BC4.11–BC4.13.

BC4.26. Almost always, the existence of a present obligation will be apparent. Most present obligations are legally enforceable, including obligations arising from binding contracts, agreements, statutes, or other legal or contractual means. However, situations lacking clear legal or contractual evidence of a present obligation pose particular challenges that may make it difficult to discern whether a present obligation exists.

BC4.27. Determining when a present obligation exists has caused confusion with the existence of business risks. Business risks result from the nature of the business and where, when, and how an entity conducts its business. While certain businesses pose risks of future events occurring that will cause a transfer of economic benefits, the Board decided that the risks themselves are not present obligations because exposure to a potential negative consequence does not constitute a present obligation. Rather than viewing all business risks as liabilities, the Board decided that an entity has

a present obligation only after an event occurs that demonstrates that the inherent business risk has created a present obligation. Thus, distinguishing when a business risk makes an entity presently obligated requires analysis of the facts and circumstances at the standards level.

BC4.28. Determining the existence of a present obligation is particularly challenging in evaluating constructive obligations. Interpreting constructive obligations too narrowly will tend to exclude significant actual obligations of an entity, while interpreting them too broadly will effectively nullify the definition by including items that lack an essential characteristic of liabilities.

BC4.29. Given that constructive obligations and other noncontractual obligations are created by circumstance rather than explicit agreement, it can be unclear whether a present obligation exists. In the absence of an explicit agreement, sufficient information to distinguish a present obligation is likely only available at the specific standards level. Thus, the Board decided that specific facts and circumstances at the standards level must be assessed to determine whether an entity has created a constructive obligation.

## RELEVANT LITERATURE

### Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy

### Generally Accepted Accounting Principles

- FASB Statement of Financial Accounting Concepts No. 8, Conceptual Framework for Financial Reporting – Chapter 4, Elements of Financial Statements

### Effective Date

20. As issue papers are not authoritative and are not represented in the Statutory Hierarchy (see Section V of the Preamble), the consideration and adoption of this issue paper will not have any impact on the SAP clarifications adopted to SSAP No. 5R by the Working Group on **TBD**.

**EXHIBIT A – SAP Clarification Revisions to SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets****Statement of Statutory Accounting Principles No. 5 - Revised****Liabilities, Contingencies and Impairments of Assets**

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**SCOPE OF STATEMENT**

1. This statement defines and establishes statutory accounting principles for liabilities, contingencies and impairments of assets.

**SUMMARY CONCLUSION****Liabilities**

2. A liability is defined as a present obligation of an entity to transfer an economic benefit. ~~certain or probable FNI future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).~~

3. A liability has ~~three~~ two essential characteristics: (a) it is a present obligation ~~embodies a present duty or responsibility to one or more other entities that entails settlement by probable FNI future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, and~~ (b) the obligation required an entity to transfer or otherwise provide economic benefit to others ~~duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and~~ (c) the transaction or other event obligating the entity has already happened. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statements when incurred.

4. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies.

~~FN1—FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.~~

**Relevant Literature**

39. This statement adopts *FASB Statement No. 5, Accounting for Contingencies* (FAS 5), *FASB Statement 114, Accounting by Creditors for Impairment of a Loan* only as it amends in part FAS 5 ~~and paragraphs 35 and 36 of FASB Statement of Financial Accounting Concepts No. 6—Elements of Financial Statements~~. *FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss, An Interpretation of FASB Statement No. 5* (FIN No. 14) is adopted with the modification to accrue the loss amount as the midpoint of the range rather than the minimum as discussed in paragraph 3 of FIN No. 14. This statement adopts with modification *ASU 2013-04, Obligations Resulting from Joint and Several Liability*

*Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date* with the same statutory modification adopted for FIN 14. [This statement incorporates the definition of a liability from FASB Statement of Financial Accounting Concepts No. 8, Chapter 4, Elements of Financial Statements, paragraphs E37 and E38.](#)

## REFERENCES

### Relevant Issue Papers

- *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*
- *Issue Paper No. 20—Gain Contingencies*
- *Issue Paper No. 135—Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*
- [\*Issue Paper No. 16X – Updates to the Definition of a Liability\*](#)

[https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/Fall - December/Hearing/9 - 22-01B - IP No. 16X - Liability.docx](https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National%20Meetings/A.%20National%20Meeting%20Materials/2022/Fall%20December/Hearing/9%20-22-01B%20-IP%20No.%2016X%20- Liability.docx)

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

**Issue: Collateral for Loans**

**Check (applicable entity):**

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Description of Issue:**

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

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

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

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

**Existing Authoritative Literature:**

***SSAP No. 20—Nonadmitted Assets* (Bolding added for emphasis):**

4. Consistent with paragraph 2, the following assets shall be nonadmitted:
  - a. Deposits in Suspended Depositories—Amounts on deposit with suspended depositories may not be fully recoverable. Any amounts not reasonably expected to be recovered shall be written off in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*. Amounts in excess of that written off shall be nonadmitted as they are not available to satisfy obligations to policyholders;

- b. **Bills Receivable Not for Premium and Loans Unsecured or Secured by Assets That Do Not Qualify As Investments**—In accordance with SSAP No. 5R, amounts determined to be uncollectible or otherwise impaired shall be written off. Amounts in excess of that written off are not considered to be properly collateralized **as there are no underlying assets which would otherwise be admitted assets. Such amounts shall be nonadmitted as they may be of questionable economic value if needed to fulfill policyholder obligations. Receivables arising from working capital finance programs designated by the Securities Valuation Office are subject to the guidance in SSAP No. 105R—Working Capital Finance Investments;**
- c. **Loans on Personal Security, Cash Advances To, Or In The Hands Of, Officers Or Agents And Travel Advances**—In accordance with SSAP No. 5R, amounts determined to be uncollectible or otherwise impaired shall be written off. Amounts in excess of that written off typically are **unsecured and as such have no underlying assets which would otherwise be admitted assets. Such amounts shall be nonadmitted as they may be of questionable economic value if needed to fulfill policyholder obligations. Some of these items may also be considered prepaid expenses which, per SSAP No. 29—Prepaid Expenses, are nonadmitted;**
- d. All “Non-Bankable” Checks—Examples of “non-bankable” checks are NSF (non-sufficient funds) checks, post-dated checks, or checks for which payment has been stopped. Although these checks may still maintain probable future benefits (and thus meet the definition of assets), at the date on which they are non-bankable they are not available for policyholder obligations and shall be nonadmitted until the uncertainty related to the probable future benefit is resolved and the checks are converted to available funds;
- e. Trade Names And Other Intangible Assets<sup>1</sup>—These assets, by their nature, are not readily marketable and available to satisfy policyholder obligations and shall be nonadmitted;
- f. Automobiles, Airplanes and Other Vehicles—Automobiles, airplanes and other vehicles meet the definition of assets established in SSAP No. 4. However, they are not readily available to satisfy policyholder obligations and as a result the undepreciated portion shall be nonadmitted. The accounting for these assets shall be consistent with the accounting for equipment provided in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* or for commercial airplane leveraged leases, refer to the guidance in *SSAP No. 22R—Leases*;
- g. Company’s Stock as Collateral for Loan—When a reporting entity lends money and accepts its own stock as collateral for the loan, it shall report the amount of the loan receivable and any related accrued interest on the loan as a nonadmitted asset. The asset is nonadmitted as the collateral could not be used to satisfy the obligation in the event of default.

**Footnote 1:** Defensible intangible assets are defined as an intangible asset acquired in a business combination or an asset acquisition that an entity does not intend to actively use but does intend to prevent others from using. These may also be referred to as a “locked-up asset” because while the asset is not being actively used, it is likely contributing to an increase in the value of other assets owned by the entity. These assets are not readily available to satisfy policyholder obligations and shall be nonadmitted.

**SSAP No. 21 – Revised—Other Admitted Assets (Bolding added for emphasis)**

**Collateral Loans**

4. Collateral loans are unconditional obligations<sup>1</sup> for the payment of money secured by the pledge of an investment<sup>2</sup> and meet the definition of assets as defined in SSAP No. 4, and are admitted assets to the extent they conform to the requirements of this statement. The outstanding principal balance on the loan and any related accrued interest shall be recorded as an admitted asset subject to the following limitations:

- a. Loan Impairment—Determination as to the impairment of a collateral loan shall be based on current information and events. When it is considered probable that any portion of amounts due under the contractual terms of the loan will not be collected the loan is considered impaired. The impairment shall be measured based on the fair value of the collateral less estimated costs to obtain and sell the collateral. The difference between the net value of the collateral and the recorded asset shall be written off in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*;
- b. **Nonadmitted Asset—In accordance with SSAP No. 20—Nonadmitted Assets, collateral loans secured by assets that do not qualify as investments shall be nonadmitted. Further, any amount of the loan outstanding which is in excess of the permitted relationship of fair value of the pledged investment to the collateral loan shall be treated as a nonadmitted asset.**

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

**Footnote 2:** Investment defined as those assets listed in Section 3 of *Appendix A-001—Investments of Reporting Entities*.

**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.

**Staff Review Completed by:** Robin Marcotte – NAIC Staff – July 2022

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

Proposed revisions to *SSAP No. 21 – Revised—Other Admitted Assets*

**Collateral Loans**

4. Collateral loans are unconditional obligations<sup>1</sup> for the payment of money secured by the pledge of a [qualifying](#) investment<sup>2</sup> and meet the definition of assets as defined in SSAP No. 4, and are admitted assets to the extent they conform to the requirements of this statement. The outstanding principal balance on the loan and any related accrued interest shall be recorded as an admitted asset subject to the following limitations:

- a. Loan Impairment—Determination as to the impairment of a collateral loan shall be based on current information and events. When it is considered probable that any portion of amounts due under the contractual terms of the loan will not be collected the loan is considered impaired. The impairment shall be measured based on the fair value of the collateral less estimated costs to obtain and sell the collateral. The difference between the net value of the collateral and the recorded asset shall be written off in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*;
- b. Nonadmitted Asset—In accordance with *SSAP No. 20—Nonadmitted Assets*, collateral loans secured by assets that do not qualify as investments [which would otherwise be admitted](#) shall be nonadmitted. Further, any amount of the loan outstanding which is in excess of the permitted relationship of fair value of the pledged investment to the collateral loan shall be treated as a nonadmitted asset.

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

**Footnote 2:** [A qualifying investment](#) defined as those assets listed in Section 3 of *Appendix A-001—Investments of Reporting Entities* [which would, if held by the insurer would qualify for admittance. For example, if the collateral would not qualify for admittance under SSAP No. 4 due to encumbrances or other third-party interests, then it does not meet the definition of "qualifying" and the collateral loan, or any portion thereof which is not adequately collateralized, is not permitted to be admitted.](#)

**Status:**

On August 10, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 21R to clarify that invested assets pledged as collateral for admitted collateral loans must qualify as admitted invested assets.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2022/Fall-December/Hearing/10-22-11-Collateralloans.docx>

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

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

**Check (applicable entity):**

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Description of Issue:**

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

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

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

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

SSAP No. 25 describes economic transactions and non-economic transactions (See Authoritative Literature). Economic transactions are defined as arm’s-length transactions which results in the transfer of the risks and rewards of ownership and represents a consummated act thereof, i.e., “permanence.” SSAP No. 25, paragraph 18 indicates that economic transactions between related parties shall be recorded at fair value at the date of the transaction and also notes that to the extent that the related parties are affiliates under common control, the controlling reporting

entity shall defer the effects of such transactions that result in gains or increases in surplus until such time that the asset is sold outside the group.

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

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

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

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

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

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

### **Existing Authoritative Literature:**

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

8. Therefore, based on the foregoing guidance and background, the statutory accounting intent is to avoid surplus gains for the ceding entity as a result of implementing a modification to an intercompany pooling arrangement. On that basis, such a modification does not represent an economic transaction to the insurance group or to the impacted companies. As such, the transfer of both the assets and the liabilities valued at statutory book value ensures that there is no impact to surplus as a result of implementing a modification to an existing pooling arrangement.
11. The accounting issues are:
  - a. What is the relevant guidance for modifications to intercompany pooling arrangements?
  - b. What is the appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement?

The Working Group reached a consensus as follows:

12. SSAP No. 62R provides accounting for property and casualty reinsurance agreements including specific guidance on intercompany pooling agreements. SSAP No. 62R provides two methods of accounting for changes in intercompany pooling agreements, depending on whether or not the pooling results in a gain in surplus.

13. The appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement is statutory book value for assets and statutory value for liabilities. Book value is defined in the glossary of the *Accounting Practices and Procedure Manual*.

### *SSAP No. 25—Affiliates and Other Related Parties*

#### **Transactions Involving the Exchange of Assets or Liabilities**

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

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

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

- a. Whether the seller has a continuing involvement in the transaction or in the financial interest transferred, such as through the exercise of managerial authority to a degree usually associated with ownership;
- b. Whether there is an absence of significant financial investment by the buyer in the financial interest transferred, as evidenced, for example, by a token down payment or by a concurrent loan to the buyer;
- c. Whether repayment of debt that constitutes the principal consideration in the transaction is dependent on the generation of sufficient funds from the asset transferred;
- d. Whether limitations or restrictions exist on the buyer's use of the financial interest transferred or on the profits arising from it;
- e. Whether there is retention of effective control of the financial interest by the seller.

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

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

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

- a. Economic transactions between related parties shall be recorded at fair value at the date of the transaction. To the extent that the related parties are affiliates under common control, the controlling reporting entity shall defer the effects of such transactions that result in gains or increases in surplus (see paragraph 16);
- b. Non-economic transactions between reporting entities, which meet the definition of related parties above, shall be recorded at the lower of existing book values or fair values at the date of the transaction;
- c. Non-economic transactions between a reporting entity and an entity that has no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, shall be recorded at the fair value at



the date of the transaction; however, to the extent that the transaction results in a gain, that gain shall be deferred until such time as permanence can be verified;

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

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

### Transactions Involving Services

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

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

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

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

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

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

- c. The termination of, or reduction in participation in, reinsurance treaties entered into in the ordinary course of business;
  - d. **Intercompany reinsurance agreements, and any amendments thereto, among companies 100% owned by a common parent or ultimate controlling person provided there is no gain in surplus as a result of the transaction; or**
  - e. Reinsurance/retrocession agreements that meet the criteria of property/casualty run-off agreements described in paragraphs 102-105.
37. **Retroactive reinsurance agreements resulting in surplus gain to the ceding entity (with or without risk transfer)** entered into between affiliates or between insurers under common control (as those terms are defined in Appendix A-440) shall be reported as follows:
- a. The consideration paid by the ceding entity shall be recorded as a deposit and reported as a nonadmitted asset; and
  - b. No deduction shall be made from loss and loss adjustment expense reserves on the ceding entity's balance sheet, schedules, and exhibits.

**Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):**

INT 03-02 was exposed in March of 2003 and adopted in June 2003. The interpretation was not subsequently amended. The final vote on this consensus had three members opposed. The March 2003 exposure received six different comment letters to the Emerging Accounting Issues (E) Working Group from: 1) Ohio (EAIWG member); 2) New Hampshire (EAIWG member); 3) Interested parties, 4) Liberty Mutual and 5) PriceWaterhouseCoopers (one of the very few letters ever submitted directly by the firm.) and 6) CNA. Five out of the six commenters noted concerns that the proposed guidance (which was ultimately adopted) would conflict with SSAP No. 25 guidance regarding economic transactions. While the interested parties comment letter was more neutral, the verbal comments provided supported the use of SSAP No. 25.

Several commenters recommended not adopting the guidance regarding the use of book value and instead following SSAP No. 25 guidance for economic and non-economic transactions. The commenters noted that SSAP No. 25 directs the use of fair value when such transactions meet the definition of an economic transactions and that tax regulations would provide a result similar to SSAP No. 25. Multiple comments noted concerns similar to those highlighted in the illustration above. Commenters also noted that intercompany pooling reinsurance transaction are economic transactions. They noted that when assets (such as bonds valued at amortized cost) are transferred, if the assets have a different fair value than book value, that difference should be recognized since the transferor no longer controls the assets. Commenters also noted that treatment for reinsurance transactions for asset transfers should not be different than the treatment for other intercompany transactions.

CNA comments were supportive of adopting the exposed consensus, the comment letter provided illustrations and noted that intercompany reinsurance agreements were subject to regulatory approval. The comments tried to illustrate concerns possibly having premature gain / surplus recognition. .

The June 2003 minutes Emerging Accounting Issues (E) Working Group discussion on the INT 03-02 are excerpted below.

The working group was referred to INT 03-02: *Modification to an existing intercompany pooling arrangement* (Attachment D). Written comments were received from Ohio, New Hampshire and interested parties. Ohio and New Hampshire believe that the transfer of assets and liabilities in an intercompany pooling arrangement constitute an economic transaction and the accounting guidance in SSAP No. 25—*Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties* (SSAP No. 25), should be followed. As such, the assets should be transferred at fair value and the ceding entity should record a realized gain or loss. Keith Bell (Travelers) spoke on behalf of interested parties. Interested parties

commented that if the transaction was considered to be an economic transaction, SSAP No. 25 should be followed. If the modification of an intercompany pooling arrangement is considered a noneconomic transaction, the guidance in SSAP No.62—*Property and Casualty Reinsurance*(SSAP No. 62) is applied, as such, statutory book value should be used for assets and statutory value should be used for liabilities. Jeff Alton (CNA) presented his comments by summarizing the statements made in his comment letter. Mr. Alton stated that no revenue recognition should occur and suggested using a modified statutory book value for transferring assets and liabilities. Mr. Clark stated that the Statutory Accounting Principles Working Group must address the recommended transfer at modified statutory book value as this recommendation would require substantive adjustments to statutory accounting principles. Shelly Zimmerman (Liberty Mutual) provided comments which supported that intercompany pooling changes should follow the accounting guidance in SSAP No. 25 as these are economic transactions between affiliates. Jean Connelly (PriceWaterhouseCoopers) provided comments that summarize those outlined in the comment letter. Ms. Connelly stated that intercompany pooling arrangements are economic transactions and that INT 03-01 provides a substantive change to SSAP No. 25.

Mr. Johnson then stated that he believes there is a stronger case for non-economic transaction treatment and as such, statutory book value is appropriate for valuation purposes. Additionally, all these transactions are subject to regulatory review under the Insurance Holding Company Act, affording regulators some control over the approval of these transactions. Mr. Fritsch commented that if this guidance is not adopted in the form of a new interpretation, SSAP No. 25 should be followed. Mr. Alton stated that he believes the current guidance in effect for intercompany pooling arrangements exists in SSAP No. 62, paragraph 30d which supports surplus neutrality: hence, the need is for an interpretation of paragraph 30d. Mr. Johnson stated that language clarification in SSAP No.61—*Life, Deposit-Type and Accident and Health Reinsurance*(SSAP No. 61) and SSAP No. 62 should be addressed as a project of the reinsurance subgroup of the SAPWG. Mr. Johnson made a motion to adopt Interpretation 03-02 with deletion of the first two sentences in paragraph 11. Mr. Stolte seconded the motion. Mr. Johnson requested a roll call vote. There were 9 yeas from Alabama, Connecticut, Florida, Illinois, Louisiana, Michigan, Texas, Pennsylvania and Virginia. There were 3 nays from New York, Ohio, and Wisconsin. Therefore, the working group adopted Interpretation 03-02 by consensus. Mr. Johnson also made a motion to refer to the Reinsurance Subgroup of the SAPWG, review of the current guidance in SSAP No. 61, SSAP No. 62 and SSAP No. 63—*Underwriting Pools and Associations Including Intercompany Pools*. Mr. Ford seconded the motion. The working group unanimously adopted the referral.

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

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

**Staff Review Completed by:** Robin Marcotte – NAIC Staff, July - 2022

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

**Status:**

On August 10, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed the intent to nullify INT 03-02.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2022/Fall-December/Hearing/11-22-12-ReviewINT03-02.docx>

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**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	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Description of Issue:**

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

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

**Existing Authoritative Literature:**

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

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

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

31. This statement adopts FASB Interpretation No. 43, Real Estate Sales, an Interpretation of FASB Statement No. 66 (FIN 43), which clarifies that the phrase “all real estate sales” includes sales of real estate with property improvements or integral equipment that cannot be removed and used separately from the real estate without incurring significant costs. This statement adopts FASB Emerging Issues Task Force No. 84-17, Profit Recognition on Sales of Real Estate with Graduated Payment Mortgages or Insured Mortgages, FASB Emerging Issues Task Force No. 89-13, Accounting for the Cost of Asbestos Removal,

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

**SSAP No. 19:**

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

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

### **SSAP No. 73:**

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

### **Staff Review Completed by Jake Stultz, September 2021**

#### **Status:**

On December 11, 2021, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 19 and SSAP No. 73 to ensure that the guidance for the leasehold improvements matches the treatment provided in SSAP No. 40. These edits clarify that amortization of leasehold improvements will immediately end when a lease is terminated and will require that any remaining, unamortized leasehold improvement balance be immediately expensed. This will include scenarios where the lease terminates naturally or when the lessee purchases a property it was leasing.

On April 4, 2022, the Statutory Accounting Principles (E) Working Group reviewed comments on prior exposed revisions which intended to clarify that in any scenario in which a lease terminates early, all remaining leasehold improvements shall be immediately expensed. The Working Group directed NAIC staff to continue to work with interested parties to refine the guidance for subsequent consideration.

On August 10, 2022, the Statutory Accounting Principles (E) Working Group exposed this agenda item, incorporating proposed revisions after considering comments from interested parties shown highlighted in gray below. The changes provide an explicit exception to companies that provide direct healthcare. It is limited to situations where the real estate lease agreement has a purchase option that contains language that allows leasehold improvements necessary for the functionality of specific health care delivery assets to be excluded from the purchase cost of the real estate.

### **SSAP No. 19:**

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter of their estimated useful life or the remaining lease term, as defined in SSAP No. 22R. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired. [The amortization of leasehold improvements \(including property improvements and integral equipment\) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting](#)

entity lessee. Such improvements related to the functionality of health care delivery assets shall follow the accounting, reporting and impairment guidance in *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities*, and an exception to the application of this guidance to leasehold improvements necessary for the functionality of health care delivery assets is included in *SSAP No. 73*. 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 lessee but excludes situations where the real estate lease agreement has a purchase option that contains language that allows leasehold improvements necessary for the functionality of specific health care delivery assets<sup>1</sup> to be excluded from the purchase cost of the real estate. Upon acquisition, such leasehold improvements necessary for the functionality of healthcare delivery assets shall follow the guidance for health care delivery assets in this statement. If leased real estate is acquired, recognition of the real estate shall follow the provisions in *SSAP No. 40R—Real Estate Investments*.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2022/Fall-December/Hearing/12-21-25-LeaseImprovementsTermination.docx>

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<sup>1</sup> The application of this exception is limited to leasehold improvements necessary for the functionality of health care delivery assets that qualified for admittance under *SSAP No. 73*.



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October 7, 2022

Mr. Dale Bruggeman, Chairman  
Statutory Accounting Principles Working Group  
National Association of Insurance Commissioners  
1100 Walnut Street, Suite 1500  
Kansas City, MO 64106-2197

RE: Items Exposed for Comment by the Statutory Accounting Principles Working Group on August 10, 2022, with Comments due October 7<sup>th</sup>

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the exposure drafts released for comment by the NAIC Statutory Accounting Principles (E) Working Group (the Working Group) during its meeting on August 10<sup>th</sup> in Portland.

We offer the following comments:

**Reporting Lines/Descriptions Proposal: Issuer Credit Obligations and Asset Backed Securities**

The Working Group exposed the following 2 items which propose reporting changes to improve transparency and granularity as part of the Principles-Based Bond Definition Project. The first document includes proposed reporting lines and descriptions for bonds. The second document includes a new proposed Schedule D-1 with new sections, columns, and reporting instructions to separate and capture information specific to issuer creditor obligations (Schedule D – Part 1 – Section 1) and asset-backed securities (Schedule D – Part 1 – Section 2). A variety of schedule and instruction changes are proposed for each schedule.

Attached is a marked-up version for each of the above items exposed that includes substantive comments that begin with ‘IP Comments:’ next to the item being addressed. The attachment also includes editorial revisions as appropriate. Also attached is a clean version that reflects all of our

comments and revisions.

The following are the key items highlighted in our comments:

- If ABS investments will no longer be allowed to be reported on Schedule DA – Part 1 (Short-Term Investments) and Schedule E – Part 2 (Cash Equivalents), should consideration be given to modifying SSAP No. 2R—*Cash, Cash Equivalents, Drafts, and Short-Term Investments*?
- In several instances, we are recommending that the column data referencing ‘Acquisition’ data be changed to ‘Origination’ to provide consistency of the data and match the instructions.
- We recommend removing the ‘Current Overcollateralization Percentage (ABS)’ field as it is industry’s understanding that the assessment of whether the reporting entity benefits from substantive credit enhancement through subordination and/or overcollateralization is done at the date of acquisition of the investment based on the characteristics of the investment at origination.
- We are unsure as to what is being requested in the ‘PIK Interest Due and Accrued’ column.

Interested parties understand that the new Schedule D – Part 1 – Section 1 aligns with SSAP No. 26R and Schedule D – Part 1 – Section 2 aligns with SSAP No. 43R. To assist in this alignment, would it make sense to rename SSAP No. 26R ‘Bonds – Issuer Credit Obligations’ and SSAP No. 43R ‘Bonds – Asset-Backed Securities’?

Our comments and suggested changes to the proposed reporting changes reflect our understanding of the concurrently exposed changes to SSAP No. 26R and SSAP No. 43R to bring the accounting and reporting into sync as part of the Principles-Based Bond Definition Project. We believe there will be an opportunity to continue to work with insurance regulators and NAIC staff on further changes as new feedback is received on these important issues.

### **Ref #2019-21: Proposed Bond Definition**

Pursuant to the direction from the Working Group in October 2020, a small group of regulators and industry have been meeting regularly to draft a bond definition for consideration. The intent of this project is to clarify what should be considered a bond (whether captured in SSAP No. 26R—Bonds or SSAP No. 43R—Loan-Backed and Structured Securities) and reported on Schedule D-1: Long-Term Bonds: This exposure is specific to the proposed bond definition included in the exposed Form A, along with the glossary (page 5) and appendices (pages 6-12), but comments on future developments (such as reporting changes, accounting and reporting guidance for items that do not qualify as bonds, transition guidance, etc.) may also be submitted to assist in the development of these items. This exposure document reflects the direction of the Working Group from the July 18, 2022, call in which comments received after the March 2022 exposure were discussed. This exposure is accompanied by a proposed issue paper that details the discussions in developing the principles-based bond definition as well as proposed statutory accounting revisions to SSAP No. 26R and SSAP No. 43R. Proposed reporting changes were

exposed July 18, 2022.

Interested parties will submit comments under a separate comment letter at a later date.

### **Ref #2021-25: Leasehold Improvements After Lease Termination**

The Working Group exposed this agenda item, incorporating proposed revisions after considering comments from interested parties shown highlighted in italics below. The changes provide an explicit exception to companies that provide direct healthcare. It is limited to situations where the real estate lease agreement has a purchase option that contains language that allows leasehold improvements necessary for the functionality of specific health care delivery assets to be excluded from the purchase cost of the real estate.

#### **SSAP No. 19:**

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter of their estimated useful life or the remaining lease term, as defined in SSAP No. 22R. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired. The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity *lessee*. *Such improvements related to the functionality of health care delivery assets shall follow the accounting, reporting and impairment guidance in SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities, and an exception to the application of this guidance to leasehold improvements necessary for the functionality of health care delivery assets is included in SSAP No. 73.* 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 lessee but excludes situations where the real estate lease agreement has a purchase option that contains language that allows leasehold improvements necessary for the functionality of specific health care delivery assets<sup>1</sup> to be excluded from the purchase cost of the real estate. Upon acquisition, such leasehold improvements necessary for the functionality of healthcare delivery assets shall follow the guidance for health care delivery assets in this statement. If leased real estate is acquired, recognition of the real estate shall follow the provisions in SSAP No. 40R—Real Estate Investments.

<sup>1</sup> The application of this exception is limited to leasehold improvements necessary for the functionality of health care delivery assets that qualified for admittance under SSAP No. 73.

Interested parties continue to agree that, in most cases, unamortized lessee owned leasehold improvements should be immediately expensed if the lease is terminated. However, in the situation where the reporting entity purchases a property that it was previously leasing, immediate expensing may not be appropriate in all circumstances as leasing and purchasing of assets is a complex business activity and takes many forms and structures.

### *General Concerns*

The NAIC appears to have based the accounting conclusions on the premise that in all circumstances the purchase price of the leased asset includes the lessee purchased and owned leasehold improvements. However, interested parties (who engage in these transactions directly) continue to emphasize that they have not seen this in practice. These transactions, when material, have been audited by external auditors and State Departments of Insurance and no double counting of assets has been identified. It would be helpful to interested parties if the NAIC could share examples where they are seeing double counting of assets in these transactions by reporting entities.

Additionally, the NAIC has noted concerns of entities being able to admit leasehold improvements that were previously non-admitted under SSAP No 19. However, we note there are several instances where an asset can be non-admitted in one period, and subsequently admitted in another upon conforming to the requirements of certain SSAP's (e.g., certain affiliate receivables that were non-admitted due to lack of written agreement as to due date pursuant to SSAP No 25, or certain healthcare receivables that do not immediately conform to the requirements under SSAP No 84, among others). Moving from leasing to owning the underlying asset that the leasehold improvements are attached to changes the overall economics (i.e., the leasehold improvement can now be utilized in a liquidation event given the utility it provides with the building, whereas in a lease situation, given the limited control over the leased facility, the leasehold improvement may not be useful in a liquidation event on a standalone basis and non-admission would be appropriate).

### *Healthcare Delivery Assets Exception*

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While interested parties appreciate the exception for leasehold improvements that are accounted for in the scope of SSAP No 73 for health care delivery assets, interested parties note that the requirement that contracts include explicit provisions about the exclusion of the leasehold improvements in a purchase situation is not practical and will be onerous particularly for entities that have a high volume of lease activity. Additionally, it is not clear why there would be a difference in accounting treatment between sectors of the insurance industry when the overall economics of leasing is generally the same. This difference adds an unusual layer of complexity.

### *Recommendation*

For the reasons noted above and to have guidance that more faithfully represents what is occurring in situations where the underlying leased real estate is purchased, interested parties recommend the following language be considered in both SSAP No 19 and 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. The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity lessee. Such improvements related to the functionality of health care delivery assets shall follow the accounting, reporting and impairment guidance in SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities, and an exception to the application of this guidance to leasehold improvements necessary for the functionality of health care delivery assets is included in SSAP No. 73. If leased real estate is acquired, recognition of the real estate shall follow the provisions in *SSAP No. 40R—Real Estate Investments*. In situations where the reporting entity lessee can demonstrate through appraisals or other means that the lessee owned leasehold improvements are not included in the purchase price of the acquired leased real estate, the unamortized leasehold improvements shall be added to the cost basis of the acquired real estate.

### **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

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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 lessee. ~~but excludes situations where the real estate lease agreement has a purchase option that contains language that allows leasehold improvements necessary for the functionality of specific health care delivery assets<sup>2</sup> to be excluded from the purchase cost of the real estate. Upon acquisition, such leasehold improvements necessary for the functionality of healthcare delivery assets shall follow the guidance for health care delivery assets in this statement.~~ If leased real estate is acquired, recognition of the real estate shall follow the provisions in *SSAP No. 40R—Real Estate Investments*. In situations where the reporting entity lessee can demonstrate through appraisals or other means that the lessee owned leasehold improvements are not included in the purchase price of the acquired leased real estate, the unamortized leasehold improvements shall be added to the cost basis of the acquired real estate.

#### *Other Matters*

Interested parties want to highlight that there is an editorial modification needed to SSAP No 19, paragraph 9. It references the legacy guidance and needs to be updated to reflect how the lease term is defined in SSAP No 22R. Accordingly, we recommend the following:

SSAP No. 19, paragraph 9:

9. The acquisition cost of depreciable assets, net of salvage, shall be depreciated against net income over the estimated useful lives of the assets in a systematic and rational manner. The acquisition cost of a leasehold improvement shall be amortized against net income over the shorter of its estimated useful life or the ~~original~~ lease term as defined in SSAP 22R ~~excluding options or renewal periods~~. For leasehold improvements capitalized subsequent to inception of the lease, the cost shall be amortized over the shorter of its estimated useful life or the remaining ~~original~~ lease term ~~excluding options or renewal periods~~. Amounts capitalized for leasehold improvements in periods subsequent to the original lease term (i.e., during renewal periods), are amortized utilizing the shorter of the estimated useful life of the asset or the remaining ~~term of the renewal period~~ lease term.

#### **Ref 2022-01: Conceptual Framework – Updates**

The Working Group adopted, as final, the exposed revisions to the Preamble and *SSAP No. 4—Assets and Nonadmitted Assets*. The revisions incorporate updates from FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7, Presentation*, which identifies factors to consider when deciding how items should be displayed on the

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financial statements, and Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which updates the definition of an asset. In addition, the Working Group adopted *Issue Paper 166—Definition of Assets*, which documents the revisions to SSAP No. 4.

Additionally, the Working Group re-exposed the proposed revisions and draft issue paper related to the definition change of a liability in *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*. This exposure intends to provide additional time for industry to review the changes in accordance with statutory accounting statements.

Interested parties suggest the following language be added to both the liability (which was re-exposed) and asset definition

The guidance in this statement shall only be applicable to the extent there is not contradictory guidance regarding liabilities addressed in other existing statements.

This will ensure that there will not be any conflicts between the new definition and specific guidance in the SSAP's.

#### **Ref #2022-09: Fair Value Hedging – Portfolio Layer Method**

The Working Group moved this agenda item to the active listing, categorized as a new SAP concept, and exposed revisions to SSAP No. 86 to incorporate guidance from *ASU 2022-01, Fair Value Hedging – Portfolio Layer Method* and certain guidance from *ASU 2017-12, Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities* to incorporate portfolio layer method hedges and partial term hedges for recognized assets. In addition, the Working Group directed NAIC staff to document the extent of the revisions in an issue paper.

Interested parties support the proposed changes.

#### **Ref #2022-10: Troubled Debt Restructuring and Vintage Disclosures**

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to *SSAP No. 36—Troubled Debt Restructuring* to reject ASU 2022-02 for statutory accounting. The revisions update the relevant literature section to detail consideration of U.S. GAAP as the statutory accounting guidance in SSAP No. 36 will now reflect adoption of superseded U.S. GAAP concepts.

Interested parties have no comments on this item.

#### **Ref #2022-11: Collateral for Loans**

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 21R to clarify that invested assets pledged as collateral for admitted collateral loans must qualify as admitted invested assets.

Interested parties understand the need to align SSAP No. 20 and SSAP No. 21 guidance and agree with the exposed change. We recommend further clarity for one particular collateral type: an equity investment in a joint venture, partnership, or LLC (“equity investment in an LLC”), which would be accounted for under SSAP No. 48 if it were owned directly.

SSAP No. 48 investments qualify as admitted assets when acquired; however, investors are ultimately required to obtain a GAAP audit, subject to a reporting lag on a consistent annual basis in order for the investments to continue to qualify as admitted assets. Interested Parties believe the GAAP audit requirement is primarily driven by the requirement to apply equity method accounting (“EMA”) and to value directly held equity investments based on the reporting entity’s share of underlying GAAP equity is not applied to collateral loans in SSAP No. 21. SSAP No. 21 specifies that a fair value assessment is required to determine that sufficient collateral exists to support admittance of a collateral loan. In the rare case where the collateral itself is owned outright by the insurer, due to default on the collateral loan and foreclosure on the loan, it is primarily important that the collateral has sufficient fair value such that if it were liquidated by the insurer, it would support the initial investment in the collateral loan. Interested parties note also that the same fair value assessment is already required to support SSAP No. 21, paragraph 4a, which defines impairment rules for collateral loans, using the fair value of collateral as an input to the impairment assessment.

In short, interested parties believe that a fair value assessment is the most relevant valuation information applicable to equity-type collateral. On the other hand, audited statements are the most relevant valuation information for directly held equity-type investments but are not necessarily useful for collateral assets.

To provide additional clarity and consistency with directly acquired SSAP No. 48 investments, we would suggest additional footnote language, as follows:

In cases where an equity investment in a joint venture, partnership or LLC is pledged as collateral in a collateral loan, an adequate fair value assessment (in compliance with SSAP No. 100), is required to support an admitted asset for the purpose of collateral sufficiency. In the event that the loan is foreclosed, ownership of the SSAP No. 48 investment would initially be recognized as an admitted asset, but a GAAP audit must ultimately be obtained on a consistent annual basis to continue to support valuation and admittance of the SSAP No. 48 investment, consistent with requirements for directly acquired investments in such assets.

### **Ref #2022-12: Review of INT 03-02: Modification to an Existing Intercompany Pooling Arrangement**

The Working Group exposed the intent to nullify Interpretation 03-02: *Modification to an Existing Intercompany Pooling Arrangement* (INT 03-02), because of conflicts between INT 03-02 and SSAP No. 25—*Affiliates and Other Related Parties* guidance regarding economic and



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non-economic transactions between related parties. The guidance in INT 03-02 can result in unrecognized gains (dividends) or losses through the use of statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements.

Included in the discussion in INT 03-02 is the following:

Further, since modifications to intercompany pooling agreements typically involve the transfer of net liabilities incurred since the inception of the existing pooling agreement (i.e., prior to the effective date of the new agreement), the retroactive reinsurance accounting guidance in paragraphs 33-39 of SSAP No. 62R is applicable. Paragraph 33 states that this special accounting treatment is warranted “due to the potential abuses involving the creation of surplus to policyholders and the distortion of underwriting results...” However, paragraph 36.d. specifically applies to intercompany reinsurance arrangements, and amendments to intercompany reinsurance agreements, since the reinsurance agreement is among companies 100% owned by a common parent.

INT 03-02 notes that the “statutory accounting intent is to avoid surplus gains for the insurance group as a result of implementing a modification to an intercompany pooling arrangement.” As a result, INT 03-02 concludes that the appropriate valuation basis for assets and liabilities transferred among affiliates as part of the modification of an intercompany pooling arrangement is statutory book value. With respect to the intent of paragraph 36.d of SSAP No. 62R, INT 03-02 specifically states: “The presumption of this intent was that there would be no surplus gains to the ceding entity resulting from amendments or modifications to these types of reinsurance agreements.”

We have concerns regarding the proposal to nullify the INT and offer the following comments:

- The discussion in the proposal to nullify INT 03-02 addresses whether intercompany pooling transactions are economic or non-economic transactions. Interested parties note that, with regard to the loss reserves that are moved among entities as part of a change in intercompany pooling, the transferor(s) still has continuing involvement in the reserves (through participation in the pooling arrangement) resulting in a non-economic transaction that is currently recorded as such. Consistent with the movement of the loss reserves, the movement of bonds related to a change in an intercompany pooling arrangement is also treated as a non-economic transaction under the INT.
  - We also note that the transfer of loss reserves at statutory book values in a modification of an intercompany pooling arrangement is consistent with the guidance in SSAP No. 68 regarding statutory mergers.
- Modifications to intercompany pooling arrangements are typically effective retroactive to the beginning of the year. Therefore, the statutory book values of the liabilities at the beginning of the year are used in the transfer of underwriting and claim assets and

liabilities. The use of market value for the transfer of bonds in the same transaction would create an inconsistency with the use of historical cost on the transfer of underwriting and claim assets and liabilities and would also create the opportunity for recognizing a gain in surplus, just the opposite of what the INT intended to prevent. Currently, many companies will net the amount of underwriting and claim assets and liabilities with the amount of supporting assets to minimize the movement of invested assets.

- GAAP requires that transfers among entities under common control be reflected at historical cost. The proposed nullification of INT 03-02 would result in accounting that is less conservative than GAAP for bonds with fair values in excess of amortized cost. GAAP treats the transfer of assets and liabilities between entities under common control as non-economic transactions. This same concept is contained in the guidance for intercompany or statutory mergers in SSAP No. 68. While the guidance in SSAP No. 25 is focused on legal entity reporting, the guidance in INT 03-02 is focused on the accounting for the group comprising an intercompany pooling arrangement.
- Intercompany pooling arrangements have the characteristics of a single entity, and in many ways are treated as such. Intercompany pools qualify for combined reporting, upon approval from the domiciliary regulator, for purposes of complying with the NAIC Model Audit Rule and an audit opinion may be obtained on the pool rather than individual legal entities. Additionally, intercompany pools are rated as a group by external rating agencies, the actuarial opinions are prepared on a group basis, and internal controls and governance is usually evaluated on a group rather than individual legal entity basis.
- The generation of internal gains/losses on the transfer of bonds used to settle changes in intercompany pooling arrangements, in the context of a combined group operating as a single entity, would be contrary to the concept of an economic transaction with an independent third party.
  - Since property-casualty companies do not maintain dedicated bond portfolios that are matched to particular property-casualty insurance products, nullification of the INT creates the opportunity to move gross investment assets and cherry-pick the assets used in the transaction to create a gain in surplus.
- If bonds are transferred at market value in order to settle amounts due from/to affiliates as a result of a modification of an intercompany pooling arrangement, any realized investment gains resulting from the transfer would have to be deferred at the common parent reporting entity level until such time as the security either matures or is sold to an outside party by recording a deferred gain and an unrealized loss at every common parent level of reporting within the intercompany pool. For an intercompany pool which files combined audited statutory basis financial statements, realized gains would be eliminated in the presentation of the financial statements of the intercompany pool. This would

require the common parent reporting entities to reverse all gain/loss transactions resulting from the transfer of bonds at market value within the group and establish deferred gain liabilities.

- As previously noted, the exception to retroactive reinsurance accounting in SSAP No. 62R paragraph 36.d specifically applies to intercompany reinsurance arrangements: “The accounting principles for retroactive reinsurance agreements in paragraph 34 shall not apply to the following types of agreements (which shall be accounted for as prospective reinsurance agreements unless otherwise provided in this statement)... Intercompany reinsurance agreements, and any amendments thereto, among companies 100% owned by a common parent or ultimate controlling person *provided there is no gain in surplus as a result of the transaction.*” Under the proposal to nullify the INT, legal entity intercompany pool participants which are not common parent entities will likely recognize a gain upon the transfer of bonds at market value (as payment consideration) in the modification of an intercompany pooling arrangement. A reasonable interpretation of paragraph 36.d of SSAP No. 62R would be that the totality of the intercompany pooling modification transaction should be taken into account when evaluating whether the intercompany transaction results in a surplus gain. As a result, the modification of the intercompany pooling arrangement would result in a gain in surplus and would not qualify for prospective reinsurance accounting. We do not believe this is the intent of the Working Group, nor is it desired by interested parties.
- The majority of bond investments owned by property-casualty insurers are generally held until maturity and are usually comprised of bonds that are rated NAIC 1 or 2. The use of market value for bonds still held within the combined intercompany pool would be inconsistent with the statutory accounting valuation guidance for such bonds.

Interested parties recommend that the Working Group retain INT 03-02. We believe that there are valid reasons for the inconsistency noted by NAIC staff between INT 03-02 and SSAP No. 25 given the unique nature of intercompany reinsurance pooling agreements as noted above. Interested parties also believe that the risk that a company can manipulate economic results by transferring bonds at book value is mitigated by the regulatory scrutiny over modifications to intercompany reinsurance pooling agreements (including the transfer of assets and liabilities that comprise the modification transaction), as changes to such agreements are subject to prior regulatory approval.

### **Ref #2022-13: Related Party – Footnote Updates**

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 25 and SSAP No. 97 to incorporate language to exempt foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction from the look-through provisions included in SSAP No. 25 and SSAP No. 97.

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Interested parties have no comments on this item.

\* \* \*

Thank you for considering interested parties' comments. If you have any questions in the interim, please do not hesitate to contact us.

Sincerely,

D. Keith Bell

Rose Albrizio

cc: NAIC staff  
Interested parties