Hearing Agenda

Statutory Accounting Principles (E) Working Group

Hearing Agenda
July 30, 2020
10:00 A.M – 12:00 P.M. Central

ROLL CALL

Dale Bruggeman, Chair
Carrie Mears, Vice Chair
Richard Ford
Kim Hudson
Kathy Belfi
Dave Lonchar
Eric Moser
Caroline Brock / Stewart Guerin
Ohio
Iowa
Alabama
California
Connecticut
Delaware
Illinois
Louisiana
Judy Weaver
Doug Bartlett
Tom Dudek
Joe DiMemmo
Doug Slape / Jamie Walker
Doug Stolte / David Smith
Amy Malm

Michigan
New Hampshire
New York
Pennsylvania
Texas
Virginia
Wisconsin

NAIC Support Staff: Julie Gann, Robin Marcotte, Jim Pinegar, Fatima Sediqzad, Jake Stultz

Note: The Summer Virtual National Meeting may be recorded on WebEx for subsequent use.

REVIEW AND ADOPTION OF MINUTES

1. March 18, 2020 Conference Call (Attachment 1)*
2. March 26, 2020 E-Vote (Attachment 2)
3. April 15, 2020 Conference Call (Attachment 3)
4. April 17, 2020 E-Vote (Attachment 4)
5. May 5, 2020 E-Vote (Attachment 5)
6. May 20, 2020 Conference Call (Attachment 6)
7. June 15, 2020 Conference Call (Attachment 7)
8. July 15, 2020 E-Vote (Attachment 8)

(*Note: prior reference to the “2020 Spring National Meeting” will be revised to reflect the March 18, 2020 conference call throughout all minute references. There will be no Spring compilation for 2020.)

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 #2019-38: Financing Derivatives
2. Ref #2020-01: Update / Remove References to SVO Listings
4. Ref #2020-05: Repeal of the Affordable Care Act Section 9010 Assessment
5. Ref #2020-13: Health Industry Request on 2020 Health Insurance Assessment
Summary:
During the March 18 conference call, the Working Group exposed revisions to SSAP No. 86—Derivative to require gross reporting of derivative activity for financing derivative transactions. A financing derivative transaction is one in which the premium to acquire the derivative is paid throughout the derivative term or at maturity of the derivative. With the accounting and reporting that has been utilized by some companies, the associated “cash flows” (related to the derivative obtained versus the premium liability owed) are netted, generally resulting with zero-value reporting at inception. Over the course of the derivative term, an unrealized loss is recognized for changes in the present value of the premium liability (increase), which may be offset by any value change in the underlying derivative (increase or decrease). (With derivative financing, a gain would only ever be recognized if the fair value change of the derivative exceeded the cost of the derivative.) When the derivative matures, the calculation of realized gains and losses reflects the deferred cost (amount owned), adjusted for any actual fair value change.

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

Recommended Action:
NAIC staff recommends adopting the exposed nonsubstantive revisions to SSAP No. 86—Derivatives with an effective date of January 1, 2021. The revisions ensure consistency 1) in the gross reporting of derivatives - without inclusion of financing components, and 2) in reporting amounts owed to / from the reporting entity from the acquisition or writing of derivatives. NAIC staff highlights that the concepts are consistent with existing statutory accounting guidelines, but these revisions will clarify the guidance and improve uniform application across the industry. (A blanks proposal (2020-26BWG) to capture the “present value of financing premium” in calculating the net exposure is exposed and planned to be considered during the Blanks August call for 2021.)

Summary:

1. The first proposal was to rename the “U.S. Direct Obligations/Full Faith and Credit Exempt List” to the “NAIC U.S. Government Money Market Fund List.” No revisions to the NAIC Accounting Practices and Procedures (AP&P) Manual would be required, as this list is not specifically identified. (Revisions would however likely be needed in the Blanks and RBC filings / instructions.)
2. The second proposal was to discontinue the “NAIC Bond Fund List.” Items which were on this list would be eligible for consideration for the “NAIC Fixed Income-Like SEC Registered Funds List.” The discontinuance of usage of the NAIC Bond Fund List will require an update in the AP&P Manual. (Although the “bond list,” this listing requires 100% government securities in the fund.)

Interested Parties’ Comments:
Interested parties agree with the conclusion on this item.

Recommended Action:
NAIC Staff recommends adopting the exposed nonsubstantive revisions to 1) SSAP No. 26R—Bonds and SSAP No. 30R—Unaffiliated Common Stock to eliminate references to the NAIC Bond Fund List (Bond List) and 2) add reference to the “NAIC Fixed Income-Like SEC Registered Funds List” in SSAP No. 30R. On July 1, the Valuation of Securities (E) Task Force adopted their corresponding agenda item and thus this item appropriately updates the AP&P Manual to reflect the recent adoption to the P&P Manual.

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<th>Comment Letter Page Number</th>
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<tbody>
<tr>
<td>2020-04 SSAP Nos, 51R, 52, &amp; 54R (Robin)</td>
<td>Commissioner Discretion in the Valuation Manual</td>
<td>11 – Agenda Item</td>
<td>No Comment</td>
<td>IP - 3</td>
</tr>
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</table>

Summary:
During the March 18 conference call, the Working Group exposed this agenda item proposing a disclosure on the use of commissioner discretion when choosing between acceptable methods under the Valuation Manual. The proposed disclosures to SSAP No. 51R—Life Contracts, SSAP No. 52—Deposit-Type Contracts and SSAP No. 54R—Individual and Group Accident and Health Contracts note that voluntary decisions to choose one allowable reserving methodology over another, which require commissioner approval under the Valuation Manual, shall be reported as a change in valuation basis. The Working Group also directed notification of the exposure to the Life Actuarial (A) Task Force.

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

Recommended Action:
NAIC staff recommends adopting the exposed nonsubstantive revisions to SSAP No. 51R—Life Contracts, SSAP No. 52—Deposit-Type Contracts and SSAP No. 54R—Individual and Group Accident and Health Contracts to specify that voluntary decisions to choose one allowable reserving methodology over another, which require commissioner approval under the Valuation Manual, shall be reported as a change in valuation basis. This is a nonsubstantive change and is effective immediately.
Summary:
During the March 18 conference call, the Working Group exposed the intent to supersede SSAP No. 106—Affordable Care Act Section 9010 Assessment and to nullify INT 18-02: ACA Section 9010 Assessment Moratoriums. This guidance was proposed to be eliminated as the ACA insurer fee, addressed within this guidance, has been repealed beginning Jan. 1, 2021.

Interested Parties’ Comments:
Interested parties support the conclusion reached for this item. We note, however, that annual statement disclosures in the 2020 blanks would apparently still be required and recommend that the disclosures be simplified considering the repeal of the Assessment. Specifically, the disclosures should be moved to note 21.C as Other Disclosures for year-end 2020 (since not a subsequent event) and then removed entirely for year-end 2021 as proposed; the disclosures should be limited to the amount of the assessment paid in the current and prior year, the amount of premium written for the prior year that is the basis for the determination of the section 9010 fee assessment paid in the current year (net assessable premium), and the estimated amount of the assessment that was payable in the current year as of the end of the prior year.

Recommended Action:
NAIC staff recommends adopting the exposed intent to supersede SSAP No. 106—Affordable Care Act Section 9010 Assessment and to nullify INT 18-02: ACA Section 9010 Assessment Moratoriums. This action will move this guidance to Appendix H—Superseded SSAPs and Nullified INTs of the Accounting Practices and Procedures Manual.

With this action, NAIC staff recommends that the Working Group sponsor a blanks proposal to incorporate reporting changes for 2021. NAIC staff does not recommend significant revisions to the existing financial statement note for year-end 2020. The SSAP No. 106 disclosures are reflected in Note 22 and are data-captured. Revising this disclosure immediately before year-end, when the program is still in effect, will likely cause confusion and inconsistent reporting. Rather than revise the existing disclosure requirements for 2020, if preferred by the Working Group, NAIC staff can draft additional instruction on how to complete the disclosure for year-end 2020 since there will not be an ACA fee assessment in 2021. This instruction can be posted as additional narrative guidance on the Blanks (E) Working Group webpage.

For illustration purposes, the existing disclosure requirements are detailed below.

<table>
<thead>
<tr>
<th></th>
<th>Current Year</th>
<th>Prior Year</th>
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<tbody>
<tr>
<td>A</td>
<td>Did the reporting entity write accident and health insurance premium that is subject to Section 9010 of the federal Affordable Care Act (YES/NO)?</td>
<td>___________</td>
</tr>
<tr>
<td>B</td>
<td>ACA fee assessment payable for the upcoming year</td>
<td>$ __________</td>
</tr>
<tr>
<td>C</td>
<td>ACA fee assessment paid</td>
<td>$ __________</td>
</tr>
<tr>
<td>D</td>
<td>Premium written subject to ACA 9010 assessment</td>
<td>$ __________</td>
</tr>
</tbody>
</table>
E. Total Adjusted Capital before surplus adjustment (Five-Year Historical Line 30) $ __________

F. Total Adjusted Capital after surplus adjustment (Five-Year Historical Line 30 minus 22B above) $ __________

G. Authorized Control Level (Five-Year Historical Line 31) $ __________

H. Would reporting the ACA assessment as of December 31, 2019, have triggered an RBC action level (YES/NO)? __________

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<tr>
<td>2020-13 SSAP No. 106 (Robin)</td>
<td>Health Industry Request on 2020 Health Insurance Assessment</td>
<td>13 – Agenda Item</td>
<td>IP - Request to Withdrawal</td>
<td>IP - 5</td>
</tr>
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</table>

**Summary:**
In April 2020, the Working Group received a request from America’s Health Insurance Plans (AHIP) to alter the recognition of the SSAP No. 106 “insurer provider fee” in response to COVID-19. On April 27, 2020 AHIP rescinded this request.

**American's Health Insurance Plans (AHIP) Comments:**
To confirm our recent email transmission, after discussion with members and review of the referenced exposure and the NAIC staff’s recommendation that SAPWG reject our request, please consider this letter as AHIP’s withdrawal of that request.

We appreciate NAIC Staff’s view (as expressed in SAPWG exposure 2020-13) that the subject of SSAP No. 106 interim reporting relief is a matter that could warrant domiciliary state regulator review for consideration as either a permitted or prescribed practice. We would be grateful if you would share with SAPWG members our concerns that the dynamic nature of the pandemic might make such action appropriate in some states, and that other issues may yet arise that would require involvement by SAPWG at the NAIC level.

**Recommended Action:**
**NAIC Staff** recommends that the Working Group move this item to the rejected listing without statutory revisions.

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<tr>
<td>2020-16EP SSAP No. 2R (Jim)</td>
<td>Editorial Maintenance Update</td>
<td>14 – Agenda Item</td>
<td>No comments were received</td>
<td>IP -</td>
</tr>
</tbody>
</table>

**Summary:**
On June 15, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed editorial maintenance revisions to SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments to update the reporting line for cash pools and to edit guidance for readability.
Interested Parties’ Comments:
No comments were received.

Recommended Action:
NAIC Staff recommends that the Working Group adopt the editorial revisions to SSAP No. 2R as final.

REVIEW AND ADOPTION of NON-CONTESTED POSITIONS with MINOR EDITS
The Working Group may individually discuss the following items, or may consider adoption in a single motion:
1. Ref #2019-04: SSAP No. 32 – Investment Classification Project
2. Ref #2020-02: Accounting for Bond Tender Offers

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<tr>
<td>2019-04 SSAP No. 32 (Jim)</td>
<td>SSAP No. 32 – Investment Classification Project</td>
<td>15 – Agenda Item 16 – Issue Paper</td>
<td>In Agreement (Minor Edit Received)</td>
<td>IP - 1</td>
</tr>
</tbody>
</table>

Summary:
During the March 18 conference call, the Working Group exposed an issue paper and substantively revised SSAP No. 32R—Preferred Stock to revise the definitions, measurement and impairment guidance for preferred stock pursuant to the investment classification project. This exposure reflected revisions suggested by the interested parties from the prior exposure.

Interested Parties’ Comments:
Interested parties agree with the revisions made in response to our comments and the January 1, 2021 effective date.

Interested parties acknowledge the proposed footnote regarding preferred units issued by SSAP 48 entities. However, we suggest the wording changes in underline below so not to introduce a change in accounting or diversity in practice since the issuance of preferred units that are similar to preferred stock of a corporation generally occur in LLCs that are more corporate-like.

“Certain legal entities captured in SSAP No. 48 such as LLCs that are corporate-like do not issue preferred stock in legal form, but instead issue identical instruments labeled preferred units, interests, or shares. These instruments shall be captured in this statement provided they meet the structural characteristics as defined in paragraph 3. Additionally, these instruments shall not be in-substance common stock in which the holder has risk and reward characteristics that are substantially similar to common stock.”

Recommended Action:
NAIC Staff recommends that the Working Group adopt the exposed issue paper and SSAP with the minor modification suggested by interested parties to footnote 1. It is proposed that the substantively revised SSAP No. 32R be effective January 1, 2021.

Proposed edits to Footnote 1 suggested by interested parties: (This new paragraph was presented in the prior exposure, but only the edits proposed by the interested parties are shown as tracked changes.)

1 Certain legal entities captured in SSAP No. 48, such as LLCs that are corporate-like, do not issue preferred stock in legal form, but instead issue identical instruments labeled preferred units, interests, or shares. These instruments shall be captured in this statement provided they meet the structural characteristics as defined in paragraph 3. Additionally,
these instruments shall not be in-substance common stock in which the holder has risk and reward characteristics that are substantially similar to common stock.

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<tr>
<td>2020-02</td>
<td>Accounting for Bond Tender Offers</td>
<td>17 – Agenda Item</td>
<td>In Agreement (Effective Date Request)</td>
<td>IP - 2</td>
</tr>
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</table>

**Summary:**
During the March 18 conference call, the Working Group exposed revisions to SSAP No. 26R—Bonds to clarify that the guidance for “called” bonds is also applicable to “tender offers.” From a bond holder’s perspective, the only material difference between a called and tendered bond is that with the tender offer, the bond holder must elect to accept the repurchase offer. If the tender offer is not accepted, the bond’s terms (including scheduled maturity date) remain unchanged.

Specific guidance for the reporting and allocation of investment income and/or capital gain/loss associated with callable bonds (where the issuer, at its sole discretion, can redeem a bond before its scheduled maturity date) is noted in SSAP No. 26R—Bonds; however, guidance is not reflected for when a bond is retired early through a tender offer. As previously discussed, called bonds and bond tender offers are similar in the fact that the issuer can retire a bond early, however with a bond tender offer, the holder must elect to accept the offer. If the offer is not accepted, the original terms of the bond are not modified.

**Interested Parties’ Comments:**
Interested parties request that the effective date for the updated guidance be set at January 1, 2021, so that insurers have sufficient time to make necessary systems changes to treat the excess compensation over market as a prepayment penalty as described in the updated guidance.

**Recommended Action:**
NAIC staff recommends adopting the exposed nonsubstantive revisions to SSAP No. 26R—Bonds to clarify that the accounting and reporting of investment income and capital gain/loss, due to the early liquidation either through a call or a tender offer, shall be similarly applied. In response to interested parties’ request for a Jan. 1, 2021 effective date, NAIC staff has proposed edits to allow this effective date with early application permitted. NAIC staff has incorporated this effective date to allow for system changes from prior application or interpretation of SAP guidance, but highlights that the proposed edits simply clarify existing SAP guidance, as the historical provision in SSAP No. 26R is not limited to “called” bonds, but encompasses all bonds that are liquidated prior to the scheduled termination date. Proposed edits from the prior exposure are shown below.

**Effective Date and Transition (New Paragraph)**

37. In July 2020, nonsubstantive revisions were adopted to clarify existing guidance that all prepayment penalty and acceleration fees for when a bond is liquidated prior to its scheduled maturity date, including those from tendered bonds, shall follow the guidance in SSAP No. 26R. Reporting entities that have historically applied this guidance shall not change historical practices, but an effective date of January 1, 2021, with early application permitted, is allowed for reporting entities to make systems changes to capture tendered bonds in scope of this guidance.
REVIEW of PREVIOUSLY ADOPTED INTERPRETATIONS for POSSIBLE EXTENSION

The Working Group indicated that during the Summer National Meeting, that interpretations adopted in response to COVID-19 would be evaluated for possible extension. The INTS have been grouped for discussion based on current effective date.

The following INTs were effective through 2nd quarter, 2020:
1. INT 20-02: Extension of the Ninety-Day Rule for the Impact of COVID-19
2. INT 20-04: Mortgage Loan Impairment Assessment Due to COVID-19
3. INT 20-05: Investment Income Due and Accrued

The following INTs are effective for the 60-days following the termination of the National Emergency, or Dec. 31, 2020, whichever occurs first:
4. INT 20-03: Troubled Debt Restructuring Due to COVID-19
5. INT 20-07: Troubled Debt Restructuring of Certain Investments Due to COVID-19

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<tbody>
<tr>
<td>INT 20-02</td>
<td>Interpretations in Response to COVID-19 Expiring 2nd Quarter 2020</td>
<td>18-20</td>
<td>Effective through 2nd Quarter Expires September 29, 2020</td>
</tr>
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</table>

Summary:
In April and May 2020, the Working Group adopted a number of interpretations in response to COVID-19 effective through 2nd quarter 2020:

1. **INT 20-02: Extension of the Ninety-Day Rule for the Impact of COVID-19:** This interpretation provides a one-time optional extension of the ninety-day rule of uncollected balances for: 1) premiums receivables from policyholders or agents per SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers, 2) uncollected uninsured plan receivables (excluding Medicare and similar government plans) per SSAP No. 47—Uninsured Plans, 3) life premium due and uncollected per SSAP No. 51—Life Contracts, and 4) high deductible policies per SSAP No. 65—Property and Casualty Contracts. The exception to the ninety-day rule only apply for policies which were in effect and current prior to the date as of the declaration of a state of emergency by the U.S. federal government (March 13, 2020) and policies written or renewed on or after March 13.

2. **INT 20-04: Mortgage Loan Impairment Assessment Due to COVID-19:** This interpretation provides a temporary, limited-time statutory exception for the assessment of impairment for bank loans, mortgage loans and investment products with underlying mortgage loans. This exception only defers the assessment of impairment due to situations caused by the forbearance or modification of mortgage loan payments and does not delay the recognition of other than temporary impairments if the entity made a decision to sell the investment and/or if provisions other than the limited-time forbearance or modifications of mortgage loan payments caused the entity to identify that they would not recover the reported carrying value of the investment.

3. **INT 20-05: Investment Income Due and Accrued:** This interpretation provides a limited-time collectability assessments and admittance exceptions for SSAP No. 34—Investment Income Due and Accrued. Under the interpretation: 1) The INT would continue with existing guidance for the recognition of investment income. 2) The INT would continue with requirements to assess collectability of investment income, with a presumption that mortgage loans, bank loans and investment products with underlying mortgage loans impacted by forbearance or modifications that were current as of Dec. 31, 2019 were not experiencing
financial difficulties at the time of the modification. For these items, further evaluation of collectability would not be required for the 1st and 2nd quarter financial statements unless other indicators that interest would not be collected are known (e.g., entity has filed bankruptcy). 3) The INT provides an exception for the nonadmittance of recorded investment income due and accrued deemed collectible and over 90-days past due. With the exception, reported investment income that becomes over 90-days past due in the 1st or 2nd quarter may continue to be admitted in the 2nd quarter financial statements.

**Recommended Action:**
NAIC staff recommends that the Working Group discuss potential extensions to the above noted interpretations and consider exposure (if supported) of extensions to the 3rd quarter of 2020 for a shortened two-week comment period ending Aug. 14, 2020. (Exposure is proposed to ensure there is ability for concerns to be communicated prior to adopting extensions. It will also ensure that a decision could not occur that would result with these INTs being applicable for third quarter if INT 20-03 or INT 20-07 are no longer applicable.) Although the Working Group has not previously adopted guidance via an email vote, it is suggested that unless comments noting concern with the extensions are raised during the exposure period, that the Working Group proceed with adopting the revised INTs, with extensions to 3rd quarter, via an email vote. NAIC staff will inform the Working Group, interested regulators, and interested parties of the comments received and whether an email vote will occur. If there are concerns for a potential email to adopt, please provide those comments to NAIC staff during the exposure period.

If this extension is supported by the Working Group, the INTs will be updated to reflect that they are applicable to the September 30, 2020 financial statements. Furthermore, the interpretations will be updated to note that they will expire automatically on Dec. 30, 2020 (and not effective for year-end). If directed by the Working Group, continued reference of subsequent review for possible extension (during the Fall NM) will be reflected in the interpretations.

With the SAPWG Summer NM occurring in July, and not August, it will be possible for the National Emergency to be declared over before August 1st. If this occurs, the provisions of the CARES Act and INT 20-03 and INT 20-07 will not be applicable for 3rd quarter. (This is because they expire 60 days after the National Emergency terminates.) If preferred by the Working Group, consideration of an extension for INT 20-02, 20-04 and 20-05 could be deferred until August (which was the original plan), or if an extension is supported, it could be contingent on the National Emergency not terminating prior Aug. 1, 2020. This would prevent these INTs from being extended for the third quarter if INTs 20-03 and 20-07 will no longer be in effect.

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<tbody>
<tr>
<td>INT 20-03</td>
<td>Interpretations in Response to COVID-19 Expiring 60 Days after Termination of the National Emergency of Dec. 31, 2020</td>
<td>21-22</td>
<td>Effective for 60-Days After the National Emergency Terminates or Dec. 31, 2020 – Whichever Occurs First</td>
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</tbody>
</table>

**Summary:**
In April and May 2020, the Working Group adopted a number of interpretations in response to COVID-19 with effective dates consistent with the CARES Act. Pursuant to the CARES Act, the interpretations will only be applicable for the period beginning on March 1, 2020 and ending on the earlier of December 31, 2020, or the date that is 60 days after the date on which the national emergency concerning the novel coronavirus disease (COVID–19) outbreak declared by the President on March 13, 2020 under the National Emergencies Act (50 U.S.C. 1601 et seq.) terminates.

1. **INT 20-03: Troubled Debt Restructuring Due to COVID-19:** The Working Group reached a consensus to clarify that a modification of mortgage loan or bank loan terms in response to COVID-19 shall follow the provisions detailed in the April 7, 2020 “Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus” (detailed in paragraph 8) and
2. INT 20-07: Troubled Debt Restructuring of Certain Investments Due to COVID-19: This interpretation provides limited-time practical expedients in determining whether a modification under SSAP No. 36—Troubled Debt Restructuring are insignificant, and therefore is not a concession. If a modification is not a concession, recognition of the modification as a troubled debt restructuring is not required. For a practical expedients, it was determined that if a restructuring 1) results with a change that reflects a 10% or less shortfall amount in the contractual amount due, and 2) results in an extension of the maturity of the debt by no more than three years, the modification shall be considered insignificant and thus not requiring troubled debt accounting. Additionally, the interpretation clarified that restructurings that solely modify debt covenants are not considered troubled debt restructurings.

**Recommended Action:**
As the National Emergency has not yet been terminated, these INTs are still in effect. If the National Emergency is not terminated prior to Aug. 1, these INTS will be effective through the 3rd quarter. As such, NAIC staff does not believe extension consideration is needed at this time. In the event the National Emergency is terminated prior to Aug. 1st, the Working Group can consider subsequent extension consideration at that time.

**REVIEW of COMMENTS on EXPOSED ITEMS**

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

1. Ref #2019-34: Related Parties, Disclaimer of Affiliation and Variable Interest Entities
2. Ref #2020-03: Enhanced Goodwill Disclosures
3. Ref #2019-24: Levelized and Persistency Commission

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<tbody>
<tr>
<td>2019-34</td>
<td>Related Parties, Disclaimer of Affiliation and Variable Interest Entities</td>
<td>23 - Agenda Item 24 – Referral Response</td>
<td>Comments Received</td>
<td>Attachment 26, page 13</td>
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<tr>
<td>SSAP No. 25 (Jake)</td>
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**Summary:**
During the March 18 conference call, the Working Group deferred discussion on this agenda item. During the 2019 Fall National Meeting, the Working Group exposed this agenda item to clarify identification of related parties and affiliates in SSAP No. 25—Affiliates and Other Related Parties and to incorporate new disclosures to ensure regulators have the full picture of complicated business structures. After the 2019 Fall National Meeting, the Working Group sent a referral to the Group Solvency Issues (E) Working Group that outlines agenda item 2019-34 and asked for any further guidance or clarification. The Group Solvency Issues (E) Working Group recommended consideration of a new statutory disclosure that would provide information on minority ownership interests, as well as significant relationships between minority owners and other U.S. domestic insurers/groups. NAIC staff has worked with interested parties to draft proposed revisions to capture this information.

The proposed SSAP revisions intend to address the following key aspects:

- 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.

• Proposes rejection of several U.S. GAAP standards addressing variable interest entities.

Interested Parties’ Comments – These Comments are from the 2019 Fall NM Exposure:
Interested parties understand and agree with the need for transparency in disclosures of related party transactions. However, we have significant concerns with the proposal as it is not very clear based on the proposed changes to SSAP No. 25 what it is that will be required going forward based on the expansion of the definition of a related party. We include some of our observations below.

Interested parties would like clarity around the new proposed wording that states that non-controlling ownership over 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation. One of our concerns in this area relates to limited partnership/joint ventures/limited liability company (LPs/JVs/LLCs) investments where the insurer owns more than 10% of the equity of the investee but has no affiliation to the investee’s general partner/asset manager. SSAP No. 97 currently includes a possible scope exception in paragraph 6 for these types of investments so that they are not considered affiliated or controlled investees of the insurer. It is not clear from the proposal what the expected impact is from now having to consider all investments in unaffiliated LPs/JVs/LLCs where the insurer owns more than 10% of the equity but has no other affiliation, as related parties. If the intent is just to have insurers disclose material transactions with these entities other than the equity investment held in each entity, we believe that this needs to be more clearly stated in the proposal so that there is no misrepresentation of what needs to be disclosed or whether these investments need to be reported in a different section of Schedule BA (i.e., affiliated vs. non-affiliated).

Another, but similar concern relates to certain entities consolidated under U.S. GAAP based on the Variable Interest Entity (VIE) guidance. For some of these consolidated VIEs, the insurer has no control or affiliation with the VIE other than its debt investment in the entity. The insurer is simply a passive investor in the structure. However, under the VIE rules, the insurer must consolidate the entity as the insurer may be able to make decisions for the VIE if there is ever an event of default of the assets at some point in the future. These rights are given to certain classes of bonds issued by the securitization as a protection to the investors, but do not give the investors any type of power or control over the VIE at inception or on a day-to-day basis. It is important to note that consolidation rules under FASB Codification Topic 810 are very complex with some insurers concluding consolidation is required under a set of fact and circumstances and others concluding consolidation is not required under the same set of facts and circumstances. In the example just shared, some insurers have concluded consolidation is required because when no day-to-day decisions are being made for the VIE, decisions upon the occurrence of a certain event which may be unlikely to occur, rise to the point where they are the decisions that have the most significant impact on the economic results of the VIE. We believe that even though insurers have to consolidate these entities, there is no true related party affiliation. The proposal requires that any entity identified as a related party under U.S. GAAP will also be considered a related party for statutory reporting. Since these entities are consolidated for GAAP, the presumption would be that they are a related party of the insurer. If these entities will be considered related parties on a statutory basis going forward, the exposure needs to clarify that the inclusion of these types of entities only impacts related party disclosures for any material transactions held with these entities other than the debt investment held by the insurer in the VIE and that the debt instrument is still reported on Schedule D as unaffiliated.

Interested parties also have concerns with SSAP No. 25 including references to U.S. GAAP and SEC reporting for mutual insurers that do not prepare U.S. GAAP financial statements and do not file with the SEC. Therefore, interested parties recommend that the specific guidance from the GAAP and SEC be stated in SSAP No. 25 (rather
than incorporated by reference) so that any future changes in GAAP and SEC guidance are subject to NAIC review prior to being applicable. Also, it is important to note that even when an entity is considered a related party under U.S. GAAP, disclosure of that relationship is only required when there are material transactions with that party. U.S. GAAP allows reporting entities to evaluate the significance of a relationship and determine when disclosure of that relationship is material/significant enough for disclosure to a user of the financial statements. As a result, we suggest this be clarified in the exposure as well so that it is clear that the reference to related parties under GAAP and SEC rules is only relevant if the insurer has material transactions with such parties outside of the insurer’s investment in the entity.

Response from the Group Solvency Issues (E) Working Group to the Working Group’s referral at the 2019 Fall National Meeting:

The Group Solvency Issues (E) Working Group has recently noted several challenges in identifying and tracking the various affiliated/related parties within insurance groups, as well as the relationships an insurance group may have with other insurance groups. At the same time, regulators have noted an increased number of situations where the solvency and liquidity of insurers were negatively impacted by affiliated investments and relationships. Given the above-mentioned issues and concerns, the Working Group would like to express its support for the changes to SSAP No. 25—Affiliates and Other Related Parties that are proposed in agenda item 2019-34.

The Working Group agrees that each of the clarifications provided within the proposed revisions are valuable and will assist insurers and regulators in understanding the proper accounting treatment and disclosure requirements in this area. However, the Working Group notes that there may be additional disclosures necessary to clearly understand the nature of relationships across insurance groups. For example, Working Group members have found it difficult to understand and track relationships between insurers that are not affiliated (i.e., not under common control) but that share some level of common ownership. The Working Group recommends consideration of a new statutory disclosure that would provide information on minority ownership interests, as well as significant relationships between minority owners and other U.S. domestic insurers/groups.

Recommended Action:
NAIC Staff recommends exposing the revised agenda item. The revisions included in the proposed exposure incorporate changes that were made based on discussion with interested parties and also include a proposed new disclosure that was recommended by the Group Solvency Issues (E) Working Group.

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Summary:
During the March 18 conference call, the Working Group exposed this agenda item to capture additional goodwill information and to clarify reporting on Schedule D, Part 6, Section 1 – Valuation of Shares of Subsidiary, Controlled and Affiliated Companies.

The exposed agenda item also requested feedback in terms of the proposed edits to Schedule D – Part 6 – Sections 1 and 2. As detailed in the proposal, two column headings and related Blanks instruction refer to “Intangible Assets,” however NAIC staff believed the original intent of these disclosures were to capture goodwill. FASB defines intangible assets as assets (not including financial assets) that lack physical substance and refer to assets other than goodwill. Feedback was requested from regulators and interested parties regarding what has historically been included in this disclosure and if changing the definition to articulate goodwill is warranted. Upon a sampled review...
by NAIC staff, it appears as though goodwill is the sole number currently being reported in these applicable columns.

Interested Parties’ Comments:
Interested parties request that the proposal be revised (similar to Ref #2019-14) to exclude “pushdown” goodwill until the Working Group concludes on that issue. We also note that item 3 of the Description of the Issue on page 1 should be corrected as follows:

The goodwill limitation of 10% of the insurance reporting entity’s goodwill capital and surplus is a calculation…

Recommended Action:
NAIC staff recommends adopting the exposed nonsubstantive revisions to SSAP No. 68—Business Combinations and Goodwill, adding additional disclosure elements for existing goodwill. However, if the Working Group wishes to resolve pushdown accounting prior to adopting additional goodwill disclosure elements, NAIC staff recommend deferring action on this agenda item as omitting pushdown accounting would dilute the usefulness of existing disclosures.

The proposed disclosures will improve the validity and accuracy of numbers currently being reported and will assist with the regulators’ review of reported assets not readily available for the payment of policyholder claims. Due the timing of a concurrent Blanks exposure (item 2020-22BWG), if this agenda item is adopted during the Summer National Meeting, disclosure would be included in the year-end 2020 financial statements but would not be data captured until 2021.

NAIC staff notes that this agenda item only proposes enhanced disclosure granularity for existing reported goodwill. It does not provide new guidance on the determination, calculation or admissibility of goodwill. As such, omitting any goodwill from the goodwill disclosures would result in incomplete information being provided to regulators and financial statement users as the disclosures would only contain partial information. Accordingly, NAIC staff does not recommend excluding pushdown goodwill from the goodwill disclosures.

Additionally, the interested parties proposed edit was in the “description of the issue” for the agenda item and was not authoritative or proposed authoritative guidance, however, will be reflected for documentation purposes.

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Summary:
During the March 18 conference call, the Working Group deferred this item. During the 2019 Fall National Meeting, the Working Group exposed revisions to SSAP No. 71—Policy Acquisition Costs and Commissions to provide clarifications to the long standing levelized commissions guidance and provide additional guidance regarding commission that is based on policy persistency. The revisions clarify that a levelized commission arrangement (whether linked to traditional or nontraditional elements) requires the establishment of a liability for unpaid principal and accrued interest payable, regardless of the timing of payments made to a third party. Additionally, persistency commission shall be accrued proportionately over the policy period in which the commission relates to and is not deferred until fully earned.
The exposed recommendations are intended to be consistent with the original intent of SSAP No. 71 as well as the Statutory Statement of Concepts focusing on Recognition (noted in the Preamble, paragraphs 37 and 38) stating that liabilities require recognition as they are incurred and accounting treatments which tend to defer expense recognition do not generally represent acceptable SAP treatment.

Notice of the exposure was also sent to the Life Actuarial (A) Task Force. The Working Group forwarded comments received at the Fall National Meeting inquiring whether there is specific Valuation Manual language in VM-20, Requirements for Principle-Based Reserves for Life Products, and VM 21, Requirements for Principle-Based Reserves for Variable Annuities, that needs to be addressed in the coordination process as part of this agenda item. NAIC Staff understanding is that the PBR methodology takes commission into account when projecting the present value of future cash flows. However, the projected future cash flows would not be separately accrued again, if there is an existing liability.

Interested Parties’ Comments:
Interested parties appreciate staff’s availability to discuss the proposed revisions. Based on that discussion and the discussion at the Fall Meeting, interested parties propose suggested edits that we believe achieve the goal of a nonsubstantive change and clarify the original intent of SSAP 71. (Note: the NAIC Accounting Practices and Procedures Manual-Life which was in force prior to the effective date of current SAP includes the same wording as current SSAP No. 71). The suggested edits add a clear definition of a funding agreement. This will clarify the distinction between funding agreements and persistency-based commissions, without unintentionally changing the existing accounting. We welcome the opportunity to discuss the suggested edits further with the Working Group.

Interested parties’ revisions shown as shaded and tracked text to the exposed language.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported. Commission contracts that include persistency (or other such components) shall not use these clauses to defer recognition of commission expense. If a commission is based on annual policy persistency (or other similar components), the commission shall be accrued based on experience to date for the policy period that the commission relates. In regard to persistency commission, it is inappropriate to wait until the amount is fully earned and/or unavoidable to accrue experience to date commission expenses. Actual policy cancellation would reverse the accrual of the related persistency commission.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. A funding agreement is an agreement whereby a third party provides a lump sum of money in return for a guaranteed stream of payments over a predetermined time period enabling the third party to earn investment spread. The payment stream is fixed without regard to the traditional elements of continued premium payments or policy persistency. The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.
5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party to the agents requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions.

New Footnote – The guidance in this paragraph notes that levelized commissions which use a third party to pay agents that are linked to traditional elements require establishment of a liability for the amounts that have been paid to the agents and any interest accumulated to date.

Acadia/Capital Solutions’ Comments:
We have reviewed the proposed changes to SSAP No. 71 – Policy Acquisition Costs and Commissions as outlined in Ref. #2019-24 as revised on December 7, 2019.

The most effective way to appreciate the unintended consequences of the proposal is to start with a basic understanding of a typical distribution structure. Reporting entities execute distribution agreements, including compensation structure, with distribution partners (IMO, BGA, TPM, MGA, BD, for example). These distribution partners recruit, contract, train, supervise, and compensate smaller organizations (agencies, selling groups, brokerages, etc.) and individual producers (agents, brokers, etc.).

SSAP No. 71 proscribes statutory accounting treatment for reporting entity compensation agreements entered for the sale, distribution, and servicing of policies. The revisions proposed in Exposure Draft 2019-24 (as revised December 7, 2019) focus on two areas: (1) levelized commissions or “trail” payments paid directly to distribution partners or individual producers by a reporting entity and (2) levelized commissions or other installment payments paid to “third parties” by the reporting entity solely in exchange for the third party making non-levelized payments to the distribution partners or individual producers in place of the reporting entity (sometimes called “funding agreements”).

The proposed Exposure Draft relating to the first are in Paragraph 2 and call for “…commission shall be accrued based on experience to date for the policy period that the commission relates.” This specifically relates to the required timing or obligating event of a reporting entity’s liability for the cost of a commission payment specifically linked to persistency or policy renewal upon the anniversary of a policy issue date or some other future date or event.

The proposed Exposure Draft revisions relating to the second are (a) in paragraph 4, “…regardless of how the payment to the third party is characterized.”, (b) in paragraph 5, “…paid by a third party to the agents…by the reporting entity.”, and (c) in a footnote to paragraph 5, “The guidance in this paragraph notes that levelized commissions which use a third party to pay agents that are linked to traditional elements require establishment of a liability for the amounts that have been paid to the agents and any interest accumulated to date.”

The proposed revisions have different implications for different constituencies. We have endeavored to capture the essence of the concern from each party below. The proposed revisions have substantive implications for each of the noted constituencies, contrary to the non-substantive assertion in the revised exposure draft 2019-24. As a direct result of the inequity of the proposed changes upon various constituencies and the potential for substantial financial and economic harm incurred by the adoption of these changes to a variety of constituencies, we strongly recommend and request that the proposal not go forward.

Reporting Entity/ Carrier perspective:

1. Levelized commission programs are economic equivalents to “normal (non-level) commissions.” Levelized commission programs are preferable as they create a virtuous cycle linking the interests of consumers, agents, distribution partners and carriers to maintain ongoing servicing relationships, improving consumer support and policy persistency. Distribution relationships are multi-faceted, including agent recruitment
and oversight, sales, sales support, underwriting support, premium collection, policy delivery and agent payment. Characterizing distribution partners as a ‘third party’ under the proposed footnote to paragraph 5 of SSAP No. 71 discounts the complexity of these relationships and the value of these vital roles dramatically altering carrier dynamics with distribution partners.

2. Reporting entities or carriers will be unduly penalized for economic transactions negotiated under existing accounting principles as a direct result of this proposal. The value of those transactions is retroactively altered by the introduction of a modified accounting principle which neither party initially anticipated, negotiated or priced.

3. Higher required capital and lower returns resulting from an arbitrary modification to an existing accounting practice will drive product design reviews and likely product redesigns modifying or eliminating levelized commission options or reducing value to the consumer through higher premiums and/or lower benefits.

4. The proposal to require reserves for future persistency based levelized commissions creates a disconnect with GAAP accounting where there is no reserve requirement. Moreover, the proposal creates new uncertainty around which other, long standing accounting treatment will be changed next.

Distributor/Agent perspective

1. The trail compensation approach incentivizes all parties to maintain a long-term relationship based upon ongoing agent support of consumer needs. Reducing or removing recurring compensation in the form of persistency based levelized commissions, shifts distributor economic motivation to new product sales, further degrading product level returns for the carrier. Reducing benefit levels or increasing premiums for the same benefit levels will lower the value proposition for effected products very likely reducing sales and consumer protection delivered by the products.

Consumer perspective:

1. The fallout from the changes will diminish value of insurance products through higher premiums and/or lower benefits enacted by carriers seeking to make up lost economic value and from lower service levels provided by brokers or agents as their incentives shift from ongoing consumer service relating to in-force policies to selling new policies (whether to the individual policyholder or other prospective clients).

GreenbergTraurig’s Comments: on behalf of DRB Insurance Solutions

Thank you for the opportunity to provide comments on Proposal 2019-24 from the Statutory Accounting Principles Working Group regarding Policy Acquisition Costs and Commissions. The Working Group voted to re-expose revisions to SSAP 71 – Policy Acquisition Costs and Commissions - for comment at the NAIC Fall Meeting on December 7, 2019, continued to categorize the revisions as non-substantive, and further clarified levelized commission guidance and direction regarding certain commission obligations. I offer comments on behalf of our client, DRB Insurance Solutions, LLC, a licensed insurance producer (“DRB”).

SSAP No. 71 provides that levelized commissions occur in situations in which a third party, such as a funding agent, pays agents non-levelized commissions and the reporting entity pays the third party by levelized payments. The Working Group notes that it is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third-party would ultimately be repaid to the third-party from the reporting entity. SSAP No. 71 identifies such arrangements as “funding agreements” between the reporting entity and the third-party. SSAP No. 71 further provides that the use of a commission arrangement where commission payments are not linked to traditional elements (such as premium payments and policy persistency) requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which is payable to a third-party related to levelized commissions.

While revisions were made to several paragraphs and footnote 1 in the initial proposal at the Working Group’s meeting in December, the current exposure language remains overly broad to address the issue identified and intended to be clarified by the Working Group. Regulators have identified levelized commissions as funding
arrangements to bypass recognition of acquisition costs by insurers and believe recognizing the full acquisition expense at the time of policy issuance is appropriate accounting treatment pursuant to SSAP No. 5R and the Statement of Concepts focusing on Recognition. Notably, the Working Group intended to restrict intercompany and affiliated transfers of trailing commission structures as pure accounting transactions solely for the purpose of deferring expense recognition of commission obligations, which is a laudable goal.

However, the language exposed to classify trailing commission transactions as funding arrangements is so broad, it encompasses practically every broker contract with an insurer that allows for any alternative payment arrangement between the broker and the issuing agent. DRB Insurance Solutions is an independent third-party master producer which uses various contracts between DRBIS and its sub-agents for commission payment, including trailing, heaped, partially heaped and trailing commissions, etc. The agreements between DRBIS and reporting entities are arms-length transactions, include the transfer of lapse risk, mortality risk and the commission expense obligation. The proposal requiring all insurers to accrue the full commission expense under these circumstances is illogical when the insurer no longer has the legal obligation to pay the expense and therefore, no longer has legally incurred the expense.

While regulators have opined that affiliated transactions shrouded as commission arrangements appear to circumvent accrual of commission expense at policy issuance, the goal to affect those transactions may continue to be addressed while narrowing the language to clarify that non-affiliated third-party contracts are not included. Accordingly, DRBIS offers the following amendment to the exposure draft to narrow the applicability to those affiliated transactions. Suggested language for Paragraph 4 and the footnote to Paragraph 5 is shown as shaded text as follows:

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party under the control of the reporting entity, its parent, and/or any subsidiary or affiliate of the reporting entity or its parent. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party under the control of the reporting entity, its parent, and/or any subsidiary or affiliate of the reporting entity or its parent to the agents requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party under the control of the reporting entity, its parent, and/or any subsidiary or affiliate of the reporting entity or its parent related to levelized commissionsFN.

New Footnote – The guidance in this paragraph notes that that levelized commissions which use a third party to pay agents does not imply that levelized commissions that are linked to traditional elements, do not require establishment of a liability for the amounts that have been paid to the agents and any interest accumulated to date. Rather, such levelized commission obligations should be accrued for as set forth in paragraph 3.
while excepting unaffiliated third-party transactions from similar treatment. In these unaffiliated contractual arrangements, where risk and liability is transferred, the reporting entity may not even be aware of the payment schedule between the master producer and its sub-agents and certainly should not be required to accrue the full amount of the commission expense at policy issuance when the insurer is no longer legally required to pay that expense.

**Non-Substantive Change**

Finally, DRBIS would like to restate its opposition to consideration of the exposure draft as a non-substantive change. As previously stated, levelized commission programs began over thirty years ago, before the 1998 publication of Statutory Issue Paper No. 71 and the January 1, 2001 codification of Statutory Accounting Principles. The primary objectives of a levelized commission structure include aligning the interests of the customer, the agent, and the company and improved persistency from providing ongoing customer service. There is a duty to act in the best interests of the policyholder, as well as a compensation incentive, to make sure policies are well serviced so they stay in-force.

The proposed revisions to SSAP No. 71 are designated as non-substantive and deemed to be a clarification of intent of the codified statutory guidance. However, levelized commission programs were implemented more than a decade before the codification in 2001. Therefore, this is a material change to historical accounting practices and not a clarification of original intent. Even after codification, levelized commission programs continued for years and were not identified as applying statutory accounting incorrectly.

In conclusion, the current exposure draft of SSAP 71 is clearly not “non-substantive” and would have substantial unintended consequences without the amendments proposed above. Additionally, the expansive effect of this policy decision should be subject to open deliberation and public comment as the Working Group considers adoption. Thank you for the opportunity to comment.

**Recommended Action:**

NAIC Staff recommends that the Working Group adopt the revisions as exposed from the 2019 Fall National Meeting or provide additional direction to NAIC Staff. As summarized below, the proposed language from Interested Parties and DRB Insurance Solutions are not viable as both proposals are inconsistent with existing principles. The exposed language would not allow the use of a third-party agent agreement to delay recognition of liability and expense from an in-force insurance contract. If the Working Group wants to consider changes to allow third-party agents agreements to delay the recognition of liability and expense by the insurance reporting entity, then this would be considered a substantive change from existing statutory accounting principles. While parties agree that the related amounts are ultimately liabilities/expenses, the issue is when to record the liability/expense. NAIC Staff believe a liability and expense is incurred when the insurance contract is written, not when the payment is due. In addition, NAIC Staff has concern with the comments regarding assumption of insurance risk by brokers and other third parties.

**Overview of Interested Parties’ proposed revisions**

Interested parties’ proposed language recommends deleting most of the exposed revisions and adding guidance that would redefine a funding arrangement to only include those items where repayment is guaranteed. This proposal would conflict with the long-standing guidance in SSAP No. 71, paragraph 4 which notes that “It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid…” The existing language seeks to look at the big picture substance of the transactional arrangement noting, that in essence, a third party would not prepay an entity’s commission expenses without an expectation of repayment. As the proposed language would conflict with the existing principle, NAIC staff does not view this as a viable proposal.
Overview of Acadia/Capital Solutions’

The comments from Acadia Capital Solutions focus on what they describe as unintended consequences and potential impacts to various entities. It asserts that clarifying existing language is a substantive change. However, NAIC staff notes that the proposed revisions are trying to emphasize existing language that has been in effect since prior to codification is being ignored by some reporting entities in an attempt to defer expense recognition. Expensing acquisition costs when incurred is a long-standing principle in statutory accounting.

Overview of GreenbergTraurig on behalf of DRB Insurance Solutions

DRB’s proposed language recommends only requiring levelized commission liability recognition if the third party, which prepays the commission, is under the control or has common control with the insurance reporting entity. Presumably that means if an unrelated party fronts the commission expense, no liability recognition is required by the insurance reporting entity. As the substance of the transaction is the same for related and unrelated parties, NAIC staff does not view this as a viable proposal.

NAIC staff also notes that the comment letter asserts that the third-party broker, by virtue of their agreement, has assumed “lapse risk, mortality risk and the commission expense obligation.” It also asserts that “requiring all insurers to accrue the full commission expense under these circumstances is illogical when the insurer no longer has the legal obligation to pay the expense and therefore, no longer has legally incurred the expense.” NAIC staff notes that some of the identified items that are noted as being transferred to the broker are insurance risks that should only be transferable to an insurance entity through a reinsurance agreement. NAIC staff also notes that the substance of the arrangement is still profit based. The company that fronts the commission expense of behalf of the insurance reporting entity has the expectation of repayment until the policy is cancelled.

SSAP No. 71 With Revisions Exposed at the Fall National Meeting for Potential Adoption Consideration:

SUMMARY CONCLUSION

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported. Commission contracts that include persistency (or other such components) shall not use these clauses to defer recognition of commission expense. If a commission is based on annual policy persistency (or other similar components), the commission shall be accrued based on experience to date for the policy period that the commission relates. In regard to persistency commission, it is inappropriate to wait until the amount is fully earned and/or unavoidable to accrue experience to date commission expenses. Actual policy cancellation would reverse the accrual of the related persistency commission.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. The continuance of the stream of payments specified in the levelized commission
contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party to the agents requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions FN.

New Footnote – The guidance in this paragraph notes that levelized commissions which use a third party to pay agents that are linked to traditional elements require establishment of a liability for the amounts that have been paid to the agents and any interest accumulated to date.

The comment letters are included in Attachment 27 (5 pages).

Comment letters previously received (in conjunction with the March 18 Conference Call), are included in Attachment 28 (53 pages).
Draft Pending Adoption

Attachment One
Accounting Practices and Procedures (E) Task Force
4/1/20

Draft: 4/2/20

Statutory Accounting Principles (E) Working Group
Conference Call
March 18, 2020

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met via conference call March 18, 2020. The following Working Group members participated: Dale Bruggeman, Chair (OH); Carrie Mears, Vice Chair (IA); Sheila Travis (AL); Kim Hudson (CA); Kathy Belfi and William Arfanis (CT); Rylynn Brown (DE); Eric Moser (IL); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Tom Dudek (NY); Joe DiMemmo and Kimberly Rankin (PA); Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI).

1. Adopted its Jan. 8 and 2019 Fall National Meeting Minutes

Ms. Walker made a motion, seconded by Ms. Malm, to adopt the Working Group’s Jan. 8 (Attachment One-A) and Dec. 7, 2019, (see NAIC Proceedings – Fall 2019, Accounting Practices and Procedures (E) Task Force, Attachment One) minutes. The motion passed unanimously.

2. Adopted Non-Contested Statutory Accounting Revisions During its Public Hearing

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

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

a. Agenda Item 2018-26

Mr. Bruggeman directed the Working Group to agenda item 2018-26: SCA Loss Tracking – Accounting Guidance (Attachment One-C). Fatima Sediqzad (NAIC) stated that this non-substantive agenda item adopts language that reported equity losses of a subsidiary, controlled and affiliated entity (SCA) would not go negative, thus stopping at zero; however, any guaranteed liabilities would be reported to the extent that there is a financial guarantee or commitment.

b. Agenda Item 2018-38

Mr. Bruggeman directed the Working Group to agenda item 2018-38: Prepayment to Service and Claims Adjusting Providers (Attachment One-D). Robin Marcotte (NAIC) stated that this non-substantive agenda item expands language emphasizing that loss and loss adjusting expense liabilities shall be established regardless of payments to third parties, except for capitated health claim payments. Furthermore, prepayments to third-party administrators (TPAs) that are not for claims or loss adjusting expenses are miscellaneous underwriting expenses.

c. Agenda Item 2019-32

Mr. Bruggeman directed the Working Group to agenda item 2019-32: Look-Through with Multiple Holding Companies (Attachment One-E). Ms. Sediqzad stated that this non-substantive agenda item emphasized existing guidance stating that a look-through is permitted through more than one downstream holding company if each entity complies with the look-through requirements of Statement of Statutory Accounting Principles (SSAP) No. 97—Investments in Subsidiary, Controlled and Affiliated Entities.

d. Agenda Item 2019-35

Mr. Bruggeman directed the Working Group to agenda item 2019-35: Update Withdrawal Disclosures (Attachment One-F). Ms. Marcotte stated that this non-substantive agenda item updates withdrawal disclosures that were previously developed by the Financial Stability (EX) Task Force. This agenda item made minor consistency and cross-reference edits in various SSAPs.
e. **Agenda Item 2019-43**

Mr. Bruggeman directed the Working Group to agenda item 2019-43: *ASU 2017-11, Earning Per Share, Distinguishing Liabilities from Equity, Derivatives & Hedging* (Attachment One-G). Jim Pinegar (NAIC) stated that this non-substantive agenda item addressed the complexity of accounting for certain financial instruments that are not prevalent in the insurance industry. However, it provided the opportunity to address principle concepts regarding the accounting for instruments with characteristics of both liability and equity. This agenda item requires that issued, free-standing financial instruments with characteristics of both a liability and equity shall be reported as a liability, to the extent that they represent an unconditional obligation to the issuer.

f. **Agenda Item 2019-45**

Mr. Bruggeman directed the Working Group to agenda item 2019-45: *ASU 2013-11, Income Taxes – Presentation of an Unrecognized Tax Benefit* (Attachment One-H). Mr. Pinegar stated that this non-substantive agenda item addressed the financial statement presentation of an unrecognized tax benefit. However, as an unrecognized tax benefit does not meet the more-likely-than-not recognition threshold, current statutory accounting guidance requires immediate expensing of the item. Mr. Pinegar stated that interested parties proposed one minor clarification change, and NAIC staff supported adoption with the edits proposed.

g. **Agenda Item 2019-48**

Mr. Bruggeman directed the Working Group to agenda item 2019-48: Disclosure Update for Reciprocal Jurisdiction Reinsurers (Attachment One-I). Jake Stultz (NAIC) stated that this non-substantive agenda item adds reference of reciprocal jurisdictions as a result of the Executive (EX) Committee and Plenary adoption revisions to the *Credit for Reinsurance Model Law* (#785) and the *Credit for Reinsurance Model Regulation* (#786).

h. **Agenda Item 2019-46**

Mr. Bruggeman directed the Working Group to agenda item 2019-46: *ASU 2016-14, Presentation of Financial Statements for Not-for-Profit Entities* (Attachment One-J). Mr. Pinegar stated that *Accounting Standards Update (ASU) 2016-14, Presentation of Financial Statements for Not-for-Profit Entities* detailed the financial statement presentation required for non-for-profit entities. He stated that requirements included the presentation of two classes of net assets. He stated that the non-substantive revisions to *Appendix D—Nonapplicable GAAP Pronouncements* are to reject ASU 2016-14.

3. **Adopted Revisions to Statutory Accounting with Minimal Discussion**

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

a. **Agenda Item 2019-08**

Mr. Bruggeman directed the Working Group to agenda item 2019-08: Reporting Deposit-Type Contracts. Mr. Pinegar stated that this non-substantive agenda item originated to gather information on deposit-type contracts that were reported in the annual statement Exhibit 5 – Aggregate Reserves for Life Contracts or Exhibit 6 – Aggregate Reserves for Accident and Health Contracts. He stated that the long-standing industry practice is to classify and report contracts in the appropriate schedule at policy inception and not move reporting schedules throughout the policy lifecycle. Accordingly, the exposed footnote for Exhibit 5 would capture contracts that no longer contain a mortality risk. Mr. Pinegar stated that the agenda item also sought feedback regarding the instructions for classifying deposit-type contracts in Exhibit 7 – Deposit-Type Contracts; however, if warranted, that may be addressed in a separate agenda item.

John Bauer (Prudential), representing interested parties, stated that they recommend adoption of this agenda item.

Ms. Belfi made a motion, seconded by Ms. Weaver, to adopt the recommendation to add a footnote for annual statement Exhibit 5, noting that no updates were required for statutory accounting (Attachment One-K). The motion passed unanimously.
b. Agenda Item 2019-40

Mr. Bruggeman directed the Working Group to agenda item 2019-40: Reporting of Installment Fees and Expenses. Ms. Marcotte stated that exposed non-substantive edits address potential diversity in the application of the SSAP No. 53—Property Casualty Contracts—Premiums installment fee guidance. She stated that the recommendation in the agenda item was to clarify that the installment fee and service charges guidance should be applied narrowly to the specific situation described and not analogized to exclude other fees from premium. Furthermore, diversity in reporting was noted regarding installment fee expenses, even though the annual statement provides for reporting these items in underwriting expenses. This agenda requested input regarding the reporting of installment fee expenses. Mr. Marcotte stated that interested parties suggested a one-word edit, and NAIC staff were supportive of the suggested edit.

Ms. Marcotte stated that notifications of the exposure were sent to the Casualty Actuarial and Statistical (C) Task Force and the Property and Casualty Risk-Based Capital (E) Working Group. However, comments were not expected to be received until after the Summer National Meeting. She noted that, if warranted, comments can be addressed in a separate agenda item as they are received regarding installment fee expenses

Richard Poniatowski (Travelers), representing interested parties, stated that they agreed with the language proposed for SSAP No. 53.

Mr. Hudson made a motion, seconded by Ms. Mears, to adopt the exposed agenda items with minor changes from interested parties, clarifying language in SSAP No. 53 stating that the existing installment fee revenue guidance should be narrowly applied (Attachment One-L). The motion passed unanimously

c. Agenda Item 2019-33

Mr. Bruggeman directed the Working Group to agenda item 2019-33: SSAP No. 25 – Disclosures. Julie Gann (NAIC) stated that this non-substantive agenda item was drafted to data-capture disclosures from SSAP No. 25—Affiliates and Other Related Parties. She noted that disclosures from SSAP No. 25 are currently completed in a narrative format. With the proposal to data-capture disclosures, the state insurance regulators can aggregate and query various related party relationships. She noted that interested parties proposed minor modifications, one of which was supported by NAIC staff. The Blanks (E) Working Group has a concurrent exposure to ensure reporting for year-end 2020.

Mr. Smith made a motion, seconded by Mr. Dudek, to adopt the exposed agenda item with minor changes from interested parties, detailing the data-capture of certain SSAP No. 25 disclosures, which are currently completed in narrative form (Attachment One-M). The motion passed unanimously

d. Agenda Item 2019-39

Mr. Bruggeman directed the Working Group to agenda item 2019-39: Acceptable Collateral for Derivatives. Mr. Pinegar stated that the intent of this agenda item was to facilitate a discussion to determine if a reporting entity should receive credit for initial margin pledged to them in central clearinghouse transactions. However, discussions with interested parties found that utilization of initial margin is not only a rare event, but additional compensating controls are in place to ensure variation margin compliance. Furthermore, non-cash collateral is often utilized for posting the initial margin and, as such, that collateral should remain on the books of the provider as they maintain the full rights of ownership. Mr. Pinegar stated that due to these facts, NAIC staff believe that the third-party derivative exposure is appropriately captured in existing reporting, and he recommended disposal of this agenda item.

Josh Bean (Transamerica), on behalf of interested parties, stated support for disposal of the agenda item, as they believe the derivative activity in central clearinghouse activities is appropriately captured in existing reporting framework.

Mr. Moser made a motion, seconded by Mr. Hudson, to dispose of this agenda item without statutory revision (Attachment One-N). The motion passed unanimously.

4. Reviewed Comments and Considered Exposure of Agenda Items with Minimal Discussion

The Working Group held a public hearing to review comments (Attachment One-B) on previously exposed items.
Mr. Smith made a motion, seconded by Mr. Hudson, to expose all items for comment with a distinction of the differing exposure periods for each item. The motion passed unanimously.

a. **Agenda Item 2019-04**

Mr. Bruggeman directed the Working Group to agenda item 2019-04: SSAP No. 32 – Investment Classification Project. Mr. Pinegar stated that the intent of the agenda item was to revise SSAP No. 32—Preferred Stock pursuant to the investment classification project. The revisions include definitions, measurement and impairment guidance. Mr. Pinegar stated that with this and prior exposures, comments were received regarding the proposed definitions (e.g., whether redemption is within control of the holder). He stated that while the original terminology proposed by NAIC staff reflects the common terminology used by industry and U.S. Generally Accepted Accounting Principles (GAAP), a potential reclassification of certain preferred stock could occur if adopted, which was not the intent of the project. He stated that NAIC staff agreed to the terminology and phraseology suggested by interested parties. The addition of a footnote was also added to cover certain joint venture or partnership entities in which issue instruments were identical to preferred stock but used differing legal naming conventions. He stated that NAIC staff support for the exposure of the issue paper and the revised SSAP No. 32R—Preferred Stock to reflect the proposed edits of all interested parties. This agenda item has a comment deadline of May 29.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

b. **Agenda Item 2019-38**

Mr. Bruggeman directed the Working Group to agenda item 2019-38: Financing Derivatives. Ms. Gann stated that this non-substantive agenda item addresses the reporting of financing derivatives, which represents situations where the premium due, as a result of acquiring or writing a derivative, is paid throughout the derivative term or at maturity. She stated that the agenda item proposes the elimination of the allowance of net reporting, with a requirement for gross reporting for derivatives purchased or sold. She stated that the proposed revisions to SSAP No. 86—Derivatives would require gross reporting of derivatives without the effect of financing premiums due or payable, and they would present the true financial asset and liability position associated with the use of derivatives. She noted that proposed concepts included in the agenda item suggest revisions to a Blanks proposal to capture additional information regarding any derivative financing components. She stated that the interested parties’ comments requested an effective date of Jan. 1, 2021, and other editorial changes. NAIC staff were supportive of the effective date and edits proposed, and they recommended exposure of the agenda item. Finally, with exposure, a referral would be sent to the Capital Adequacy (E) Task Force for consideration of these risked-based capital (RBC) changes.

Mr. Bruggeman stated that he appreciated staff and interested parties’ continual, collaborative effort on this agenda item to ensure that the appropriate reporting occurs without incurring any unintended consequences from this reporting change, and they confirmed that the exposure deadline for this item was May 29.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

c. **Agenda Item 2019-14**

Mr. Bruggeman directed the Working Group to agenda item 2019-14: Attribution of Goodwill. Ms. Gann stated that this non-substantive agenda item is a disclosure item for when a reporting entity purchases a holding company and said company owns multiple entities. The goodwill from the acquisition of the holding company shall be allocated to each entity at the time of purchase. She stated that comments received from interested parties on this item were combined with comments received for agenda item 2019-12: ASU 2014-17, Business Combinations – Pushdown Accounting regarding pushdown accounting. She stated that this agenda item does not necessarily pertain to pushdown accounting and, it is only intended to require disclosure of the goodwill attributed to the underlying holding companies in which pushdown accounting has not been applied. For clarification, an edit was proposed to ensure that pushdown is omitted from the disclosure requirements; however, she stated that once pushdown has been addressed the applicability of the attributed goodwill disclosure may be reassessed. This agenda item has a comment deadline of May 29.

D. Keith Bell (Travelers), representing interested parties, stated that they did not understand the intent nor the proposal, and they requested a conference with NAIC staff for further discussion. He stated that if an entity is sold, the associated goodwill should be removed. Ms. Gann stated that the intent of this agenda item was to assist NAIC staff and state insurance regulators
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with the identification of the amount of goodwill that should be removed upon the sale of an SCA, as that information is not currently available.

Mr. Bruggeman declared his understanding that U.S. GAAP allows instances where goodwill is associated with a business unit and perhaps not with a legal entity, and he encouraged the NAIC staff and interested parties’ continued collaboration on this agenda item.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

d. **Agenda Item 2019-20**

Mr. Bruggeman directed the Working Group to agenda item 2019-20: Rolling Short-Term Investments. Mr. Pinegar stated that this non-substantive agenda item was originally exposed to address certain investments that were structured as short-term investments, with those investments being rolled or renewed and remaining on a short-term schedule for multiple years. As the original agenda item captured both affiliated and unaffiliated investments, he stated that interested parties requested separating the discussion of both types of investments. NAIC staff agreed with the separation, as unaffiliated investments do occur in an arm’s length transaction, indicating that each party can independently review and elect not to renew an investment. With this independence, renewal or rolling of the investments and subsequent reporting as a short-term investment was likely appropriate. Additionally, certain affiliated transactions could, under certain circumstances, also operate independently as if both parties were unaffiliated. Mr. Pinegar stated that related operating units may have various review mechanisms to allow arm’s length review. He stated that this agenda item proposed additional guidance allowing certain affiliated or related party investments to be rolled or renewed if certain criteria are met. He stated that the criteria required the investment to be appropriately re-underwritten with adequate documentation, and each party must have the ability to independently review the terms and terminate the transaction prior to renewal. Additionally, a concurrent Blanks exposure includes a reporting code to identify short-term investments that remain on the short-term schedule for more than one year, and a general interrogatory has been proposed requiring certification that, if related party transactions have been renewed, appropriate re-underwriting has occurred. Mr. Pinegar stated that if adopted in current form, a referral will be sent to the Financial Analysis (E) Working Group and the Financial Analysis Solvency Tools (E) Working Group notifying them of the new reporting code, which captures renewed affiliated investments, and urging assistance to analysts and examiners on how to use the new data. This agenda item has a comment deadline of May 1.

Mr. Bruggeman confirmed that for efficiency in reporting, the code used to identity renewed short-term investment would apply to all investments and not solely affiliated investments. He stated that this code would allow state insurance regulators to identify such investments, at which time additional underwriting documentation could be requested.

Stephanie Rengstorf (Nationwide), on behalf of interested parties, appreciated NAIC staff’s collaboration on this agenda item, as liquidity management, through the efficient use of capital, is a critical function in terms of servicing policyholders. She stated that the proposed edits and disclosures were a welcome change, and she will provide feedback on subsequent exposure.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

e. **Agenda Item 2019-42**

Mr. Bruggeman directed the Working Group to agenda item 2019-42: Cash Equivalent – Cash & Liquidity Pools. Mr. Pinegar stated that this non-substantive agenda item arose as a result of the short-term rolling agenda item (Ref #2019-20), in which interested parties commented that cash pools were not appropriately scoped out of the proposed short-term restriction guidance. He stated that cash pools are techniques in which affiliates combine excess cash in order to earn additional interest, access additional short-term investment markets, and improve liquidity management. He stated that this agenda item originally proposed to allow cash pools that meet certain requirements to be reported as cash equivalents. He stated that interested parties provided responses that requested consideration on three items. First, interested parties requested that the reporting of cash pool assets be allowed on the schedule that most closely reflects the assets held by the pool (i.e., cash, cash equivalents, or short-term investments). Mr. Pinegar stated that NAIC staff originally proposed reporting as a cash equivalent for simplicity, but they were supportive of the request, noting that RBC and other analysis techniques combine these assets and that reporting on one schedule versus another should not cause any adverse effects. Second, NAIC staff were supportive of interested parties’ request to remove the U.S. GAAP audit of the liquidity pool, noting that the footnote disclosure, which details the assets held
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by investment type, would be subject to an independent audit under statutory accounting principles (SAP). Mr. Pinegar stated that NAIC staff did not concur with the third request of allowing for optionality in reporting asset valuations. He noted that current guidance requires that all short-term investments be accounted for in the same manner as similar long-term investments, and NAIC staff believe assets should not be accounted for differently simply because they are in a liquidity pool. This agenda item has a comment deadline of May 1.

Diane Bellas (Allstate), representing interested parties, expressed appreciation to the Working Group for separating this agenda item, noting that cash and liquidity pools are an important function of many insurance entities, and support for the shortened exposure period.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

f. Agenda Item 2019-25

Mr. Bruggeman directed the Working Group to agenda item 2019-25: Working Capital Finance Investments. Ms. Marcotte noted that the materials contain the proposed substantive revisions, incorporating the industry proposed language for the six specific items directed by the Working Group at the 2019 Summer National Meeting to SSAP No. 105—Working Capital Finance Investments. She stated that NAIC staff recommended exposure of the SSAP and related Issue Paper No. 16x—Working Capital Finance Investment Updates. An effective date of June 30 was proposed for discussion, which, if preferred, would require comment from the Working Group by May 1.

Michael M. Monahan (American Council of Life Insurers—ACLI) stated that interested parties had no preference in the effective date; since all their requests were not granted, this will remain an un-investable asset class.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure with a proposed effective date of June 30.

g. Agenda Item 2019-36

Mr. Bruggeman directed the Working Group to agenda item 2019-36: Expand MGA and TPA Disclosures. Ms. Marcotte stated that this non-substantive agenda item was drafted pursuant to a request from two states that the existing annual statement disclosure regarding managing general agents (MGA) or TPAs be expanded to include additional information. She stated that state insurance regulators and policyholders should be able to fully understand the level and extent to which core services and binding authority are provided by MGAs or TPAs. Interested parties commented that a TPA should be consistently defined. Ms. Marcotte stated that the proposed modification is to add references to Registration and Regulation of Third-Party Administrators (TPAs) (GDL-1090). She stated that interested parties also commented on the proposed TPA claims reporting threshold, and she recommended using a premium threshold. The recommendation from the sponsors of the agenda is to use a claim count threshold. This agenda item has a comment deadline of May 1.

Mr. Bell, representing interested parties, stated that they appreciated the exposure; however they would need to reassess any operational concerns with the proposed TPA reporting thresholds.

Albert Thomas Finnell (America’s Health Insurance Plans—AHIP) requested clarification regarding the shortened comment period. Ms. Marcotte stated that due to a concurrent Blanks exposure, a shortened comment period is required if the Working Group requests adoption for 2020.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

h. Agenda Item 2019-37

Mr. Bruggeman directed the Working Group to agenda item 2019-37: Surplus Notes – Enhanced Disclosures. Mr. Pinegar stated that this non-substantive agenda item was drafted from the Working Group’s request that additional disclosures be captured in SSAP No. 41R—Surplus Notes. He stated that the originally proposed disclosures materially reflected certain key details in the surplus note data call from 2019. These disclosures were intended to give state insurance regulators further insight into the issuances of surplus notes that do not contain cash flows typically associated with surplus notes. Mr. Pinegar stated that interested parties commented that the disclosures, as originally proposed, would not accurately reflect the disclosure of
items sought by state insurance regulators and would disclose confidential pricing information. He stated that in conjunction with their comments, interested parties provided several suggested disclosure edits, of which NAIC staff note would achieve the same level of disclosure as requested by the Working Group. He stated that regarding the potential disclosure of confidential information, NAIC staff have proposed a modified disclosure element that disregards cashflows to the independent source of liquidity, thus maintaining pricing confidentiality. This agenda item has a comment deadline of May 1.

Mr. Bauer, representing interested parties, stated appreciation of NAIC staff’s efforts in integrating proposed interested party comments and how the proposed agenda item provides robust disclosure of surplus note activity.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

i. Agenda Item 2019-47

Mr. Bruggeman directed the Working Group to agenda item 2019-47: VM 21 Grading. Ms. Marcotte noted that the agenda item is addressing VM-21, Requirements for Principle-Based Reserves for Variable Annuities, and grade-in requirements for reporting changes in valuation basis for years beginning Jan. 1. She stated that the revisions to the Valuation Manual allowed different optional phase-in requirements. She stated that the exposure includes non-substantive revisions to SSAP No. 51R—Life Contracts and SSAP No. 3—Accounting Changes and Corrections of Errors for reporting years beginning Jan. 1.

Ms. Marcotte stated that what was exposed would expand the disclosure for changes in valuation basis as a change in accounting principle under SSAP No. 3 to provide details regarding grade-in of changes in valuation basis. This includes the grade-in period applied, the remaining amount to be graded-in, the remaining time for the grade-in period, and any adjustments. The exposure also provided accounting for unrecognized graded-in reserve, which represents an unrecognized adjustment to surplus. The exposed revisions would have required the unrecognized grade-in amount due to a change in valuation basis, if resulting in an increase in reserves (decrease to surplus), to be reported as an allocation from unassigned funds to special surplus until the amount has been fully graded into unassigned funds.

Ms. Marcotte stated that the interested parties provided comments were opposed to requiring the segregation in special surplus of the unrecognized phase-in amounts. She noted that NAIC staff had some concern regarding the timing of re-exposure; however, discussion with ACLI representatives noted that the Valuation Manual allows the phase-in election to occur as late as Dec. 31. NAIC staff proposed revisions recommended for a short exposure by the Working Group, incorporating the major interested parties’ proposed edit of removing the reclassification to special surplus. Ms. Marcotte noted that “grade-in” was changed to “phase-in” that paragraph 39 of the illustration has two additional edits that change “grading” to “phase-in.” She stated that the revisions for exposure did not incorporate all the interested parties’ proposed revisions, language on retroactivity was not incorporated, and coordination on future Valuation Manual grade-in proposals will be required. She noted that the proposal will provide disclosure of the change in valuation basis from the VM-21 changes and add new disclosures regarding the phase-in process being applied. She noted that consistent with the prior exposure, notice of the exposure should also be sent to the Life Actuarial (A) Task Force as part of the Valuation Manual and Accounting Practices and Procedures Manual (AP&P Manual) coordination process. Mr. Monahan noted appreciation for a re-exposure and coordination with NAIC staff.

5. Considered Maintenance Agenda—Pending Listing—Exposures

Mr. Dudek made a motion, seconded by Ms. Weaver, to move agenda items 2020-01 through 2020-11 to the active listing and expose all items for comment with distinction of each item as either substantive or non-substantive and with corresponding referrals and comment periods as recommended by NAIC staff. The motion passed unanimously.

a. Agenda Item 2020-01

Mr. Bruggeman directed the Working Group to agenda item 2020-01: Update/Remove References to SVO Listings. Mr. Pinegar stated that this agenda item reflects a Valuation of Securities (E) Task Force notice regarding two pending revisions to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual). He stated that the Task Force is renaming the “U.S. Direct Obligations/Full Faith and Credit Exempt List” the “NAIC U.S. Government Money Market Fund List.” He noted that no revisions to the AP&P Manual would be required for this revision, as this list is not specifically identified. He stated that revisions would, however, likely be needed in the Blanks and RBC filings/instructions. He stated that the second revision was to discontinue the “NAIC Bond Fund List.” He noted that items that were on this list would be eligible
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for consideration in the “NAIC Fixed Income-Like SEC Registered Funds List.” The discontinuance will require an update in the AP&P Manual in SSAP No. 26R—Bonds and SSAP No. 30R—Unaffiliated Common Stock to eliminate references to the “NAIC Bond Fund List” and add reference to the “NAIC Fixed Income-Like SEC Registered Funds List” in SSAP No. 30R.

This agenda item has a comment deadline of May 1.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

b. Agenda Item 2020-02

Mr. Bruggeman directed the Working Group to agenda item 2020-02: Accounting for Bond Tender Offers. Mr. Pinegar stated that a bond tender offer is like a called bond, except a tender offer is contingent on acceptance of the offer by the holder. He stated that specific guidance for the reporting and allocation of investment income and/or capital gain/loss associated with callable bonds is noted in SSAP No. 26R; however, guidance is not reflected when a bond is retired early through a tender offer. He stated that the non-substantive revisions in this proposal clarify that the accounting and reporting of investment income and capital gain/loss due to the early liquidation, either through a call or a tender offer, shall be similarly applied. The existing guidance would include all dynamics in which an issuer provides a penalty/fee to the holder to retire the bond prior to maturity.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

c. Agenda Item 2020-03

Mr. Bruggeman directed the Working Group to agenda item 2020-03: Enhanced Goodwill Disclosures. Ms. Sediqzad stated that this agenda item was drafted to request additional goodwill information and clarify reporting on Schedule D, Part 6, Section 1 – Valuation of Shares of Subsidiary, Controlled and Affiliated Companies. She stated that with the adoption of agenda item 2017-18: Goodwill Limitations, the information reported regarding goodwill, as provided in annual statement Footnote 3 – Business Combinations and Goodwill, has improved. She said the agenda item proposes additional disclosures to enhance the reporting of an SCA’s book adjusted carrying value (BACV). She noted that as goodwill is a significant component of many SCA’s BACV, this agenda item will assist in facilitating the review and disclosure of each balance.

Ms. Sediqzad stated that during a review of SCA Sub 2 filings, it is noted that many companies do not calculate the amortization of goodwill correctly, which sometimes overstates the value of the SCA. She stated that many companies also do not provide additional information to verify beginning goodwill and purchase price; as such, NAIC staff rely on a review of Footnote 3 for these details. She stated that if the goodwill amount is not verifiable, it is not be allowed to be admitted as part of the SCA’s value.

Ms. Sediqzad stated that the goodwill limitation of 10% of the insurance reporting entity’s goodwill is a calculation that all reporting entities who have goodwill must perform. She noted that while the admitted result is in the annual statement, the details of the calculation are not easily identifiable, and this agenda item proposes the disclosure of the calculation components to ensure transparency in the admission of goodwill.

Ms. Sediqzad noted that feedback is requested in terms of the proposed edits to Schedule D – Part 6 – Sections 1 and 2. She stated that, as detailed in the proposal, two column headings and related Blanks instructions refer to “Intangible Assets”; however, NAIC staff believe the original intent of these disclosures was to capture goodwill. She noted that the Financial Accounting Standards Board (FASB) defines intangible assets as assets (not including financial assets) that lack physical substance and refer to assets other than goodwill. She stated that feedback is requested from state insurance regulators and interested parties regarding what has historically been included in this disclosure and if changing the definition to articulate goodwill is warranted. She noted that per a review by NAIC staff, it appears as though goodwill is the sole number currently being reported in these applicable columns. This agenda item has a comment deadline of May 29.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

d. Agenda Item 2020-04
Mr. Bruggeman directed the Working Group to agenda item 2020-04: Commissioner Discretion in the Valuation Manual. Ms. Marcotte stated that this agenda item has been drafted to maintain comparability by providing disclosures regarding the use of commissioner discretion pursuant to the Valuation Manual, which became operative on Jan. 1, 2017. She stated that after reviewing the instances that require commissioner approval in the Valuation Manual, the items involve making a voluntary choice between various acceptable methods, which is subject to commissioner approval. She stated that the identified instances in the Valuation Manual are consistent with a change in valuation basis. As these changes are voluntary and not required to change by the methodology, this agenda item recommends disclosing the use of commissioner discretion required for choosing between acceptable methods, consistent with a change in valuation basis.

Ms. Marcotte noted that the non-substantive revisions to SSAP No. 51R, SSAP No. 52—Deposit-Type Contracts, and SSAP No. 54R—Individual and Group Accident and Health Contracts are illustrated in the agenda item. She noted that the proposed guidance points to an existing change in valuation basis disclosures for voluntary decisions, which require commissioner approval and the ability to choose one allowable reserving methodology over another. She also stated that as part of the coordination process with the Valuation Manual, the Life Actuarial (A) Task Force should be notified of the exposure. This agenda item has a comment deadline of May 29.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

e. Agenda Item 2020-05

Mr. Bruggeman directed the Working Group to agenda item 2020-05: Repeal of the Affordable Care Act Section 9010 Assessment. Ms. Marcotte stated that the federal Affordable Care Act (ACA) Section 9010 assessment has had more than one deferral or moratorium, as addressed in INT 16-01: ACA Section 9010 Assessment 2017 Moratorium. She stated that in December 2019, the U.S. House of Representatives (House) and U.S. Senate (Senate) passed bills repealing Section 9010 assessments for calendar years beginning Jan. 1, 2021. She stated that this bill was subsequently signed into law. She noted that the assessment is required to be paid for calendar year 2020. She stated that the agenda item addresses the substantive impacts of the Section 9010 assessment repeal for calendar years beginning on Jan. 1, 2021, by recommending that SSAP No. 106—Affordable Care Act Section 9010 Assessment be superseded and INT 16-01 be nullified. She noted that both actions are proposed to be effective Jan. 1, 2021, and with these actions, both SSAP No. 106 and INT 16-01 would be moved to Appendix H: Superseded Statements of Statutory Accounting Principles and Nullified Interpretations for the 2021 publication of the AP&P Manual. She stated referrals to coordinate the related impacts with the Blanks (E) Working Group to ensure that the annual statement disclosures related to SSAP No. 106 currently reported in Note 22 are removed beginning in reporting years 2021 and to the Health Risk-Based Capital (E) Working Group to address the RBC implications related to the 2021 removal of the federal ACA adjustment sensitivity test, which uses data from the SSAP No. 106 disclosures. This agenda item has a comment deadline of May 29.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

f. Agenda Item 2020-06EP

Mr. Bruggeman directed the Working Group to agenda item 2020-06EP: Editorial and Maintenance Update. Ms. Marcotte stated that this item provides non-substantive editorial corrections in accordance with the maintenance process, deleting an unnecessary excerpt and updating various paragraphal references in SSAP No. 21R—Other Admitted Assets and SSAP No. 51R. This agenda item has a comment deadline of May 1.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

g. Agenda Item 2020-07

Mr. Bruggeman directed the Working Group to agenda item 2020-07: Change to the Summary Investment Schedule. Mr. Stultz stated that SSAP No. 1—Accounting Policies, Risks & Uncertainties and Other Disclosures requires disclosures as detailed in Appendix A-001: Investments of Reporting Entities (A-001). He stated that Section 3 of A-001 requires the Summary Investment Schedule in the statutory annual statements and the notes of the annual audited financial statements. This agenda item arose because NAIC staff support for the Blanks (E) Working Group were notified of a cross-check error where total mortgage loans reported on the Summary Investment Schedule do not tie to the amounts reported in Schedule B, Mortgages
Part 1. Mr. Stultz noted that the non-substantive revisions will add the total valuation allowance to the Summary Investment Schedule to ensure that these schedules tie together. He stated that the agenda item is intended to be exposed concurrently with a Blanks (E) Working Group proposal. This agenda item has a comment deadline of May 1.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

h. **Agenda Item 2020-08**

Mr. Bruggeman directed the Working Group to agenda item 2020-08: ASU 2016-20, Technical Corrections & Improvements – Topic 606. Mr. Stultz stated that ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers was issued to clarify narrow aspects of the guidance issued in ASU 2014-09, Revenue from Contracts with Customers. He stated that in 2018, the Working Group rejected the guidance in ASU 2014-09 and several other ASUs related to revenue recognition in SSAP No. 47—Uninsured Plans. He stated that the guidance in ASU 2016-20 provides updates and clarifications based on issues that were found during the initial U.S. GAAP implementation of ASU 2014-09 and Administrative Services Contract (ASC) Topic 606. He noted that the agenda item proposes to reject ASU 2016-20 in SSAP No. 47 as the revisions were consistent with how the prior ASUs related to Topic 606 have been treated. This agenda item has a comment deadline of May 1.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

i. **Agenda Item 2020-09**

Mr. Bruggeman directed the Working Group to agenda item 2020-09: ASU 2018-18, Collaborative Arrangements – Topic 808. Mr. Stultz stated that this ASU clarifies and aligns revenue recognition under the new Topic 606 for collaborative arrangements. He stated that a collaborative arrangement is defined as a contractual arrangement that involves a joint operating activity involving two or more parties that are active participants in the activity and are exposed to significant risks and rewards dependent on the commercial success of the activity. He noted that the intent of this guidance is to ensure that revenue recognized within a collaborative arrangement is consistent with revenue recognition in Topic 606. He noted that this agenda item proposes to reject ASU 2018-18, Collaborative Arrangements – Topic 808 in SSAP No. 47 as the revisions were consistent with how the prior ASUs related to Topic 606 have been treated. This agenda item has a comment deadline of May 1.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

j. **Agenda Item 2020-10**

Mr. Bruggeman directed the Working Group to agenda item 2020-10: ASU 2017-14, Amendments to SEC Paragraphs in Topic 220, Topic 605 and Topic 606. Mr. Stultz stated that this ASU only affects U.S. Securities and Exchange Commission (SEC) paragraphs in Topic 220, Topic 605 and Topic 606. He stated that the revisions to Topic 220 update references from “income statement” to “statement of comprehensive income” and add a reference to revenue recognition in Topic 606. He noted that the revisions to Topic 605 remove guidance from and references to SEC Staff Accounting Bulletin 13, Revenue Recognition. He noted that the non-substantive revisions to Appendix D—Nonapplicable GAAP Pronouncements are to reject ASU 2017-14, Income Statement—Reporting Comprehensive Income (Topic 220), Revenue Recognition (Topic 605), and Revenue from Contracts with Customers (Topic 606), Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 116 and SEC Release No. 33-10403 as not applicable to statutory accounting. This agenda item has a comment deadline of May 1.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

k. **Agenda Item 2020-11**

Mr. Bruggeman directed the Working Group to agenda item 2020-11: ASU 2020-02, Amendments to SEC Paragraphs in Credit Losses and Lease. Mr. Stultz stated that this ASU only affects the SEC section in Topic 326, which clarifies reporting for SEC registrants and updates the effective date for these provisions and the updates to Topic 842, which updates the effective dates for the new lease guidance for SEC reporting companies.
Draft Pending Adoption

He noted that the non-substantive revisions to Appendix D—Nonapplicable GAAP Pronouncements are to reject ASU 2020-02, Financial Instruments—Credit Losses (Topic 326) and Leases (Topic 842), Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 119 and Update to SEC Section on Effective Date Related to Accounting Standards Update No. 2016-02, Leases (Topic 842) as not applicable to statutory accounting. This agenda item has a comment deadline of May 1.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

6. Considered Maintenance Agenda—Active Listing
   a. Agenda Item 2019-21

Mr. Bruggeman directed the Working Group to agenda item 2019-21: SSAP No. 43R. Ms. Gann stated that as the result of a conference call that occurred on Jan. 8, the Working Group directed NAIC staff to work with interested parties in the creation of an issue paper which would review SSAP No. 43R—Loan-Backed and Structured Securities for a possible substantial revision. She stated that many collaborative meetings with interested parties have produced the first draft of the issue paper; however, the draft was not a complete issue paper and only reflects the work product to-date, which is intended to continue the discussion process, not make final recommendations regarding accounting and reporting of various applicable SSAP No. 43R investments. She stated that the issue paper incorporates primary concepts used to determine if an investment is within scope of SSAP No. 43R and proposes various buckets or classifications of investments with similar characteristics. Upon agreement with the buckets, the next step would be to determine applicable accounting and reporting. She stated that while the comment period is June 26, input from interested parties through the comment period is requested as NAIC staff will continue work on this project throughout the comment period.

Mr. Bruggeman stated that the investment bucketing approach was to capture investments along a continuum of varying structures, assisting both state insurance regulators and interested parties throughout the discussion process.

Michael Reis (Northwestern Mutual), representing interested parties and the ACLI, stated that due to the magnitude of this project, the extended exposure period was appreciated. He stated that with the review of investments in scope of SSAP No. 43R, current investment portfolios would need to be analyzed for potential adverse accounting treatment or potential negative RBC implications. Under ideal circumstances, each affected company would independently review their applicable SSAP No. 43R investments; however, due to the current market and economic environment, an unprecedented amount of attention is being utilized elsewhere, which could cause issues if a substantial revision is effective in 2020. Mr. Reis stated that the issue paper may be capturing a broader set of securities known as collateralized fund obligations (CFOs); and in some instances, the bonds issued by CFOs are not dependent upon equity performance. He requested that state insurance regulators provide written comments on their concerns regarding such investment types so that they can be responded to directly as opposed through an issue paper.

Ms. Gann stated that operational procedures for substantially revised items typically require the exposure of the issue paper and the proposed substantively revised SAP. This exposure is only a partial issue paper; and while any effective date would be at the Working Group’s discretion, it would be unlikely that substantial revisions to SSAP No. 43R would occur in 2020. Additionally, a regulator-only call is anticipated to discuss equity types of investments that are categorized and reported as bonds.

Mr. Bruggeman concurred with Mr. Gann’s statement, adding that the review of these products is occurring because these are relatively new investment structures. Additionally, other known instances where certain assets were placed into a trust and repackaged as bonds may be occurring under SSAP No. 43R.

Mr. Dudek made a motion, seconded by Mr. Hudson, to expose the agenda item and direct continual collaborative effort with interested parties throughout the exposure period. The motion passed unanimously.

7. Deferred Discussion for a Subsequent Call or Meeting

Due to time constraints, the Working Group did not discuss the following agenda items. Discussion will occur later at a venue to be determined.
e. Agenda Item 2019-49: Retroactive Reinsurance Exception.

8. **Discussed Other Matters**

   a. **Reference Rate Reform - LIBOR**

   Mr. Pinegar stated that the FASB issued an ASU regarding reference rate reform, and a subsequent agenda item is forthcoming, which is anticipated for interim exposure.

   Due to time constraints, the Working Group did not discuss the following items; however, information was provided in conjunction with the meeting material:

   a. Ref #2016-20: Credit Losses
   b. Risk Corridors – Supreme Court
   c. Working Group Referrals from the Valuation of Securities (E) Task Force
   d. Process Update for SCA Filing Reviews
   e. Review of U.S. GAAP Exposures
   f. Health Test Update Notice

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

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Accounting Practices and Procedures (E) Task Force
4/1/20

Draft: 3/31/20

Statutory Accounting Principles (E) Working Group
E-Vote
March 26, 2020

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded March 26, 2020. The following Working Group members participated: Dale Bruggeman, Chair (OH); Carrie Mears, Vice Chair (IA); Sheila Travis (AL); Kim Hudson (CA); Kathy Belfi (CT); Rylynn Brown (DE); Eric Moser (IL); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Tom Dudek (NY); Jamie Walker (TX); David Smith (VA); and Amy Malm (WI).

1. Exposed Agenda Item 2020-12, INT 20-01, INT 20-02, INT 20-03 and INT 20-04

The Working Group conducted an e-vote to consider exposure of agenda item 2020-12: Reference Rate Reform, Interpretation (INT) 20-01: ASU 2020-04 - Reference Rate Reform, INT 20-02: Extension of Ninety-Day Rule for the Impact of COVID-19, INT 20-03: Troubled Debt Restructuring Due to COVID-19, and INT 20-04: Mortgage Loan Impairment Assessment Due to COVID-19 for a one-week public comment period ending April 2. A summary of the exposed interpretations are as follows:

1) Agenda Item 2020-12 and INT 20-01: Reference Rate Reform – This guidance proposes to adopt ASU 2020-04: Reference Rate Reform (Topic 848) Facilitation of the Effects of Reference Rate Reform on Financial Reporting, for statutory accounting. This guidance provides optional transition and expedient provisions to assist with the conversion from referencing the London Interbank Offered Rate (LIBOR) and other interbank offered rates (IBORs) and moving toward alternative reference rates that are more observable or transaction based. The guidance proposed to be adopted from ASU 2020-04 is that a qualifying modification as a result of reference rate reform should not be considered an event that requires contract remeasurement at the modification date or reassessment of a previous accounting determination.

2) INT 20-02: Extension of Ninety-Day Rule for the Impact of COVID-19 – This guidance proposes a limited-time exception to the 90-day rule for nonadmittance required in Statement of Statutory Accounting Principles (SSAP) No. 6—Uncollectible Premium Balance, Bills Receivable for Premiums, and Amounts Due from Agents and Brokers and SSAP No. 65—Property and Casualty Contracts for high deductible policies.

3) INT 20-03: Troubled Debt Restructuring Due to COVID – This guidance proposes to clarify that a modification of mortgage loan terms in response to COVID-19 shall follow the provisions detailed in the March 22, “Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus” in determining whether the modification shall be reported in accordance with SSAP No. 36—Troubled Debt Restructuring.

4) INT 20-04: Mortgage Loan Impairment Assessment Due to COVID-19 – This guidance proposes limited-time exceptions for impairment assessments due to situations caused by the forbearance or modification of mortgage loan payments related to COVID-19 for the following SSAPs: SSAP No. 30R—Unaffiliated Common Stocks, SSAP No. 37—Mortgage Loans, SSAP No. 43R—Loan-Backed and Structured Securities, and SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies.

Mr. Smith made a motion, seconded by Ms. Malm, to expose agenda item 2020-12, INT 20-01, INT 20-02, INT 20-03 and INT 20-04. The motion passed without opposition, with 13 members voting.

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.
Draft Pending Adoption
Attachment Three
Accounting Practices and Procedures (E) Task Force
4/1/20

Draft: 4/22/20

Statutory Accounting Principles (E) Working Group
Conference Call
April 15, 2020

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met via conference call April 15, 2020. The following Working Group members participated: Dale Bruggeman, Chair (OH); Carrie Mears, Vice Chair (IA); Sheila Travis (AL); Kim Hudson (CA); Kathy Belfi and William Arfanis (CT); Rylynn Brown (DE); Eric Moser (IL); Stewart Guerin (LA); Judy Weaver (MI); Tom Dudek (NY); Joe DiMemmo and Kimberly Rankin (PA); Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI). Also participating was: Greg Lathrop (OR).

1. Reviewed Comments and Considered Adoption of Temporary Exceptions to Statutory Accounting

Julie Gann (NAIC) stated that the intention of this call is to consider four interpretations that provide exceptions to current statutory accounting guidance and require a super majority vote for adoption.

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

a. Agenda Item 2020-12 and INT 2020-01T

Mr. Bruggeman directed the Working Group to agenda item 2020-12 and Interpretation (INT) 2020-01T: Reference Rate Reform. Jim Pinegar (NAIC) stated that this non-substantive agenda item is a result of Accounting Standards Update (ASU) 2020-04, Reference Rate Reform, which provides optional expedient guidance, allowing for the continuation of certain contracts that are modified in response to reference rate reform. Additionally, it provides waivers from derecognizing hedging transactions, and it provides some exceptions for assessing hedge effectiveness as a result of transitioning away from certain interbank offering rates. Mr. Pinegar stated that interested parties commented on two items. Interested parties wanted to ensure that ASU 2020-04 was broadly adopted, and they expressed concerns regarding the sunset date of Dec. 31, 2022. Mr. Pinegar stated that additional language was proposed affirming that all contracts within the scope of ASU 2020-04, which allows for modifications due to reference rate reform and provides for the optional expedient to be accounted for as a continuation of the existing contract, shall apply to all Statements of Statutory Accounting Principles (SSAPs). He stated that the sunset date matched the date in ASU 2020-04; however, the Financial Accounting Standards Board (FASB) continues to monitor the transition, and it may modify its guidance, if needed. If the FASB takes such action, it is anticipated that the Working Group will consider a similar response.

Angelica Tamayo-Sanchez (New York Life Insurance Company), representing interested parties, stated appreciation for ensuring that INT 2020-01T was consistent with ASU 2020-04, as the potential contract modifications are broad and may encompass all SSAPs. She stated that in terms of the sunset date, the FASB indicates that it will review for possible modifications, and it appreciates that the Working Group will review if a similar action is necessary.

Mr. Hudson made a motion, seconded by Ms. Weaver, to adopt agenda item 2020-12 and INT 2020-01T, with the modification as proposed by NAIC staff, for statutory accounting (Attachment One-B and One C). The motion passed unanimously.

b. INT 2020-02T

Mr. Bruggeman directed the Working Group to INT 2020-02T: Extension of Ninety-Day Rule for the Impact of COVID-19. Jake Stultz (NAIC) stated in response to COVID-19 that this nonsubstantive interpretation provides exceptions to the 90-day rule for uncollected premium balances, bills receivable and amounts due from agents under SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers, and high deductible policies under SSAP No. 65—Property and Casualty Contracts. He stated that previous extensions to SSAP No. 6 in response to catastrophes have generally been for an additional 60 days, resulting in a total of 150 days before nonadmission. However, due to the fact that COVID-19 is a longer lasting and broader catastrophe, the recommendation proposed allows a total of approximately 200 days before requiring nonadmission. The 200-day allowance would apply to the first and second quarters of 2020, as the interpretation would expire prior to third quarter financial reporting.
Robin Marcotte (NAIC) stated that interested parties requested the scope of INT 2020-02T be expanded to include SSAP No. 51R—Life Contracts regarding life deferred and uncollected premiums, SSAP No. 47—Uninsured Plans for uninsured plan receivables, such as administrative services contracts, and SSAP No. 84—Health Care and Government Insured Plan Receivables regarding pharmaceutical rebate receivables and risk sharing receivables. She stated that additional interested party requests included: 1) extending the exception to the 90-day rule from the end of the second quarter to the end of the third quarter; 2) including policies written or renewed after the declaration of emergency, and not only to the policies that were current as of the date of emergency; and 3) allowing the extension of the 90-day rule to apply to policies in effect prior to the expiration of the state of emergency that later become past due for 180 days before non-admission. She stated that NAIC staff did not recommend extending INT 2020-02T through the third quarter, but they recommend that the Working Group retain the existing first and second quarter timeframe with an assurance to consider whether an extension is necessary in August 2020. She stated that NAIC staff also did not recommend that the interpretation provide provisions allowing the admittance of a receivable that was previously nonadmitted because it was 90 days past due prior to the COVID-19 pandemic. Additionally, if the Working Group supports consideration of exceptions for SSAP No. 84, specifically risk sharing and pharmacy rebates, it is recommended that a separate discussion occur, as the admittance process and calculation of those items is significantly different than receivables from policyholders, and the admissibility criteria for these items is more complex.

Mr. Stultz stated that upon review of the feedback from interested parties, NAIC staff support including SSAP No. 47 and SSAP No. 51R in the interpretative accounting guidance. Clarifying language was also suggested to include policies written or renewed on or after March 13 in paragraphs 3.a. and 3.c. Additional modified language was proposed to ensure that INT 2020-02T would have consistent expiration language with INT 2020-04T: Mortgage Loan Impairment Assessment due to COVID-19. Mr. Stultz stated that while the interpretation is written to expire prior to the third quarter, it is anticipated that future discussions will occur regarding possible extensions.

D. Keith Bell (Travelers Insurance), representing interested parties, stated their appreciation for the quick issuance of this interpretation and the Working Group’s commitment to review in August for a possible extension. He stated that other areas, including paragraphs 3.b. and 3.d., within the interpretation should have similar language to include other policies written or renewed on or after March 13. Mr. Bruggeman stated that the phrase, “on or after March 13, 2020,” would be included in paragraphs 3.a through 3.d. Mr. Stultz and Ms. Marcotte concurred with adding the language to ensure consistency throughout the guidance.

Albert Thomas Finnell (Finnell & Company), representing America’s Health Insurance Plans (AHIP), stated that due to the COVID-19 pandemic, health insurers are facing financial strain through waiving copays, deductibles, and covering COVID-19 testing. These issues affect the timeliness and ultimate collectability of certain receivables. Mr. Finnell stated that while health insurers are requesting relief regarding pharmaceutical rebate and risk sharing receivables covered in SSAP No. 84, addressing those issues in a separate agenda item would be more appropriate. He stated that additional data will be gathered, and relief will likely be requested in terms of loans and advances to providers, which is also addressed in SSAP No. 84. He stated that a letter has been submitted requesting relief on SSAP No. 106—Affordable Care Act Section 9010 Assessment, and he noted that interested parties are prepared to discuss those proposed edits with the Working Group once it has considered the request.

Ms. Malm made a motion, seconded by Ms. Belfi, to adopt INT 2020-02T, with the modifications to add certain receivables from SSAP No. 47 and SSAP No. 51R to the scope of the standard and include language confirming that policies written or renewed on or after March 13 are in scope of the interpretation (Attachment One-D). The motion passed unanimously. Additionally, direction was given to NAIC staff to collaborate with industry on an agenda item covering SSAP No. 84.

c. **INT 2020-03T**

Mr. Bruggeman directed the Working Group to INT 2020-03T: Troubled Debt Restructuring Due to COVID-19. Julie Gann (NAIC) stated that this interpretation clarified that modifying mortgage loan terms in response to COVID-19 shall follow the provisions detailed in the March 22, “Joint Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus,” in determining whether the modification shall be reported as a troubled debt restructuring within SSAP No. 36—Troubled Debt Restructuring. Subsequent to the initial exposure, the proposed interpretation was revised to include the provisions from Section 4013 of the March 27 Coronavirus Aid, Relief, and Economic Security (CARES) Act, which affirmed that the interpretation is only applicable for the term of the loan modification. Additionally, the exposed interpretation was revised to reflect the updated interagency statement issued after the CARES Act
on April 7. Ms. Gann stated that the CARES Act and proposed interpretation provide guidance for modifications that include a forbearance arrangement, interest rate modification, a repayment plan, and other similar arrangements that defer or delay the payment of principal or interest. She stated that under existing U.S. generally accepted accounting principles (GAAP) and SSAP No. 36, a restructuring of a mortgage loan does not automatically result in the classification of a troubled debt restructuring. SSAP No. 36 defines the criteria for troubled debt restructuring, which generally includes the requirement of the borrower experiencing financial difficulties and the loan modification resulting in a significant change in terms. Ms. Gann stated that the proposed interpretation was initially exposed to only include mortgage loans. She stated that interested parties requested the expansion of the scope to include all debt instruments in SSAP No. 26R—Bonds and SSAP No. 43R—Loan-Backed and Structured Securities. She, in response to these comments, stated that proposed revisions include bank loans as defined in SSAP No. 26R; however, NAIC staff did not recommend including all debt instruments within scope of the interpretation. She stated that the CARES Act and the interagency statement is specific in that the loans addressed within their guidance are from financial institutions, and they are specific to loans from borrowers. She stated that the CARES Act and interagency statements reference banking agencies in collecting data on modified loans for regulatory purposes. She stated, in response to additional industry comments, that additional edits were proposed to clarify that the troubled debt restructuring relief is only applicable for the term of the modification. Additionally, in response to comments by interested parties regarding SSAP No. 34—Investment Income Due and Accrued, NAIC staff are awaiting additional technical guidance from the FASB; as such, NAIC staff have not yet proposed interpretive guidance to SSAP No. 34. Ms. Gann stated that the proposed effective date is consistent with the CARES Act, and it would be applicable for the period beginning on March 1 and ending on either Dec. 31 or the date that is 60 days after the date on which the national emergency concerning COVID-19 has terminated.

Bob Ridgeway (AHIP) inquired as to whether an extension would be possible in the event that COVID-19 loan modification occurred after Dec. 31. Ms. Gann stated that regardless if the CARES act is extended, the Working Group has the option to review this interpretation for possible extension. Mr. Bruggeman stated that due to the unknown end date of COVID-19, all related interpretations will be continually reviewed for possible extension.

Diane Bellas (Allstate), representing interested parties, stated that while insurance companies can assist with the economic recovery, additional accounting and reporting obstacles remain. She stated that the relief provided in the interpretations do provide some capital relief necessary to assist with the long-term economic recovery. She stated that while the revised interpretations were helpful, additional barriers within the regulatory framework should be reviewed. She stated that interested parties wish to review risk-based capital (RBC) and the asset valuation reserve (AVR) with the Capital Adequacy (E) Task Force. She stated that interested parties wish to discuss admissibility of investments with a going concern with the Working Group.

Daniel P. Allen (MassMutual), representing interested parties, expressed agreement with the recent modifications to the interpretation, which incorporate the revised April 7 joint interagency statement as a result of the CARES Act. He stated that while the scope of the interpretation covered mortgage loans, additional consideration should be considered to include all debt instruments covered in SSAP No. 26R and SSAP No. 43R, as these investments will likely require modifications as a result of COVID-19. He stated that interested parties were pleased to see that bank loans were included in the revised interpretation; however, due to insurers having significant private placement debt portfolios, temporary relief should extend to include these investment classes, as these items will likely require similar loan modifications. He stated that the effective date of INT 2020-03T does match the CARES Act, but he requested clarification as to whether the exceptions for loan modifications would extend beyond the projected scheduled termination date. Mr. Bruggeman inquired as to whether there was any specific language or request regarding the expansion of scope or timing of the interpretation. Mr. Allen stated that private placement loans were a significant concern, but he requested clarification regarding whether a modification would remain exempt from SSAP No. 36 in the event that it was extended beyond the effective date of the interpretation. Mr. Bruggeman stated that the scope of this interpretation was to clarify mortgage loans modified as a result of COVID-19, and they were not to be considered a troubled debt restructuring. Ms. Gann stated that the effective dates match the CARES Act; however, the modification must occur in the defined time frame.

Bruce Oliver (Mortgage Bankers Association) stated that the interpretation adopts the CARES Act’s effective date; however, the joint interagency statement does not have an effective date. He stated that clarification should be added since the interpretation references both items. Mr. Bruggeman stated that this interpretation is in response to the national emergency, and should any modifications be required 60 days after the termination of national emergency, an insurer should consult with his/her domestic regulator for possible exception allowance.
Brian Keating (Guardian Life Insurance), representing interested parties, stated that private placement loans represent a significant portion of an insurance company’s portfolio, at times up to 15–20% of invested assets. Due to the COVID-19 pandemic, several requests for loan relief or modifications have been received, especially those from the hospitality industry. Mr. Keating stated that in an effort to be equitable, the bank loan relief provided in the interpretation should be extended to insurance lenders despite the joint interagency statement not specifically referencing private placement loans. The interagency statement covers loan modifications as a result of the COVID-19 pandemic, and it would presumably allow insurance companies to apply such guidance for investments covered in SSAP No. 26R and SSAP No. 43R. Mr. Keating stated that modification requests include covenant waivers, delayed payment schedules, and that insurers have a direct relationship with the borrowers, which is similar to a typical financial institution.

Ms. Gann stated that, consistent with the interagency statement, several loan modifications are anticipated in response to the COVID-19 pandemic, and they would likely not fall into the scope of troubled debt restructuring as defined in SSAP No. 36. This is because a loan modification that is insignificant, or if the borrower is not experiencing financial difficulty, is not considered as troubled debt restructuring under existing guidance. Ms. Gann stated that the interpretation removes the analysis requirement to determine if a troubled debt restructuring has occurred. She stated that if private placement loans were to be considered for exception guidance, information would be requested from interested parties regarding the scope of loan modifications being requested and granted. Particularly, she inquired as to whether the private placement modifications would likely be considered troubled debt restructurings because they would be significant to the original loan terms. Mr. Bruggeman stated that the interpretation does not prohibit loan modification from being granted, and since insurance companies are typically issuing long-term debt, it is possible that a modification would likely not be significant enough to be determined a restructured troubled debt.

Ms. Sanchez stated that the U.S. GAAP troubled debt restructuring guidance covers both mortgage loans and debt instruments, and the joint interagency statement would presumably apply to both asset classes. However, the interpretation only applies to mortgage and bank loans. Ms. Gann stated that the troubled debt restructuring guidance in SSAP No. 36 is consistent with U.S. GAAP; however, the focus of INT 2020-03T, which provides exceptions to the requirements of SSAP No. 36, is specific to mortgage and bank loans. However, if requested by industry or the Working Group, a separate agenda item could be prepared to review other types of asset classes, specifically private placement debt. Ms. Gann stated that if a private placement modification was to occur, without the interpretation exception, the lender would follow the provisions of SSAP No. 36 to determine whether the modification should be considered a troubled debt restructuring. As noted, the guidance in SSAP No. 36 does not automatically result in a troubled debt restructuring, but assessment has to occur regarding whether the borrower is experiencing financial difficulties and whether the modification is considered insignificant.

Mr. Hudson made a motion, seconded by Ms. Mears, to adopt INT 2020-03T with the modifications to: 1) include the CARES Act, the April 7 updated joint interagency statement, and a reference to bank loans; and 2) clarify that the effective date of the interpretation mirrors the timeframe of the CARES Act (Attachment One-E). In addition, direction was given to NAIC staff to collaborate with interested parties to evaluate potential temporary troubled debt restructuring relief guidance for private placement loans and other similar debt products. The motion passed unanimously.

d. INT 2020-04T

Mr. Bruggeman directed the Working Group to INT 2020-04T. Ms. Gann stated that INT 2020-04T addresses the impact of mortgage loan forbearance or prudent modifications on the statutory accounting and reporting requirements for mortgage loans, as well as investments with underlying mortgage loans. INT 2020-04T allows for a temporary, limited-time statutory exception for the assessment of impairment due to loan modifications being granted for mortgage loans and investment products with underlying mortgage loans. This exception would only defer the assessment of impairment due to situations caused by the forbearance or modification of mortgage loan payments, and it would not delay the recognition of other-than-temporary impairments if the entity decided to sell the investment and/or if provisions other than the limited-time forbearance or modifications of mortgage loans payments caused the entity to identify that they would not recover the reported carrying value of the investment. Ms. Gann stated that in response to industry comments, revisions have been proposed to include bank loans in scope of INT 2020-04T; however, all other debt instruments covered in SSAP No. 26R and SSAP No. 43R were not added. She stated that additional comments were received regarding the applicability to SSAP No. 34, but NAIC staff proposed waiting on expected FASB technical guidance on the topic. Similar to INT 2020-02T, INT 2020-04T is effective for the first and second quarters of 2020. However, the Working Group will assess in August 2020 to determine if an extension if necessary. She stated, in response to industry questions, that an edit has been proposed to clarify that impairment assessments after the effective date...
of INT 2020-04T would be based on the contractual terms of the mortgage loan or investment after reflecting any modification. Mr. Bruggeman confirmed that while INT 2020-02T and INT 2020-04T cover the first and second quarters of 2020, it is the intent of the Working Group to review both for possible extensions.

Ms. Sanchez stated that additional consideration is requested on all debt instruments, especially private placement loans. She stated that insurance companies could be giving forbearances to debt holders due to the COVID-19 pandemic which, without temporary relief, could require impairment assessments. She inquired as to why the effective date of INT 2020-04T did not match INT 2020-03T, which allows modifications 60 days after the end of the national emergency. Mr. Bruggeman stated that impairment assessments are performed at a certain point in time, and rather than extending the temporary relief granted in INT 2020-04T at this time, the Working Group will review for possible extension in August. The effective dates in INT 2020-04T are more in line with the evaluations required for financial statement reporting. Ms. Gann stated that INT 2020-03T was in direct response to the CARES Act, and the effective dates of INT 2020-02T and INT 2020-04T are flexible, allowing for earlier or later termination depending on the timing of the national emergency. Ms. Sanchez stated interested parties stand ready to work with NAIC staff and the Working Group on an agenda item regarding SSAP No. 34, concerning interest due and accrued. She stated that every investment class will likely be affected by variations in cash flow due to the COVID-19 pandemic and interpretative guidance would be beneficial.

Mr. Lathrop stated that Oregon is supportive of extending the effective dates of INT 2020-02T and INT 2020-04T to include the third and fourth quarters of 2020. He stated that several states have issued moratoriums on tenant evictions, and they may issue moratoriums on foreclosures. He stated Oregon’s Insurance Division believes there will be an extended economic recovery, likely warranting extension of the temporary exceptions provided in these interpretations.

Ms. Belfi made a motion, seconded by Ms. Weaver, to adopt INT 2020-04T, with the modifications to include bank loans as proposed by NAIC staff, for statutory accounting (Attachment One-F). The motion passed unanimously.

2. Discussed Other Matters

a. Premium Refunds

Ms. Marcotte stated that in response to questions from industry and state insurance regulators, NAIC staff are planning an agenda item to discuss the accounting and reporting of premium refunds due to the COVID-19 pandemic. Birny Birnbaum (Center for Economic Justice [CEJ] and the Consumer Federation of America [CFA]) stated that insurance companies are utilizing a variety of techniques to issue refunds, ranging from a premium credit to a cash refund. Due to these variations, uniform reporting is encouraged.

b. SSAP No. 106

Mr. Bruggeman stated that NAIC staff have prepared an agenda item in response to a request received from industry regarding the insurer provider fee captured in SSAP No. 106. A subsequent e-vote to expose the agenda item is anticipated.

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.
The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded April 17, 2020. The following Working Group members participated: Dale Bruggeman, Chair (OH); Carrie Mears, Vice Chair (IA); Kim Hudson (CA); William Arfanis (CT); Rylynn Brown (DE); Eric Moser (IL); Stewart Guerin (LA); Doug Bartlett (NH); Joe DiMemmo (PA); Jamie Walker (TX); David Smith (VA); and Amy Malm (WI).

1. Exposed Agenda Item 2020-13

The Working Group conducted an e-vote to consider exposure of agenda item 2020-13: Health Industry Request on 2020 Health Insurance Assessment, for a one-week public comment period ending April 24. Agenda item 2020-13 addresses an April 2020 request from America’s Health Insurance Plans (AHIP) (Attachment 1) to the Working Group regarding SSAP No. 106—Affordable Care Act Section 9010 Assessment. The federal Affordable Care Act (ACA) Section 9010 fee is also known as the health insurance tax (HIT). The payable amount is assessed on applicable 2019 premium, and it is due once the reporting entity provides health insurance in January 2020. The amount due is then remitted in September 2020 to the U.S. Department of the Treasury.

The exposed recommendation is to reject the request to defer liability recognition of the ACA fee due in September 2020 and move the agenda item to the rejected listing. The rejection would not result in any statutory accounting revisions.

The agenda item notes, “This request has the potential to materially distort the financial statements, as a known liability would not be fully recognized. In times of financial stress, it is important to be able to accurately assess the financial solvency of reporting entities. With the potential impact of the financial statements, any consideration for such a request warrants domiciliary state regulator review. Any state specific considerations would be either permitted practices (individual requests) or prescribed practices (state bulletins, etc.). If granted by the domestic state, such practices would be disclosed in the financial statements.”

Ms. Mears made a motion, seconded by Ms. Walker, to expose agenda item 2020-13. The motion passed unanimously, with 11 members voting.

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

Statutory Accounting Principles (E) Working Group
E-Vote
May 5, 2020

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded May 5, 2020. The following Working Group members participated: Dale Bruggeeman, Chair (OH); Carrie Mears, Vice Chair (IA); Richard Ford (AL); Kim Hudson (CA); William Arfanis (CT); Rylynn Brown (DE); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Tom Dudek (NY); Joe DiMemmo (PA); Jamie Walker (TX); and Amy Malm (WI).

1. Exposed Agenda Item 2020-14, INT 20-05, INT 20-06, INT 20-07 and INT 20-08

The Working Group conducted an e-vote to consider exposure of agenda item 2020-14: Assessment of OTTI Based on Original Contract Terms; Interpretation (INT) 20-05: Investment Income Due and Accrued; INT 20-06: Participation in the 2020 TALF Program; INT 20-07: Troubled Debt Restructuring for Certain Debt Instruments Due to COVID-19; and INT 20-08: COVID-19 Premium Refunds, Rate Reductions and Policyholder Dividends for a one-week public comment period ending May 14. A summary of the exposed interpretations is as follows:

1) Agenda Item 2020-14 – This agenda item proposes nonsubstantive revisions to address a long-standing disconnect in the assessment of other-than-temporary impairment (OTTI) after there has been a modification to a debt security captured in scope of SSAP No. 26R—Bonds. The current guidance requires OTTI assessment based on contract terms at the date of acquisition. This agenda item incorporates minor revisions to clarify that subsequent to modification under SSAP No. 36—Troubled Debt Restructuring or SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, future assessments of OTTI shall be based on the current contractual terms of the debt instrument.

2) INT 20-05 – This guidance proposes limited-time exceptions to the collectability and nonadmittance guidance in SSAP No. 34—Investment Income Due and Accrued, and it also considers technical guidance for the recognition of investment income issued by the Financial Accounting Standards Board (FASB) when there is a payment holiday and interest is not accrued. The proposed exceptions provide a collectability assessment exception for certain items modified in response to COVID-19, and it proposes an exception to the nonadmittance provisions for all items that are deemed collectable and are over 90 days past due.

3) INT 20-06 – This guidance proposes provisions for reporting entities participating in the federal Term Asset-Backed Securities Lending Facility (TALF) program. The guidance addresses both direct borrowers and reporting entities that participate as an investor to a direct borrower. The guidance proposes a statutory accounting exception for direct borrowers who pledge assets to the TALF program to allow admittance of the pledged assets, as the TALF program does not permit substitutions to the collateral.

4) INT 20-07 – This guidance proposes limited-time practical expedients in determining whether a restructuring reflects a “concession” under paragraph 10 of SSAP No. 36. Under existing statutory accounting guidance, a restructuring that is insignificant is not a concession; therefore, it is not a troubled debt restructuring. The guidance proposes a 10% threshold for the shortfall in the contractual amount due and a 6-month delay in payments as practical expedients for the existing guidance. Under the proposed provisions, if a modification falls within these parameters, it would be considered insignificant and not a concession. The guidance also proposes to clarify that if a modification is below 10%, then further analysis would not be needed under SSAP No. 103R to determine if the modification is substantive and does not require extinguishment with recognition of a new security.

5) INT 20-08 – This guidance proposes provisions on how to account for premium refunds in response to COVID-19. Due to the different ways in which these refunds can be provided, the proposed guidance addresses a variety of methods. For premium refunds that are outside policy terms, the proposed guidance identifies that these shall be reported as a reduction of premium and not as an expense. The proposed guidance also directs an aggregate disclosure
of all refunds in response to COVID-19 to allow for easy identification of the full impact in the statutory financial statements.

Ms. Walker made a motion, seconded by Ms. Mears, to expose agenda item 2020-14, INT 20-05, INT 20-06, INT 20-07 and INT 20-08. The motion passed without opposition, with 12 members voting.

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

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The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met via conference call May 20, 2020. The following Working Group members participated: Dale Bruggeman, Chair (OH); Carrie Mears, Vice Chair (IA); Richard Ford (AL); Kim Hudson (CA); Kathy Belfi (CT); Rylynn Brown (DE); Eric Moser and Kevin Fry (IL); Stewart Guerin (LA); Judy Weaver (MI); Tom Dudek (NY); Joe DiMemmo (PA); Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI).

1. Adopted Non-Contested Statutory Accounting Revisions During its Public Hearing

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

Ms. Malm made a motion, seconded by Mr. Hudson, to adopt the statutory accounting revisions detailed below as non-contested statutory accounting revisions. This motion also included the disposal of agenda item 2019-41. The motion passed unanimously.

a. Agenda Item 2019-37

Mr. Bruggeman directed the Working Group to agenda item 2019-37: Surplus Notes – Enhanced Disclosures (Attachment One-B). Jim Pinegar (NAIC) stated that this nonsubstantive agenda item was drafted from the Working Group’s request that additional disclosures be captured in Statement of Statutory Accounting Principle (SSAP) No. 41R—Surplus Notes. He stated that the proposed disclosures materially reflected certain key details from the 2019 surplus note data call. These disclosures were intended to give state insurance regulators further insight into the issuances of surplus notes that do not contain the cash flows typically associated with surplus notes while providing adequate pricing confidentiality sought by interested parties.

b. Agenda Item 2019-41

Mr. Bruggeman directed the Working Group to agenda item 2019-41: Eliminating Financial Modeling Process (Attachment One-C). Mr. Pinegar stated that this nonsubstantive agenda item was in response to an earlier referral received from the Valuation of Securities (E) Task Force. The agenda item originally was drafted so the Accounting Practice and Procedures Manual (AP&P Manual) would reflect a revision that was under consideration by the Task Force regarding financial modeling of residential mortgage-backed securities (RMBS)/commercial mortgage-backed securities (CMBS) securities. However, the Task Force has since elected to retain the financial modeling approach and will now map the designation derived from the model to a new NAIC designation category. Mr. Pinegar stated that considering this change, the proposed update in this agenda item was no longer applicable and recommended disposal of this agenda item without statutory revisions.

c. Agenda Item 2019-47

Mr. Bruggeman directed the Working Group to agenda item 2019-47: VM 21 Grading (Attachment One-D). Robin Marcotte (NAIC) noted that the agenda item addresses VM-21, Requirements for Principle-Based Reserves for Variable Annuities, and grade-in requirements for reporting changes in valuation basis for years beginning Jan. 1, 2020. She stated that the revisions to the Valuation Manual allowed different optional phase-in requirements. The exposure includes nonsubstantive revisions to SSAP No. 51R—Life Contracts and SSAP No. 3—Accounting Changes and Corrections of Errors for reporting years beginning Jan. 1, 2020. Ms. Marcotte stated the exposure incorporated many of the previous edits recommended by interested parties and would expand the disclosure for changes in valuation basis, which are reported as a change in accounting principle under SSAP No. 3. The additional disclosure would identify specific details regarding phase-in of changes in valuation basis.

d. Agenda Item 2020-06EP

Mr. Bruggeman directed the Working Group to agenda item 2020-06EP: Editorial and Maintenance Update (Attachment One-E). Ms. Marcotte stated that this item provides nonsubstantive editorial corrections in accordance with the maintenance process.
deleting an unnecessary excerpt and updating various paragraph references in SSAP No. 21R—Other Admitted Assets and SSAP No. 51R.

e. Agenda Item 2020-07

Mr. Bruggeman directed the Working Group to agenda item 2020-07: Change to the Summary Investment Schedule (Attachment One-F). Jake Stultz (NAIC) stated that SSAP No. 1—Accounting Policies, Risks & Uncertainties and Other Disclosures requires disclosures as detailed in Appendix A-001: Investments of Reporting Entities (A-001). He stated that Section 3 of A-001 requires the Summary Investment Schedule in the statutory annual statements and the notes of the annual audited financial statements. This agenda item arose because NAIC support staff for the Blanks (E) Working Group were notified of a cross-check error where total mortgage loans reported on the Summary Investment Schedule do not tie to the amounts reported in Schedule B, Mortgages – Part 1. Mr. Stultz noted that the nonsubstantive revisions will add the total valuation allowance to the Summary Investment Schedule to ensure these schedules appropriately tie together.

f. Agenda Item 2020-08

Mr. Bruggeman directed the Working Group to agenda item 2020-08: Accounting Standard Update (ASU) 2016-20, Technical Corrections & Improvements – Topic 606 (Attachment One-G). Mr. Stultz stated that ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers was issued to clarify narrow aspects of the guidance issued in ASU 2014-09, Revenue from Contracts with Customers. He stated that in 2018, the Working Group previously rejected the guidance in ASU 2014-09 and several other ASUs related to revenue recognition in SSAP No. 47—Uninsured Plans. He stated that this agenda item proposes to reject ASU 2016-20 in SSAP No. 47, and the proposed action is consistent with how the prior ASUs related to Topic 606 have been treated.

g. Agenda Item 2020-09

Mr. Bruggeman directed the Working Group to agenda item 2020-09: ASU 2018-18, Collaborative Arrangements – Topic 808 (Attachment One-H). Mr. Stultz stated that this ASU clarifies and aligns revenue recognition under the new Topic 606 for collaborative arrangements. He stated that a collaborative arrangement is defined as a contractual arrangement that involves a joint operating activity involving two or more parties that are active participants in the activity and are exposed to significant risks and rewards dependent on the commercial success of the activity. He stated that this agenda item proposes to reject ASU 2018-18 in SSAP No. 47, and the proposed action is consistent with how the prior ASUs related to Topic 606 have been treated.

h. Agenda Item 2020-10

Mr. Bruggeman directed the Working Group to agenda item 2020-10: ASU 2017-14, Amendments to SEC Paragraphs in Topic 220, Topic 605 and Topic 606 (Attachment One-I). Mr. Stultz stated that this ASU only affects U.S. Securities and Exchange Commission (SEC) paragraphs in Topic 220, Topic 605 and Topic 606. He noted that the nonsubstantive revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2017-14, Income Statement—Reporting Comprehensive Income (Topic 220), Revenue Recognition (Topic 605), and Revenue from Contracts with Customers (Topic 606), Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 116 and SEC Release No. 33-10403 as not applicable to statutory accounting.

i. Agenda Item 2020-11

Mr. Bruggeman directed the Working Group to agenda item 2020-11: ASU 2020-02, Amendments to SEC Paragraphs in Credit Losses and Lease (Attachment One-J). Mr. Stultz stated that this ASU only affects the SEC section in Topic 326, which clarifies reporting for SEC registrants and updates the effective date for these provisions and the updates to Topic 842. He noted that the nonsubstantive revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2020-02, Financial Instruments—Credit Losses (Topic 326) and Leases (Topic 842), Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 119 and Update to SEC Section on Effective Date Related to Accounting Standards Update No. 2016-02, Leases (Topic 842) as not applicable to statutory accounting.
2. Reviewed Comments on Exposed Items

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

a. Agenda Item 2019-25

Mr. Bruggeman directed the Working Group to agenda item 2019-25: Working Capital Finance Investments. Ms. Marcotte noted that the materials contain substantive revisions, incorporating the industry proposed language for the six specific items directed by the Working Group at the 2019 Summer National Meeting to SSAP No. 105—Working Capital Finance Investments. She stated that NAIC staff recommended adoption of the substantively revised SSAP No. 105 and Issue Paper No. 163—Working Capital Finance Investment Updates, noting a proposed effective date of June 30.

Ms. Belfi stated she requested that the Working Group consider removing the last sentence in paragraph 16, which states, “Initial permission to invest in Working Capital Finance Investment Programs may be required by the domiciliary commissioner.” She stated that since Connecticut does not currently possess the resources to adequately evaluate such an investment program, they would rely upon the NAIC Securities Valuation Office (SVO) for input. Ms. Belfi stated that as the SVO must already preapprove these transactions, that control regarding these investments was sufficient and thus not requiring a secondary preapproval by the domiciliary commissioner. Additionally, the statement could result in regulator misinterpretation in that domiciliary commissioners may feel compelled to review transactions in which they do not possess the resources to adequately evaluate. She stated that regulators already can review any transaction or investment deemed appropriate and the statement in paragraph 16 was unnecessary. Ms. Belfi proposed a friendly amendment to remove this single sentence from paragraph 16.

Mr. Fry stated agreement with Ms. Belfi’s comments and noted that no other investment SSAPs contain such language, adding that the language confuses the substance of the SSAP. He stated that with the current requirements such as the SVO preapproval, investments being restricted to investment grade and state investments laws, these investments should remain short-term and of relatively low risk. Ms. Marcotte stated that NAIC staff did not object to the friendly amendment, noting that in addition to the single sentence removal to paragraph 16 of SSAP No. 105, minor edits would also be required in Issue Paper No. 163 documenting the revision. Michael Monahan (American Council of Life Insurers—ACLI) stated that interested parties support the friendly amendment that Ms. Belfi proposed.

Ms. Belfi made a motion, seconded by Mr. Fry, to adopt the substantially revised SSAP No. 105 and Issue Paper No. 163 incorporating the additional revisions discussed (Attachments One-K, One-L and One-M). The motion passed unanimously.

b. Agenda Item 2019-42

Mr. Bruggeman directed the Working Group to agenda item 2019-42: Cash Equivalent – Cash & Liquidity Pools. Mr. Pinegar stated that this nonsubstantive agenda item was drafted to scope certain cash and liquidity pools into SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments. He stated that cash pools that met specific criteria would be permitted to be captured in SSAP No. 2R, but the intent of the agenda item was not to permit reporting entries to move short-term investments into the pool or conduct activities that would not be permitted under statutory accounting, such as circumventing reporting or disclosures. Mr. Pinegar stated that interested parties requested consideration for reporting based on a determination, based on management’s judgment at the time the pool is formed, as to the expected characteristics of the pool assets. He stated that NAIC staff supported single line reporting in Schedule E – Part 2. Single line reporting will ensure unilateral, uniform reporting among all pool participants and all reporting entities who participate in various, qualified cash pools. Additionally, a unique reporting line specifically for qualified cash pools is expected to be available in 2021. Mr. Pinegar stated that interested parties also requested an effective date of Jan. 1, 2021. However, NAIC staff were supportive of an immediate effective date to ensure that cash pools that do not meet the qualifying parameters, absent permission from a reporting entity’s domestic regulator, would not be allowed to be reported as a cash equivalent or short-term investment. However, for qualifying cash pools that would require a reclassification to Schedule E, the agenda item would allow current schedule reporting until Jan. 1, 2021.

Diane Bellas (Allstate), representing interested parties, noted the importance of single line reporting and agreed with the proposed Jan. 1, 2021, effective date as entities may need to analyze their qualified pools for potential schedule changes. She requested clarification regarding the requirement for a permitted or prescribed practice in terms of entities that hold pools that do not qualify upon adoption of this agenda item.

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Julie Gann (NAIC) stated that there are currently no provisions in SSAP No. 2R that permit the admittance of cash pools. She stated that if an entity were to continue to hold a cash pool that does not meet the qualifying parameters, for continued reporting as a cash equivalent or a short-term investment, a permitted or prescribed practice would be required. In terms of the Jan 1, 2021, effective date, this was simply a recategorization deadline for qualifying cash pools that meet the parameters in this agenda item.

Mr. Bruggeman stated that state investment laws may prescribe reporting of cash pool participation. However, reporting entities should work with their domestic regulators for cash pools not within scope. This agenda item effectively proposes guidance for valuation and reporting of cash pools, which were not previously in scope of SSAP No. 2R. He stated that the intent of cash pools is to effectively use the idle cash of several affiliated entities. Regulators do not want to find nonqualifying investments in these pools, and the principles of this agenda item should not be violated.

Mr. Hudson made a motion, seconded by Ms. Mears, to incorporate the modifications as proposed by NAIC staff and adopt nonsubstantive revisions to SSAP No. 2R (Attachment One-N). The motion passed unanimously.

c. **Agenda Item 2019-20**

Mr. Bruggeman directed the Working Group to agenda item 2019-20: Rolling Short-Term Investments. Mr. Pinegar stated that this nonsubstantive agenda item was originally exposed to address certain investments that were structured as short-term investments, with those investments being rolled or renewed and remaining on a short-term schedule for multiple consecutive years. This agenda item proposes specific revisions that would restrict related party or affiliated investments in scope of SSAP No. 26R—Bonds, SSAP No 43R—Loan-Backed and Structured Securities or that would be reported as other invested asset investments from being continually classified as a cash equivalent or short-term investment. He stated that additional provisions are included to recognize the independent operational nature of some affiliated or related party reporting entities, and the agenda item provides special carveouts from the short-term rolling restrictions. Mr. Pinegar stated that if a reporting entity re-underwrites the investments, maintains appropriate re-underwriting documentation and each party had the ability to independently review the terms and can terminate the transaction prior to renewal, the short-term rolling restrictions would not apply. He stated that interested parties proposed a few minor, corrective edits, all of which were supported by NAIC staff. Additionally, interested parties proposed to remove the term “substantially similar” from the disclosure requirement that requires identical or substantially similar investments in which remain on the short-term schedule for more than one year be identified. NAIC staff believe that removing the substantially similar verbiage could allow for minor, insignificant modifications to be made to an investment that would then preclude disclosure and remove the substance of the agenda item.

Josh Bean (Transamerica), on behalf of interested parties, suggested one additional minor editorial change (removing an extra period within a sentence) for clarification purposes. Ms. Gann stated agreement with a minor editorial suggestion and noted that any other modifications would occur in the normal process of using an editorial update agenda item.

Angelica Tamayo-Sanchez (New York Life) requested clarification regarding the term “substantially similar” and if disclosure requirements would apply to both short-term and cash equivalent investments. She stated that parameters or expanded guidance would be needed to adequately define “substantially similar,” noting that for liquidity purposes, many nonaffiliated investments continually roll.

Mr. Bruggeman stated the term “substantially similar” was originally intended to capture investments that were renegotiated. Ms. Gann stated that the disclosure element is a code in the reporting blanks to identify both affiliated and non-affiliated investments, which remain on the short-term schedule for more than one consecutive year. She stated that the concept of “substantially similar” is a common accounting term and that there is existing reference in SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities for substantially similar investments. She stated that the principal intent of the reference in SSAP No. 2R is to prevent minimal changes in investments solely to circumvent the short-term rolling restrictions and/or the disclosure requirements. She stated that the disclosure of rolled investments is the use of a code in the financial statements, not a narrative statement.

Mr. Bruggeman stated that currently the disclosure only specifically identifies short-term investments. However, he stated the impact was to also include cash equivalent investments. Ms. Gann stated the intent of the agenda item was to capture both short-term and cash equivalents due to potential risk-based capital (RBC) arbitrage. However, she stated the edit to explicitly add
Mr. Bruggeman directed the Working Group to agenda item 2019-36: Expand MGA and TPA Disclosures. Ms. Marcotte stated that this nonsubstantive agenda item was drafted pursuant to a request from two states to expand the existing annual statement disclosure regarding managing general agents (MGAs) or third-party administrators (TPAs) to include additional information. She noted that in agreement with interested parties’ comments, additional work needs to be completed on the definitional terms of TPAs. She stated that the previously referenced NAIC guideline only applies to a few specified lines of business and that the sponsors of the agenda item would like the disclosure to be applied broadly to all lines of business. She stated that NAIC staff are supportive of trying to find reasonable metrics for the disclosure but noted that finding one definition that works for all state laws to define TPA will not be practical or feasible. She recommended that this agenda item be deferred and NAIC staff be directed to coordinate with regulators, industry and the sponsors to develop recommendations including a functional definition. She stated that NAIC staff do not recommend the formation of a study group. She stated that the Working Group should also notify the Blanks (E) Working Group of the decision to withdraw the concurrently exposed annual statement blanks proposal.

The Working Group did not object to the recommendation to defer the agenda item and directed NAIC staff to coordinate with the sponsors and industry to refine the definition of TPA used in the disclosure to one that is inclusive of more lines of business and more functional. The Working Group also directed the notification of the Blanks (E) Working Group of the decision to withdraw the concurrently exposed annual statement blanks proposal.

e. Agenda Item 2020-14

Mr. Bruggeman directed the Working Group to agenda item 2020-14: Assessment of OTTI Based on Original Contract Terms. Ms. Gann stated this nonsubstantive agenda item was drafted to clarify the other-than-temporary impairment (OTTI) guidance in SSAP No. 26R. She stated it has been identified that there is a disconnect between SSAP No. 26R, SSAP No. 36R—Troubled Debt Restructuring and SSAP No. 103R with how modifications to debt instruments are considered for OTTI. Existing guidance in SSAP No. 26R identifies that OTTI assessments are based on the contractual terms of a debt security in effect at the date of acquisition. However, if a debt instrument has been modified pursuant to SSAP No. 36R or SSAP No. 103 (nontroubled situations), subsequent assessments of OTTI shall be based on the modified contractual terms of the debt instrument, and not refer to the original acquisition terms. Ms. Gann stated that NAIC staff agree with the minor edit as proposed by interested parties, clarifying that the OTTI shall be assessed on the modified contract terms.

Mr. Hudson made a motion, seconded by Ms. Malm, to incorporate the modification as proposed by interested parties and adopt nonsubstantive revisions to SSAP No. 26R (Attachment One-P). The motion passed unanimously.

f. Tentative INT 20-05

Mr. Bruggeman directed the Working Group to Interpretation (INT) 20-05T: Investment Income Due and Accrued. Ms. Gann stated that the upcoming proposed interpretations provide an exception to statutory accounting standards and require a two-thirds vote for adoption. She stated this interpretation provides limited-time collectibility assessments and admittance exceptions for SSAP No. 34—Investment Income Due and Accrued. This interpretation allows an exception to the collectibility assessment for investments that have had a forbearance or modifications, in response to COVID-19, that were both current as of Dec. 31, 2019, were not experiencing financial difficulties at the time of the modification. For these items, further evaluation
of collectibility would not be required for the first- and second-quarter financial statements unless other indicators that interest would not be collected were known. Ms. Gann stated the second exception is related to the admittance of recorded investment income due and accrued that is deemed collectible and is more than 90 days past due. With this exception, reported investment income that becomes more than 90 days past due in the first or second quarters may be admitted in the second-quarter financial statements. She stated comments received from interested parties requested clarification regarding impairment for mortgage loans. This interpretation does not provide an exception for accrued interest on mortgage loans in default, as existing guidance in SSAP No. 37—Mortgage Loans already states impairment shall be based on the modified contractual terms. Ms. Gann stated that in response, NAIC staff have proposed minor edits clarifying that accrued interest on mortgage loans that were in default are not in scope of this interpretation.

Ms. Weaver made a motion, seconded by Ms. Mears, to adopt the consensus in INT 20-05, with the modification as proposed by NAIC staff, for statutory accounting (Attachment One-Q). The motion passed unanimously.

g. Tentative INT 20-06

Mr. Bruggeman directed the Working Group to INT 20-06T: Participation in the 2020 TALF Program. Ms. Gann stated this interpretation proposes guidance for reporting entities participating in the federal Term Asset-Backed Securities Lending Facility (TALF) program. The guidance addresses both direct borrowers and reporting entities that participate as an investor to a direct borrower. She stated INT 20-06T differs from the TALF interpretation issued in 2009 as the earlier interpretation only provided accounting and reporting guidance for reporting entities who were direct participants in the program. However, from a public records search, it appears as though most reporting entities were not direct participants but rather were material investors to the direct participant. Ms. Gann stated that for direct participants, this interpretation follows existing statutory accounting guidance with the exception of allowing direct borrowers who pledge assets to the TALF program to continue admittance of those pledged assets. This exception was required as the TALF program does not permit substitutions of collateral. For investors, the interpretation proposes to follow existing statutory accounting guidance in that the investment shall follow the appropriate SSAP. She stated that NAIC staff agreed with interested parties’ proposed edits, which eliminated minor redundant verbiage.

Mr. Hudson made a motion, seconded by Mr. Moser, to adopt the consensus in INT 2020-06, with the modifications as proposed by interested parties, for statutory accounting (Attachment One-R). The motion passed unanimously.

h. Tentative INT 20-07T

Mr. Bruggeman directed the Working Group to INT 20-07T: Troubled Debt Restructurings of Certain Debt Instruments Due to COVID-19. Ms. Gann stated this interpretation was drafted after receiving comments in response to INT 20-03: Troubled Debt Restructuring Due to COVID-19 and INT 20-04: Mortgage Loan Impairment Assessment Due to COVID-19, which requested consideration of similar accounting exceptions for private placement investments. She stated that interested parties had proposed broad exceptions for all debt securities in an effort not to spend resources on obtaining a collaborative agreement regarding the definition of private placement investments. Ms. Gann stated this guidance proposes limited-time practical expedients in determining whether a restructuring reflects a “concession” under paragraph 10 of SSAP No. 36. Under existing statutory accounting guidance, a restructuring that is insignificant is not a concession; therefore, it is not a troubled debt restructuring. The interpretation originally proposed two practical expedients in determining what is an insignificant debt modification. The original expedients proposed were a 10% shortfall threshold in the contractual amount due and a repayment duration delay no greater than six months. Had both occurred, the modification was deemed to be insignificant. However, in response to comments received from interested parties, NAIC staff have proposed a three-year time duration for the modification in place of the original six-month duration as most debt modifications would likely extend well beyond a six-month time horizon. As proposed by NAIC staff, a modification that does not extend the original contract duration by more than three years and does not change the contractual cash flows by more than 10% would be considered an insignificant change and thus, by definition, not a troubled debt restructuring. Ms. Gann stated that debt covenant changes also do not rise to the level of a troubled debt restructuring and if a modification is not automatically deemed insignificant by the provisions of this interpretation, a reporting entity still has the ability to independently assess, or assess with the assistance of its domestic regulator, if the concession was insignificant. Additionally, if a modification was deemed insignificant under SSAP No. 36, even if the modification does not fall within scope of this interpretation, the investment does not need to be derecognized as an exchange of debt instruments under SSAP No. 103R. She stated the guidance in INT 20-07T does not affect the guidance in INT 20-03 and investments, such as commercial mortgage loans would first follow applicable guidance in INT 20-03. If INT
20-03 does not provide applicable guidance, a reporting entity would then follow the temporary expedience in INT 20-07T.

Mr. Bruggeman stated the intent of this interpretation was to provide a practical expedient for determining what was an insignificant modification under SSAP No. 36. However, if a modification does not fall within scope of this interpretation, it does not necessarily mean the modification is insignificant and thus requiring troubled debt accounting.

Mr. Hudson made a motion, seconded by Mr. Moser, to adopt the consensus in INT 20-07, with the modification as proposed by NAIC staff, for statutory accounting (Attachment One-S). The motion passed unanimously.

i. Tentative INT 20-08

Mr. Bruggeman directed the Working Group to INT 20-08T: COVID-19 Premium Refunds, Rate Reductions and Policyholder Dividends. Ms. Marcotte stated that this interpretation was exposed to address questions related to refunds, rate reductions and policyholder dividends in response to decreased insured activity related to COVID-19 stay home orders. She noted that the overall guiding principle is that the accounting shall follow existing statutory accounting principles and annual statement reporting where feasible. She stated that the interpretation noted that several property/casualty (P/C) lines of business had offered refunds, rate reductions or policyholder dividends. She said after the exposure, a large health insurance carrier also announced refunds or rate reductions and that the draft in the materials also recommends adding a reference to SSAP No. 54R—Individual and Group Accident and Health Contracts.

Ms. Marcotte stated that seven comment letters were received, including comments from: the group of interested parties representing several companies, America’s Health Insurance Plans (AHIP), American Property Casualty Insurance Association (APCIA), the Cincinnati Insurance Company, Grange Insurance Company, National Association of Mutual Insurance Companies (NAMIC) and Travelers Insurance Companies. She stated that most of the comments focus on Issue 1: How to account for refunds not required under the policy terms and on clarifying the scope of the proposed disclosure in Issue 5.

Ms. Marcotte stated there seems to be general support for:
- Issue 2: How to account for refunds required under the policy terms.
- Issue 3: How to account for rate reductions on in-force and renewal business.
- Issue 4: Requires policyholder dividends to follow existing guidance and complete the disclosures per Issue 5.

Ms. Marcotte stated that Issue 5 regarding disclosures requires that reporting entities continue to comply with all statutory accounting disclosure requirements and also requires that all premium refunds, rate reductions or policyholder dividends provided because of the decreased activity due to COVID-19 be aggregated and reported in Note 21A as unusual and infrequent items. She noted that the P/C actuaries who perform rate review and analysis noted that transparency will assist them in evaluating 2020 activities.

Ms. Marcotte provided an overview of comments received. She noted that there was primarily support for the exposure by APCIA and Travelers Insurance on Issues 1–4, and interested parties on Issues 2–4.

Ms. Marcotte noted that there was the most diversity in the comments regarding premium refunds in Issue 1. She stated that some of the interested parties, APCIA and Travelers all supported the exposure requirements of reporting as an adjustment to premium. She said that the interested parties group recommended adding more guidance regarding adjustments to unearned premium. She stated that Grange Insurance Company, Cincinnati Insurance Companies and some of the interested parties group recommended adding a new issue that allows payments under modified policy terms to be recognized as an “other underwriting expense” referencing SSAP No. 70—Allocation of Expenses as an alternative to recognizing adjustments to premium. She stated that Grange Insurance Company noted it was not able to provide dividends to isolated lines of business and viewed the payment as akin to the treatment of a policyholder dividend. She stated that the comment letter from interested parties included a proposed draft supported by some of the interested parties, which illustrated industry-proposed revisions. She stated that NAMIC supports allowing the reporting entity to choose between multiple different methods of recognition, including premium refunds, policyholder dividends and also bad debt expense. She noted that NAMIC’S comment letter prefers the flexibility of reporting payments similar to dividends even if they were not technically policyholder dividends so that the payments are reflected in the combined ratio.
Ms. Marcotte stated that AHIP noted its written comments as preliminary and that it prefers more health-specific guidance. She stated that AHIP also noted that immediate adjustments to premium may be too quick as some entities amortize the rate adjustments.

Ms. Marcotte stated that comments regarding Issue 5 were directed at refining the scope of the disclosures. She stated that AHIP, interested parties and APCIA recommended adding a sentence clarifying that other refunds required under policy terms are not required to be aggregated with the COVID-19 refunds. She stated that Travelers Insurance commented that for commercial rate adjusted policies, it will not be practical to separately identify refunds and rate reductions from changes in premium due to loss experience and as such, policies should be excluded from the disclosure. She stated that NAMIC recommended an editorial deletion of a reference to disclosure of stockholder dividends required under SSAP No. 72—Surplus and Quasi Reorganizations to be clearer that the focus of this interpretation is policyholder dividends.

Ms. Marcotte stated that APCIA recommended putting more permanent guidance in the SSAPs on an expedited basis.

Ms. Marcotte stated that NAIC staff have proposed a limited number of revisions to reflect a few of the comments. She stated the first proposed revision is to Issue 1 on refunds, adding a reference to unearned premium as suggested by interested parties to note, “The refund shall be recognized as a reduction to written or earned premium and the unearned premium reserve adjusted accordingly.” She stated that the next proposed revision in Issue 1 is to add a new paragraph and a new subparagraph to reference SSAP No. 54 regarding individual accident and health to address refunds and rebates announced on health business subsequent to the exposure. She stated that overall, the recommendations for Issue 1 are consistent with the exposed guidance with minor health specific references.

Ms. Marcotte stated that NAIC staff have proposed modified revisions to Issue 4 – Policyholder Dividends to incorporate the NAMIC comments that provide editorial deletions to remove references to stockholder dividend disclosures as not needed and maintain the focus on policyholder dividends.

Ms. Marcotte stated for Issue 5 on disclosures, NAIC staff recommend a modification to the clarification suggested by AHIP, the interested parties’ group and APCIA. The industry-proposed language would exclude all policies whose terms require an adjustment to premium. The NAIC staff proposed modification is to include policies whose terms were modified in response to COVID-19. She noted that Travelers Insurance made a similar comment in that it noted, “For commercial rate adjusted policies, it will not be practical to separate refunds and rate reductions from changes in premium due to loss experience and therefore, such policies should be excluded.” She stated that the NAIC staff recommendation is to include policies whose terms were modified after the declaration of emergency in the disclosure of the COVID-19 inspired premium refunds, rate reductions and policyholder dividends.

Ms. Marcotte stated the exposed interpretation is also not proposed to be modified to allow reporting the refunds or rate reductions on in-force policies as premium balances charged off (e.g., bad debt expense). She noted this industry recommendation is inconsistent with guidance in SSAP No. 53—Property Casualty Contracts-Premiums, paragraph 14, on earned but uncollected premium. She also noted that it is inconsistent with the annual statement instructions as the amount is not an uncollectible amount, but rather a voluntary choice by the reporting entity to reduce the amount charged.

Mr. Bruggeman stated that it appears there is consensus regarding Issue 2, Issue 3 and Issue 4. He noted that a good example of the scoping problem identified by industry for Issue 5 on disclosure is that for a workers’ compensation policy in which the policyholder would normally have 100 active employees and now has 10 employees, a refund would normally be required under the policy terms because of the decrease in covered risks. Ms. Marcotte noted that the NAIC staff recommendation was, “For clarification, refunds required under policy terms in-force prior to the federal declaration of emergency for the COVID-19 pandemic as discussed in paragraph 13 (i.e., policies that require an adjustment to premium based on either the level of exposure to insurance risk or the level of losses) are not required to be aggregated in disclosures of COVID-19 inspired premium refunds, rate reductions and policyholder dividends. Policies whose terms were modified after the declaration of emergency in response to COVID-19 are required to disclose the COVID-19 inspired premium refunds, rate reductions and policyholder dividends.” Mr. Bruggeman said that the NAIC staff recommendation on Issue 5 adequately addressed the issue.

Mr. Bruggeman stated that at this point, he is not certain that he has all of the information regarding the variety of ways and reasons that funds were returned to policyholders. He noted that the comment letter attachments included the illustration proposed by some of the interested parties and that he would like to understand some of the different situations better.
Additionally, he noted that most of the payments were made after April 1. Therefore, he said this is predominately a second-quarter reporting issue. He stated that while there is some time to address this issue, there was also a need for consistent guidance to be finalized expeditiously. Mr. Hudson stated California’s support for reflecting Issue 1 as an adjustment to premium but noted he is also mindful of the amount of comments. He asked if Mr. Bruggeman was suggesting exposing the issue again to allow for further discussion, particularly on Issue 1. Mr. Bruggeman responded that he wants to explore the exposure options of either all of the interpretation or finalizing aspects of the interpretation and allowing for further discussion on Issue 1. Mr. Smith said he is not opposed to another exposure, but he supports the initial recommendation to reflect as an adjustment to premium. Mr. Smith said even with different situations provided in the comments, after review of various company actions—including premium credits, premium refund or return, and rate reductions—in his view, all reflect an adjustment to premium.

Mr. Bruggeman said that some entities’ comments noted that they have returned money even though the risk has not been reduced. Mr. Moser noted that Illinois is willing to explore the accounting as an expense if it makes sense. Ms. Marcotte suggested exposure with the NAIC staff edits to narrow the scope of future comments. Mr. Bruggeman asked for commenters to focus their comments regarding Issue 1.

Keith Bell (Travelers Insurance), representing interested parties, noted that for reporting entities that reflected the payments as an adjustment to premium, they viewed the issue as a distinction of form over substance. If the reason the payment is being made to the insured is because the risk or exposure went down, then it was appropriate to reflect as a reduction of premium. He noted that premium is an important metric that measures the amount of risk that an insurer takes on as part of the contract and that is how they reached that conclusion.

Kevin Spataro (Allstate) noted that Allstate was early to announce a policyholder relief program. He noted its objective was to get relief into the hands of policyholders quickly with the least disruptions to other stakeholders. He noted that it considered reflecting the amounts as a premium refund but ultimately rejected the treatment, principally because Allstate lacked loss data to be able to reliably reassess the underwriting risk related to the policies in the current conditions. He noted that reporting as a premium refund would also affect other key stakeholders, including agents, whose commissions are based on premiums, and also the states in which they do business, who rely on premium taxes to fund their operations. He stated that as a result, Allstate ultimately decided to amend its policy forms to provide an endorsement to provide a new type of policy benefit that it classified as an other underwriting expense pursuant to SSAP No. 70. He said that Allstate believes that due to the unique nature of the payment, it fits well as an other underwriting expense in a write in line. He noted that Allstate also supported disclosure to provide transparency. He noted that Allstate has no issue with other insurers reporting as a return of premium or as a dividend based on program design. He noted that they believe that Allstate and others who designed and executed their programs around a policyholder benefit should be permitted to classify their payments as an expense. Mr. Spataro stated that while Allstate understands that there is not a specific expense category to allow this treatment, for a COVID-19 relief payment, it believes that the interpretation is an appropriate vehicle to codify its proposed accounting treatment. Mr. Spataro further noted that Allstate also does not believe that another agenda item or a permitted practice designation is either necessary or appropriate at this time.

Mr. Bruggeman summarized that it appears that Allstate’s recommendation is that the statutory accounting should follow the policy form, which was filed, i.e. a policy benefit. Mr. Spataro confirmed the comment from Mr. Bruggeman. Mr. Bruggeman noted that the subject companies actually filed amendments to their policy forms; they did not base the refund amount on data telematics from policyholders (such as decreased driving miles.) Mr. Spataro stated that Allstate does not have the data to re-underwrite the policies.

Mr. Bell stated that he is not suggesting the reduced prices were because of telematics, but rather the decrease in losses. He stated that again, the argument is form over substance. If you put aside the labels applied to the payments, the amounts were paid back to the policyholder. He stated that if the payment was because there was less exposure or less losses, then the view is that is a reduction in premium and that premium is the most important measure of an insurer’s exposure to loss.

Mr. Spataro said Allstate looks at this issue differently because it did not reassess the exposure to loss. He noted that the stay-at-home orders have resulted in some policyholders that seem to be driving faster. He stated that Allstate believed the payments were important to get into the hands of its policyholders, but it did not have the ability to re-underwrite those policies, and Allstate still believes this is a policy benefit as opposed to a return of premium. Mr. Bruggeman noted that some policyholders were driving less, and others, such as essential workers, were driving the same or sometimes more.
Thomas Finnell (AHIP) noted that AHIP did not have much time to react to the health specific change. However, he said other than a large insurer making an announcement, there is not a lot of activity on the health side regarding the same types of refunds. He said that the example may be restrictive to other insurers if they decide to take action later in the reporting year. Mr. Finnell stated that the interpretation provided more P/C examples and that additional health examples would be helpful. He said one jurisdiction has put out an announcement that such payments would require a rate filing. He noted that a few members have provided premium holidays in prior years that were reported as a reduction of premium which was amortized over the policy year. Mr. Finnell stated that such amortization is not covered by the text in the interpretation. He stated that AHIP would like to have further clarification regarding what is meant by immediate reduction in premium (written, earned or unearned). He stated that AHIP would like to bring the idea of premium holidays into the interpretation. He stated that AHIP shared the concern of interested parties regarding the scoping of the disclosure. It seems that is there are retrospective premium assessments because of the totality of activity on the policy not just as a result of COVID-19 payments. Mr. Bruggeman noted that the very large company announcement prompted inclusion of the health contracts in case other entities decided to go down that path.

Steve Broadie (APCIA) noted that APCIA’s financial management regulation committee considered all of the issues and voted to support the conclusions reached in the interpretation as an appropriate application of the existing accounting guidance. He stated that APCIA supports adoption of the INT with respect to Issue 1. Mr. Broadie stated that the diversity of comments received also indicated the need for additional permanent substantive guidance in the statements. He said that APCIA would be happy to support and work with NAIC staff on developing revisions that it believes are necessary on an expedited basis.

Rachel Underwood (Cincinnati Insurance Companies) noted support for the position of reporting the payment in Issue 1 in other underwriting expense as Mr. Spataro presented. She noted that Cincinnati Insurance Companies presented additional reasoning for its position in its comment letter.

Jonathon Rodgers (NAMIC) noted that this is unprecedented and that there is great diversity of actions and preferences among NAMIC’s members. He stated that characterizing the return of funds to policyholders as a return of premium does not work for everyone. He noted some mutual entities wanted to provide policyholder dividends, but their systems were not set up to provide the expedited payments. He noted that often a policyholder dividend is issued to share favorable loss experience. Mr. Rodgers said it is too early to substantiate the impact of the loss experience, but the losses being reported are lower. He noted that the company systems could not accommodate the accelerated payments. He stated that although the payments were not policyholder dividends, NAMIC’s members supported similar treatment. He noted another instance in which premium previously collected and earned was returned. He stated that some members supported reporting these returned amounts as premium and agents balances charged off similar to bad debt expense. He noted that the accounting guidance in SSAP No. 53 and SSAP No. 70 was not a good fit for all of the actions. He stated that this extraordinary event calls for flexibility in reporting.

Mr. Bruggeman said that at this time, he thinks that another exposure that includes the NAIC staff proposed revisions is appropriate. He asked if the Working Group had any issues with another exposure, and no objections were stated.

Mr. Hudson made a motion, seconded by Mr. Moser, to expose INT 20-08T with the modifications recommended by NAIC staff for a 16-day public comment period ending June 5. The motion passed unanimously.

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.
Statutory Accounting Principles (E) Working Group
Conference Call
June 15, 2020

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met via conference call June 15, 2020. The following Working Group members participated: Dale Bruggeman, Chair (OH); Carrie Mears, Vice Chair (IA); Richard Ford (AL); Kim Hudson (CA); Kathy Belfi (CT); Rylynn Brown (DE); Eric Moser and Kevin Fry (IL); Stewart Guerin (LA); Steve Mayhew (MI); Doug Bartlett (NH); Tom Dudek (NY); Joe DiMemmo (PA); Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI).

1. Reviewed Comments on Exposed Items and Adopted the Consensus in INT 20-08 With Modifications

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

Julie Gann (NAIC) stated that prior to discussing any topics, the tentative interpretation (INT 20-08), per the NAIC Policy Statement on Maintenance of Statutory Accounting Principles, must have 67% of the Working Group members voting with a super majority supporting adoption.

   a. INT 20-08

Mr. Bruggeman directed the Working Group to INT 20-08: COVID-19 Premium Refunds, Rate Reductions and Policyholder Dividends. Robin Marcotte (NAIC) stated that this interpretation was exposed to address questions related to refunds, rate reductions and policyholder dividends in response to decreased insured activity related to COVID-19 stay-at-home orders. She noted that the overall guiding principle is that the accounting shall follow existing statutory accounting principles and annual statement reporting, where feasible. The interpretation noted that accident and health (A&H) and multiple property/casualty (P/C) lines of business had offered refunds, rate reductions or policyholder dividends, all of which were performed in a variety of methods, warranting the numerous discussion issues in this interpretation.

Ms. Marcotte stated that several comment letters were received, noting that most commenters focused on Issue 1: How to account for refunds not required under policy terms.

Ms. Marcotte stated there seems to be general support for:

- Issue 2: How to account for refunds required under policy terms.
- Issue 3: How to account for rate reductions on in-force and renewal business.
- Issue 4: Requires policyholder dividends to follow existing guidance and complete the disclosures per Issue 5.
- Issue 5: Requires reporting entities to comply with statutory accounting disclosure requirements, and requires that all premium refunds, rate reductions or policyholder dividends provided because of the decreased activity due to COVID-19 be aggregated and reported in Note 21A as unusual and infrequent items. She noted that the P/C actuaries who perform rate reviews and analysis noted that transparency will assist them in evaluating 2020 activity.

Ms. Marcotte stated regarding issue 1, the refund will be an adjustment to written or earned premium with corresponding adjustments to unearned premium, as applicable. Liability recognition is required in accordance with Statement of Statutory Accounting Principles (SSAP) No. 5R—Liabilities, Contingencies and Impairments of Assets. It also states that refunds that are recognized in a different manner (e.g., as an expense) shall be considered a permitted or prescribed practice pursuant to SSAP No. 1—Accounting Policies, Risks & Uncertainties and Other Disclosures. She stated Issue 2 specified that refunds required under policy terms shall be recognized as an adjustment to premium. However, discounts on future business shall be recognized during the future policy period. Issue 3 addresses rate reductions on in-force and renewal business and requires rate reductions on in-force business to be recognized as immediate adjustments to income. Additionally, rate reductions on future business shall be reflected in premium upon renewal. Issue 4 requires policyholder dividends to continue following existing guidance and to complete the disclosures described in Issue 5. She stated that the interpretation notes that premium taxation requirements vary by jurisdiction and is determined by each jurisdiction as to whether premium taxation that occurs on premium is written or returned to the policyholder. Additionally, due to the short-term nature of the items included, this interpretation will be automatically nullified on Jan. 1, 2021.

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Ms. Marcotte stated the Working Group received nine comment letters. She noted, however, that comments received were not regarding the modifications added to the May 20 exposure. She stated the primary issue for discussion is whether to allow reporting entities that filed policy endorsements, allowing the insurers to voluntarily provide a return of funds to policyholders, to report the payments as a return of premium or as an other underwriting expense. She stated that some of the current and prior comment letters were in support of treating voluntary payments or rate reductions to policyholders as an adjustment to premiums. Additionally, the comment letter provided by the Connecticut Department of Insurance (DOI) was also supportive of premium adjustments and further supported guidance in the interpretation, which also provides that if reported as an underwriting expense, it should be a prescribed or permitted practice. UnitedHealth was supportive of reporting as an adjustment to premium. Ms. Marcotte noted that UnitedHealth also provided comments specific to the health industry. UnitedHealth noted that the exposed guidance is consistent with current accounting guidance for other types of premium refunds that are required by either policy terms or regulations. She additionally stated that UnitedHealth indicated that any associated liability should be reported as an aggregate write-in since the premium refund was not required by policy terms, and therefore would not be accounted for as retrospective or redetermination premium liability.

Ms. Marcotte stated several comment letters expressed support for allowing the voluntary payments or return of funds to policyholders to be reported as an other underwriting expense, especially if the policy endorsement allows discretionary payments to the policyholder at the option of the insurer. This approach was supported by the Illinois DOI, Allstate, Cincinnati Insurance Companies, Co-operative Insurance, Grange, National Association of Mutual Insurance Companies (NAMIC) and Progressive.

Ms. Marcotte stated the Illinois DOI indicated support that if an insurer has filed and received approval for policy endorsements related to such payments, then those payments would be reported as an expense in their statement of operations. She stated that comments received from industry included that amounts returned to policyholders were not as a result of re-underwriting or analysis of loss data. However, the credits were determined on a percentage of premium, and the use of an underwriting expense classification was preferred in an effort to avoid having an impact on non-policyholder stakeholders such as agent commissions or state premium taxes; additionally rate plans were not refiled with state insurance departments. Ms. Marcotte stated that Co-operative, Grange and NAMIC provided mutual specific comments indicating that even though they were not able to provide dividends to isolated lines of business, they viewed these policyholder payments as an expense as they are akin to the treatment of a policyholder dividend. Additionally, NAMIC supported allowing the reporting entity to choose between recognizing the relief payment as an expense, a premium refund, policyholder dividend or an up-front bad debt expense. Further, NAMIC’s position supported the reporting of relief similar to a dividend, even if they were not technically policyholder dividends, so the payments are reflected in the combined ratio, not the pure loss ratio.

Ms. Marcotte stated that U.S. generally accepted accounting principles (GAAP) specific comments were received from Allstate and Progressive. Allstate indicated support for other underwriting expense treatment, although it acknowledged that expenses related to insurance contracts are those typically paid or incurred in connection with originating and servicing a contract. Allstate viewed that it is appropriate to classify the incremental amount paid to the customer as a policyholder expense for U.S. GAAP and as an other underwriting expense for statutory accounting. She stated that Progressive indicated it was not aware of a difference between statutory accounting and U.S. GAAP as it relates to the accounting for insurance premiums. However, similar to other several public company registrants, it recorded the policyholder credits and payments as an underwriting expense when filing its Form 8-K with the U.S. Securities and Exchange Commission (SEC). The GAAP accounting treatment was based on the underlying premise that the credits and payments are akin to a policyholder dividend and are in essence noncontractual discretionary returning of profits that resulted from a reduction in loss due to the shelter-in-place order. Additionally, the relief payments to policyholders was determined on an enterprise-wide level as opposed to a contract level.

Ms. Marcotte stated that NAIC staff recommended regulator discussion of the two various approaches discussed. She recommended adoption or re-exposure with two minor modifications that addressed minor health-specific comments received from UnitedHealth. She stated that the Working Group has the ability to adopt individual issues within the interpretation while continuing discussion on other topics (i.e., adopting Issues 2–5, while continuing discussions on Issue 1). She noted that NAIC staff are concerned with the comparability issues that would result from allowing different options for reporting discretionary payments to policyholders, such as reporting as reduced premium, an underwriting expense or an uncollectible bad-debt expense. She said that NAIC staff recommend that such reporting would be a prescribed or permitted practice because existing statutory accounting guidance requires the return of such monetary items to policyholders be recognized as an adjustment to premium. Ms. Marcotte stated that the principle of reversing premium in the same manner in which the premium was originally recognized continues to apply. She noted that this principle is critical to health insurers, which are subject to the medical loss
ratio (MLR) calculations. She stated that while the state of domicile can provide a prescribed or permitted practice, other jurisdictions may choose not to accept the prescribed or permitted practice. The non-domiciliary state can provide other direction and require differing financial statement reporting as it deems appropriate. She stated underwriting expense recognition criteria related to insurance contracts are typically for those items paid or incurred in connection with originating and servicing the contract; these discretionary payments are not for that purpose. The payment is not consistent with any of the underwriting expense categories and is not a cost of servicing the policy, but rather a voluntary payment at the option of the insurer, generally returning previously billed premium.

Mr. Hudson and Ms. Belfi stated support for the amendments that NAIC staff proposed, incorporating minor modifications stating the liability for voluntary health premium refunds attributable to COVID-19 and that are not required under the policy terms shall be recognized in aggregate write-ins for other liabilities (while also adjusting premium).

Ms. Belfi stated an important aspect regarding statutory accounting is the concept of consistency and while states have been flexible in meeting many of the requests of industry due to COVID-19, consistent reporting would be supported by the Connecticut DOI. Ms. Belfi noted that additionally, if certain domestic states wish to grant additional reporting flexibility, the permitted practice procedures provide for such an avenue. Mr. Stolte stated agreement with Ms. Belfi and stated that Virginia will associate itself with the position of consistent reporting per the statement of concepts as developed during the codification of statutory accounting principles, unless a domestic regulator provides a permitted practice.

Mr. Moser stated that Illinois supported flexibility in reporting, noting that while consistency is important, consistent reporting would likely not occur due to the high number of permitted practices that will likely occur if the Working Group does not permit flexibility in the interpretation. He stated that comparability will be affected due to the wide range of insurers and wide range of methods in which proceeds were returned to policyholders. He stated that Illinois believes that if an insurer has filed and received approval for policy endorsements related to such payments, then those payments would be reported as an expense in their statement of operations, as the policy endorsement allows such policyholder payments.

Kevin Spataro (Allstate) stated support of the interpretation as it relates to premium refunds, rate reductions and policyholder dividends, but he stated the interpretation should be expanded to include accounting and reporting guidance for discretionary payments provided to policyholders pursuant to policy endorsements that were not designed to be and are not premium refunds, rate reductions or policyholder dividends. He stated that Allstate executed a policy endorsement because it was believed to be in the best interest of policyholders and did not want to negatively affect other parties, such as reduced commissions to agents or reduced premium taxes to states. Additionally, a rate filing was not elected due to the fact that at the time the funds were disbursed to policyholders, actuarial information such as differences in crash severity, distracted driving or other vehicle uses was not available: thus, an amended rate filing was not a viable option. Additional investment returns were also unknown, which is a critical component of a rate filing. Mr. Spataro stated that dictating an accounting method could potentially be penalizing to the organization, however, understanding that this is an unprecedented event requiring special attention. He stated that upon its review of the statutory accounting principles, Allstate believes the nature of its payments to policyholders would qualify as another underwriting expense and supports expanded comprehensive disclosures of the elective policyholder COVID-19 relief payments. Mr. Spataro stated that the discretionary payments did not affect any reinsurance agreements as Allstate’s agreements only cover excess losses.

Mr. Stolte asked Mr. Spataro for information on how reporting entities could be disadvantaged by a permitted or prescribed practice, should the Working Group direct consistent reporting among allfilers. He stated that state analyst would then appropriately review footnote 1 in the statutory financial statements to assess the impact of any permitted practice. Mr. Spataro stated he believes the disadvantage would be that the financial statements would not reflect the nature and characteristics of the program and, thus, not reflect the substance of the transaction. That is, they would reflect a discretionary payment as an expense, not a reduction in premium.

Birny Birnbaum (Center for Economic Justice—CEJ) stated the CEJ began calling for premium relief payments at the early onset of COVID-19. He stated the relief was in correlation with the reduction in risk exposure of affected policies—i.e., a significant reduction in automobile usage. The aggregate risk exposures for current policies reflect an overnight reduction in risk, and the return of funds reflect the return of premium associated with the reduced insured risk. Additionally, premium relief was only provided on in-force policies, and in many cases, the relief was calculated as a percentage of premium for a certain number of affected months. The proposed accounting treatment is analogous to removing a vehicle off a policy, thus resulting in a refund due as the risk transferred to the insurance company was reduced. Similarly, due to a significant number of vehicles...
not driving, the risk transferred to the insurance company was greatly reduced. He stated support for the accounting treatment as a return of premium, which would assist in the comparability of financial statements.

Rachel Underwood (Cincinnati Insurance Companies) stated support for recognizing as an expense those relief payments made in relation to nonparticipating policies without premium refund terms in response to decreased activity due to COVID-19. She stated that per SSAP No. 53—Property Casualty Contracts–Premium, premiums are defined as the contractually determined amount charged by the reporting entity to the policyholder for the effective period of the contract, based on the expectation of risk, policy benefits and expenses associated with the coverage period provided by the terms of the insurance contract. Additionally, premium adjustments due to changes in the exposure level are generally determined based upon audits conducted after the policy terms. She stated her position is that the relief provided to policyholders was outside the scope of both of these statements. She noted that payments made to policyholders were made in the absence of loss data. Additionally, while the insured risk was reduced for a couple of months, premium charged for the policy covers the entire policy period, not just a short time frame, such as two months. Thus, the relief should not be solely affiliated with premium. However, the relief provided to policyholders is akin to a policyholder dividend, but that option was not available as the policies written by Cincinnati Insurance Companies are not participating policies and thus are not eligible for dividends. Ms. Underwood stated that voluntary payments were in an effort to help policyholders, similar to how a donation would be accounted for as an expense. Additionally, the impact of a premium reduction would negatively affect producers through reduced commissions and states through reduced premium taxes. She stated concerns with pursuing the permitted practice process because it is uncertain whether the state will approve the request, and for those states that do not approve the deviation, further inconsistent reporting will likely result. Additionally, if a holding company has two reporting entities in two different jurisdictions, depending upon the permitted practice granted (i.e., permitted in one state and not in another), a holding company may have to report the same transaction in differing methods (i.e., one as an expense, one as a reduction in revenue). Ms. Underwood stated that the company’s reinsurance agreements would likely be affected if the relief payments are reported as a reduction in premium.

Mr. Stolte stated that through the use of a permitted practice, and its disclosure in footnote 1 of the statutory financial statements, entities would be able to quickly identify and reconcile any differences from adopted statutory accounting guidance. He stated he would support this continued, traditional approach because allowing reporting entities with flexibility in reporting would negatively affect reporting consistency among the industry.

Ms. Belfi stated that during the financial crisis, multiple permitted practices were given to multiple companies covering a wide range of issues. However, despite this, there were not any issues with comparability due to the details that are required to be provided in footnote 1. In a similar manner, the financial crisis affected an entire industry and is analogous to the COVID-19 events of today.

Jonathan Rodgers (NAMIC) stated that this event is unprecedented and that there is great diversity of actions and preferences among NAMIC’s members. He stated that characterizing the return of funds to policyholders as a return of premium does not work for everyone. Due to the unprecedented nature of the return of funds to policyholders, without flexibility being granted by the Working Group, state regulators will see an unprecedented volume of permitted practice requests. Without flexibility, the process of obtaining a permitted practice will create an unnecessary hurdle as flexibility could be granted, thus not requiring the exercise, cost and uncertainty in requesting a permitted practice. The return of funds to policyholders was done in a sense of urgency and generally with ongoing communications with domestic regulators. Additionally, at the time the funds were given, loss data was not known and not a factor. Thus, relief payments should not be considered a return of premium. If treated as a reduction in premiums, the loss ratio, an important metric, would be improperly negatively affected. While not viewed as a return of premium, NAMIC was supportive of enhanced disclosures, detailing the impact of the COVID-19 relief payments. Mr. Rodgers stated if the Working Group elects to treat the relief payments as a reduction in revenues, the impact will be felt by agents through reduced commissions and by states through reduced premium taxes.

Mariann Marshall (Progressive) stated support for allowing reporting entities to classify the policyholder credit as an other underwriting expense. She stated Progressive filed a policy endorsement, not a rate filing, to authorize and facilitate discretionary credits and payments to policyholders in response to the COVID-19 pandemic. She stated that the process to obtain a permitted practice from every state would be problematic for insurers, especially in light of not knowing which states would permit the reporting exceptions. Additionally, if not granted by all states, holding companies would have inconsistent reporting among downstream reporting entities. She said that while Progressive is supportive of reporting flexibility, it is also supportive of enhanced disclosures so regulators could assess the impact of the COVID-19 relief payments. She stated the funds provided to policyholders were done solely in the interest of the policyholders. However, if required to be treated as a
reduction of premium, agents would be negatively affected through reduced commissions, and states would be negatively impacted through reduced premium taxes. Ms. Marshall stated that if treated as a premium reduction, their reinsurance agreement would be negatively affected and would likely result in the reinsurer refunding reinsurance premiums paid by Progressive. She noted that no differentiation was made between policyholders in terms of the COVID-19 relief payments. Thus, all auto customers received some relief funds. Ms. Marshall stated that premiums received from policyholders were only used as a beginning basis for the determination of the amount of relief payment received. However, in the absence of loss data, Progressive viewed the payments as an expense, not a policyholder refund.

Mr. Birnbaum stated many of the comments received today reference the absence of loss data, thus the inability to amend a rate filing. However, insurers recognized the insured risk drastically dropped, and in the absence of a premium refund, the rates compared to the insured risk were excessive. He said due to this fact, these relief funds reflect a reduction in risk exposure and thus warrant accounting treatment as a reduction in premiums.

Ms. Underwood stated their belief was that a relief payment should be most appropriately reflected in an entity’s combined ratio, not the pure loss ratio, because the payments are akin to a policyholder dividend (returning excess profits). Additionally, while the insured risk was reduced for a short period of time, the insurance policy covers a significantly larger time frame, thus requiring a one-time relief payment, based on a temporary reduction of risk, to be accounted for as returned premium was not appropriate, in their view.

Mr. Spataro stated Allstate’s intention was to act in the best interest of the policyholder and did not have the actuarial data necessary to underwrite or rate the policy. Thus, the relief payments were not necessarily reflective of a reduction in risk that would be associated with a reduction in premium.

Mr. Birnbaum stated disagreement with the commenters in that the relief payment was not for the term of the policy period, but in fact was only for the short-term period, which reflects the reduced activity and lower insured risk. He stated insurance companies had real-time claims information and were aware of the significant reductions in claims. Without these premium relief payments, insurers would have experienced windfall profits. Thus, the accounting treatment as a reduction in premium is most appropriate.

Jim Braue (UnitedHealth Group—UHG) stated UHG agrees with the treatment of the relief payments as a reduction to written or earned premiums, in that this treatment reflects the substance of the transaction. He stated this treatment is consistent with the intent of the transaction (a return of premium to the policyholder) and is consistent with current accounting guidance for other types of premium refunds that are required by either policy terms or regulations. The timing of recognition of the premium refund also corresponds with the associated coverage period affected by the premium action. In the case of premium refunds issued for current or prior coverage periods, the recognition should be in the current reporting period. However, in situations where the premium rate is being reduced over the remaining policy period, the premium reduction may need to be recognized over the policy period affected. Additionally, with respect to any liability required to be recognized in accordance with in SSAP No. 5R, UHG believes the liability should be reported as an aggregate write-in since the premium refund was not required by policy terms, and therefore would not be accounted for as retrospective or redetermination premium liability. He stated if concerns continue regarding accounting for the relief payments as a reduction of premiums, bad debt expense may be the next logical choice. However, the reduction of premiums remains the most appropriate accounting treatment.

Steve Broadie (American Property Casualty Insurance Association—APCIA) stated the APCIA has had continuing discussions with its members and supports the position that if an insurer has filed an endorsement or an amended rate filing with the state, it communicated its intent to report the relief payments as a policyholder expense and should be allowed to do so while disclosing those payments per the requirements of this interpretation. This treatment would allow insurers that have taken such actions to be allowed to continue their earlier accounting treatment and not be disadvantaged by a subsequent accounting guideline as directed by the Working Group.

Keith Bell (Travelers) stated the evaluation process that Travelers used to arrive at the conclusion that these relief payments are in fact a reduction in premium may be helpful to the Working Group. First, Travelers eliminated categories of what the relief payments were not. He stated that the relief payments are not losses, as they are not a covered loss under the terms of the policy. Additionally, they do not reflect loss adjusting expenses as they are not payments to a third-party for cost containment, adjusting, etc. Mr. Bell noted that these clearly are not investment expenses, and they do not represent bad debt expense because in many cases, the relief was provided as a reduction of future premiums due. With regard to other underwriting expenses, a
current category for discretionary policyholder payments does not exist, so that generally precludes its use. He stated that after eliminating the expense categories, the Statutory Hierarchy in the Preamble was reviewed for further guidance. Revenues are generally defined as cash inflows as a result of continuing business operations, while expenses are generally defined as cash outflows as a result of continuing business operations. While the types of expenses vary by industry type, they all share a common component in that they reflect cash outflows to a third party for the payment of goods or services. Thus, payments to customers that do not involve the purchase of goods or services should not qualify as an expense. He stated the relief payments reflect the reduced exposure of risk and most logically should be reflected as a premium reduction. Additionally, he noted that other accounting issues may need to be considered if the policy has been modified to include a discretionary, noninsurance-related payment. If such a modification has occurred, he stated some of the inflows from premium should be reclassified because they may no longer reflect premium payments associated with the transfer of risk. He also stated concern that if the accounting treatment for transactions follows the label associated with a state filing, the accounting for transactions would vary greatly and likely no longer follow the essence of the transaction. He stated that across all legal entities, Travelers reported such transactions as a reduction in premium for both policyholders and intercompany reinsurance agreements. Mr. Bell stated that not withstanding the differences in opinion regarding accounting treatment, insurance companies did the right thing for policyholders in providing some type of relief as a result of the reduced activity resulting from COVID-19.

Mr. Bruggeman stated he is open to flexibility in reporting, noting that these payments are akin to a policyholder dividend. However, he stated he wants to consider an alternative approach, such as an aggregate write-in for miscellaneous income as a negative, used solely for the purpose of the COVID-19 relief payments. He stated he understood the relief provided was not necessarily specific to underwriting, was provided to all applicable policyholders, and was performed at an enterprise level rather than at an individual policy level. The challenge with maintaining comparability and consistency with this issue is that the formula used to determine relief payments varied greatly (i.e., a percentage of premium, a minimum payment, etc.) among all insurers. He stated he would be open to situational accounting of not necessarily requiring a reduction in premium. However, he stated he prefers an aggregate write-in for miscellaneous income as a negative, allowing for easier identification and analysis for use in future rate filings. Additionally, the aggregate write-in for miscellaneous income method would not affect many of the performance ratios used for analysis purposes. Mr. Bruggeman stated he agrees with earlier regulator comments regarding the usefulness of a permitted practice. However, he stated the diversity of acceptance could create additional comparability issues.

Mr. Hudson stated California is supportive of the comments received regarding accounting for the relief payments as a reduction of premium and appreciated comments received that detailed the many perspectives on this issue. Ms. Mears stated Iowa is also supportive of the position to account for these transactions as a reduction of premium, and any deviations should be a permitted or prescribed practice.

Mr. Hudson made a motion, seconded by Ms. Belfi, to adopt the consensus in INT 20-08, with the modification as proposed by NAIC staff, for statutory accounting (Attachment Two). The motion passed, with Delaware and Illinois dissenting and Alabama abstaining.

2. Considered Maintenance Agenda—Pending Listing—Exposures
   a. Agenda Item 2020-16EP

Mr. Bruggeman directed the Working Group to agenda item 2020-06EP: Editorial and Maintenance Update. Jim Pinegar (NAIC) stated that this item provides non-substantive editorial updates in accordance with the maintenance process and updates a reporting line reference and corrects sentence structure for guidance in SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments.

Mr. Hudson made a motion, seconded by Mr. Guerin, to expose this agenda item for a 30-day public comment period ending July 15. The motion passed unanimously.

3. Discussed Other Matters
   a. ACA risk Corridors – Supreme Court
Ms. Marcotte stated that in April, the Supreme Court of the United States issued an opinion stating insurers were entitled to pursue more than $12 billion in unpaid federal Affordable Care Act (ACA) risk corridor payments from the 2014 to 2016 program. She noted that the recent Supreme Court decision, in favor of four insurers, only provides the ability to seek payment through a damages action via the Court of Federal Claims. As such, at this time, and until resolution is reached through the damages action process, reporting entities would not have any new accruals or admission of a previously nonadmitted accrual for a risk corridor receivable. This is consistent with INT 15-01: ACA Risk Corridors Collectability. In addition, SSAP No. 5R prevents the recognition of gain contingencies until the transaction is fully completed and determinable, so it would be improper to accrue amounts at this time. Ms. Marcotte asked the Working Group if additional guidance was needed because many accounting inquiries have been received.

Mr. Bruggeman stated he believes INT 15-01 appropriately addresses the inquiries and directed NAIC staff to refer inquirers to existing guidance, noting that updates will occur as the pursuit of recoveries progresses through the Court of Federal Claims.

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

Attachment Eight

Accounting Practices and Procedures (E) Task Force

Statutory Accounting Principles (E) Working Group

E-Vote

July 15, 2020

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded July 15, 2020. The following Working Group members participated: Dale Bruggeman, Chair (OH); Carrie Mears, Vice Chair (IA); Kim Hudson (CA); William Arfanis (CT); Rylynn Brown (DE); Eric Moser (IA); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Joe DiMemmo (PA); David Smith (VA); and Amy Malm (WI).

1. Exposed Agenda Item INT 20-089

The Working Group conducted an e-vote to consider exposure of Interpretation (INT) 20-09: Basis Swaps as a result of the LIBOR Transition for a one-week public comment period ending July 22. A summary of the exposed interpretation is as follows:

- INT 20-09 - This guidance proposes provisions for the accounting and reporting of certain “basis swaps.” Basis swaps are defined as compulsory derivatives issued by Central Clearing Parties, for certain cleared derivatives, issued solely in response to the market-wide transition away from the London Interbank Offered Rate (LIBOR) and toward the Secured Overnight Financing Rate (SOFR). The interpretation directs that the basis swaps shall be reported as “hedging – other” and reported at fair value (thus qualifying for admittance), however cannot be considered or reported as an “effective” hedging derivative unless the instrument qualifies, with the required documentation, as a highly effective hedge as directed in SSAP No. 86—Derivatives.

Ms. Mears made a motion, seconded by Mr. Moser to expose INT 20-09. The motion passed without opposition, with 11 members voting.

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

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

**Issue:** Financing Derivatives

**Check (applicable entity):**

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<td>Interpretation</td>
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**Description of Issue:**

This agenda item has been prepared to reconsider the accounting and reporting of financing derivative transactions pursuant to a review of information from the 2018 year-end statutory financial statements.

Note: Although the proposed revisions in this agenda item would impact common SSAPs, from the year-end 2018 detail, there are no P/C or health entities acquiring or writing derivatives with financing arrangements. As such, the changes proposed may not impact P/C and health entities and should only impact a limited number of life insurers (16 as of year-end 2018) that engage in derivative financing arrangements.

A financing derivative transaction is one in which the premium to acquire the derivative is paid throughout the derivative term or at maturity of the derivative. With the accounting and reporting that has been utilized by some companies, the “cash flows” (the derivative obtained and the premium liability owed) are netted, generally resulting with zero-value reporting at inception. Over the course of the derivative term, an unrealized loss is recognized for changes in the present value of the premium liability (increase), which may be offset by any value change in the underlying derivative (increase or decrease). (With derivative financing, a gain would only ever be recognized if the fair value change of the derivative exceeded the cost of the derivative.) When the derivative matures, the calculation of realized gains and losses reflects the deferred cost (amount owned), adjusted for any actual fair value change.

For example, if paying $5,000 at the end of a 5-year derivative, a 1,000 unrealized loss would be recognized each year for the present value of premium due, and at maturity, the reporting entity would recognize the 5,000 as a realized loss. If the derivative had a $500 fair value gain, this would decrease the extent of the premium owed recognized as a realized loss. The financial statement presentation of a derivative with financing premiums is significantly different from traditional recognition in which the reporting entity would recognize the $5,000 derivative at acquisition and ultimately recognize a realized gain for the $500 change in fair value.

Several key concerns are noted in the agenda item; however, a few are highlighted as follows:

- Reporting is inconsistent, as not all insurers utilizing financing derivatives report using the net approach. Additionally, insurers acquiring (or writing) similar derivatives would represent the financial statement impact in substantially different ways based solely on when the cost to acquire the derivative is due.

- The amounts reported when derivative assets and liabilities are netted with financing components do not reflect actual derivative assets or liabilities, and the corresponding unrealized gains / losses do not solely reflect changes in derivative value. The amounts reported are impacted by both changes in fair value and the present value change in the premium cost for the derivative. (This approach, particularly with the recognition of unrealized losses for the premium liability owed, results with changes in AVR that do not reflect actual unrealized investment losses.)
The impact of financing derivatives can have a significant impact on the reported derivative amounts, which impacts the assessment of derivatives and the activity reported in regulator tools (e.g., profile reports / financial analysis assessments). For example, in one instance where financing derivatives were reflected, if the derivative had been reported without the financing components, the reported derivatives assets would have increased 50%, and the derivative liabilities would have decreased 60%. These two changes would have doubled the amount of overall net derivatives used in the company’s profile report. With a net presentation, the use of financing derivatives may artificially mask derivative activity, causing difficulty in regulator review to ensure derivative limitations have not been exceeded.

After reviewing the information reported in the 2018 year-end financial statements, it was noted that some entities both acquire and write derivatives using financing derivative components. For entities that are writing these derivatives, the entity has a receivable for the amount due, but the receivable is not subject to nonadmittance requirements as it is being commingled with the derivative. Under standard reporting (with premium provided at origination), the premium received would have been reported as a derivative liability (showcasing the obligation to perform under the derivative), but with financing derivatives, the written derivative is reported as a net asset as the receivable owed to the reporting entity is combined with the issued derivative. In the prior discussion of this topic, it was unknown that reporting entities were writing derivatives without collecting premium upon issuance or requiring collateral. This information was only identified with review of the new Schedule DB electronic columns.

From discussions with other NAIC staff, “financing” premiums are non-standard derivative components. Derivatives with these components are generally not marketable (without the entity providing payment of any remaining deferred or financing premium), as any new party would essentially be acquiring the initial company’s debt (liability) to pay the cost of the derivative.

**Proposed Accounting and Reporting Concepts:**
This agenda item intends to incorporate specific direction for the accounting and reporting of derivatives with financing components that are acquired and/or written. The proposed revisions reflect the following:

- **The BACV and fair value columns of derivatives acquired and/or written in Schedule DB-A or Schedule DB-B shall reflect the value without inclusion of any impact from financing provisions.**

  With this change, the Schedule DB column that currently captures “fair value of derivative, excluding impact of financing premiums” will be revised to reflect the “fair value of the derivative, including impact of financing premiums.”

  **Note:** This proposal will result in a change from U.S. GAAP, however, derivatives reported under SAP already vary from U.S. GAAP as statutory accounting does not currently allow offsetting in accordance with master netting agreements. Under U.S. GAAP, the cash inflows / outflows (derivative and financing components) are netted to arrive at the fair value of the derivative.

  This practice is not appropriate for statutory accounting because: The netting of derivatives with financing components 1) hinders the ability to assess whether derivative activity is within state investment limitations; 2) hinders the ability to utilize financial analysis tools in assessing activity or fair value changes; 3) impacts RBC and IMR calculations and 4) does not adequately present component items for admissibility.

- **Recognition of interest-related unrealized gains/losses (and then realized gains/losses at termination), shall reflect the fair value fluctuation changes in the derivative and shall not be impacted by the present value change of premium owed or premium receivable from the derivative.**

  This will impact past practice in which present value change of the premium owed / receivable has impacted gains / losses, resulting with impacts to AVR (unrealized) and IMR (realized).
The resulting balance sheet derivative assets and liabilities shall reflect the fair value of the derivatives without inclusion of the impact from financing derivatives unless the amount owed or the amount due from a derivative with financing elements meets the requirements for a valid right to setoff under SSAP No. 64. If this valid right of setoff exists, the amount shall be captured in Schedule DB-D with disclosures captured pursuant to SSAP No. 64.

Amounts owed to / from the reporting entity for derivatives written or acquired shall be separately captured in the balance sheet, unless the amounts qualify under the legal right to offset. To the extent amounts owed by the reporting entity for derivatives acquired do not meet the legal right to offset, the amount shall be recognized separately from the acquired derivative as a payable for security. To the extent amounts owed to the reporting entity for derivatives written do not meet the legal right to offset, the amount shall be recognized separately from the written derivative as a receivable for security and subject to admissibility requirements in SSAP No. 5R and SSAP No. 21R.

Note: Under SSAP No. 21R, receivables for securities are not admitted if not received within 15 days from the settlement date. If the valid right to offset provisions are not met, consideration could be given to incorporate specific guidance for these derivative premium receivables.

**Proposed RBC and AVR Concepts:**
In addition to the changes in the Schedule DB reporting for BACV and FV and the separate reporting of the amounts due to / from, the proposed concepts in this agenda item will result with key changes to AVR and RBC:

1. **Acquired Derivatives with Amount Owed to Derivative Counterparty**
With separate reporting of the derivative asset and amount owed from the acquisition of the derivative, the BACV for the derivative asset and “net exposure” (Schedule DB-D) by counterparty will increase. (As the AVR reserve does not factor in the impact if there is legal right to offset, this AVR impact will occur regardless of offsetting provisions.) From the 2018 year-end detail reviewed, in most instances, reporting entities with financing derivatives will no longer report these derivatives as liabilities and will report the derivatives as assets.

   • The AVR reserve and the RBC impact for derivatives is based on derivative counterparty “net exposure.” As such, unless other adjustments are made, the reporting entity will either need to obtain additional collateral or engage in another offsetting derivative with the counterparty to eliminate the reported increased exposure (increased RBC charge). **To address concerns with RBC, since exposure is not actually increasing, this agenda item proposes adjustments to Schedule DB-D to incorporate the amount owed by the reporting entity to the counterparty in determining net exposure.** This adjustment would eliminate the need to obtain additional collateral or engage in another offsetting derivative to reduce counterparty exposure.

   (There is an RBC charge for off-balance sheet collateral (.0039) and collateral on-balance sheet is assessed the corresponding asset charge. As such, by using financing derivatives instead of acquiring collateral, the reporting entity mitigates these collateral charges.)

   • With the proposed changes, the present value change of the premium owed will not be recognized as an unrealized loss in AVR (and impact the determination of realized interest-related capital losses/gains at termination in the IMR). These changes will result in a greater AVR reserve as the liability owed for the derivative recognized over time (present value over term of derivative) will no longer reduce the AVR as an unrealized loss. **The present value change of the premium owed for acquiring a derivative should not be considered an unrealized loss or impact AVR, therefore this change is appropriate.**
2. **Written Derivatives with Amount Owed to Reporting Entity**

With separate reporting of a derivative written by the reporting entity and the premium amount owed to the reporting entity, the BACV for the derivative asset and “net exposure” (Schedule DB-D) by counterparty will decrease. (This will likely result in a currently-reported derivative asset reversing to reflect a derivative liability.) Furthermore, the present value change of the premium due to the reporting entity will not be recognized as an unrealized gain and will no longer impact AVR (or IMR). The amount due for the written derivative will likely be considered a “receivable for security” within scope of SSAP No. 21R—Other Admitted Asset. Current guidance requires nonadmittance for these items not received within 15 days from the settlement date.

- In this situation, the derivative is currently being reported as an asset, because the amount due to the reporting entity (receivable) is increasing the derivative value. Without the amount due to the reporting entity, the derivative would be in a liability position. This approach does not seem to provide derivative RBC relief (as the RBC charge is focused on derivative assets) but the current netting approach could prevent potential nonadmittance for receivables owed to the reporting entity. In reviewing examples from the year-end 2018 reporting, premium owed to the reporting entity may not be received for a few years (until derivative maturity), which is beyond the time allotted for admittance under SSAP No. 21R. There is an RBC charge for “receivable for securities” (.014 life and 0.25 p/c & health), but this would only apply if the receivable was admitted. (This charge would be less than the charge for the derivative asset.)

- If the right to offset provisions in SSAP No. 64 are met, there would be no net impact to the financial statements by reporting the written derivative asset without the financing provisions. In these situations, the BACV and fair value on Schedule DB-A would detail the derivative without the financing components, and on Schedule DB-D, the reported amount that ties to the balance sheet would be adjusted for the offsetting receivable. With the offset, the receivable for security would be eliminated from the balance sheet. With the offset / balance sheet elimination, the receivable is essentially given “admitted asset” status (as it reduces a liability) and is not assessed for RBC. (Under SSAP No. 64, this offset would be disclosed in the financial statements.) If the right to offset provisions are not met, then the “receivable for security” would be nonadmitted after 15 days under SSAP No. 21R. This would cause a financial statement impact for any nonadmitted asset. If the asset was admitted, there would be an RBC charge for the admitted receivable.

NAIC staff is interested in whether the premium due to the reporting entity from a written derivative would generally meet the “valid right to setoff” provisions from SSAP No. 64. If the conditions would not generally be met, consideration could occur to allow offsetting presentation in Schedule DB-D for these specific situations. This would allow the amount owed to the reporting entity to decrease the derivative obligation regardless of when the amount due would be received. **If this was supported, provisions may be warranted that allow the derivative liability to be reduced to zero, but not permit the derivative to reverse into an asset position without being nonadmitted.**

**Illustration of RBC Charges to Derivative Assets / Liabilities:**

**RBC Impact – P/C and Health Entities**

As detailed below for property/casualty and health entities, the RBC charge is solely driven by the amount of derivative assets reported on the balance sheet. (This is a distinctly different from life reporting entities.) For these entities, the charge does not vary if the derivative is in a liability position or if the entity has received collateral from the counterparty. (The amount reported on balance sheet is impacted by offsetting provisions, but only if there is a valid right to offset.)

If these entities were to engage in financing derivatives, and the impact was to reverse the presentation of the derivative from an asset to a liability, this would have a direct change to the RBC calculation.

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### RBC Impact – Life Insurance Entities

As detailed below for life entities, the RBC charge is not driven by the amount of derivative assets reported on the balance sheet. Instead, the RBC charge is driven by the “net exposure” after considering collateral. In both situations (asset exposure and off-balance sheet exposure), if the derivative is in a liability position, there is no RBC charge. Since the removal of financing components will generally result with previously reported derivative liabilities flipping to represent derivative assets, this could have an RBC impact unless the premium owed to the reporting entity is considered as part of the RBC calculation. The proposal in this agenda item would consider amounts owed from the counterparty for the derivative in determining net exposure.

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<td>Liability &gt; Asset = No Charge</td>
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<td>Collateral &gt; Net Asset = No Charge</td>
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<td></td>
<td>Collateral &lt; Net Assets = Charge based on NAIC designation of counterparty</td>
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### Off BS Exposure

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<td>.300 (NAIC 6)</td>
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Derivative Liability > Derivative Asset = No Charge
Derivative Collateral > Net Derivative Asset = Charge Based on Collateral Not on Derivative
Derivative Collateral < Net Derivative Asset = Derivative Charge Based on NAIC designation of Counterparty

### Existing Authoritative Literature:

- **SSAP No. 64—Offsetting and Netting of Assets and Liabilities**
- **SSAP No. 86—Derivatives**
- **SSAP No. 100—Fair Value**

Key aspects from the standards cited above:
SSAP No. 64—Offsetting and Netting of Assets and Liabilities

2. Assets and liabilities shall be offset and reported net only when a valid right of setoff exists except as provided for in paragraphs 3 and 4. A right of setoff is a reporting entity’s legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying an amount that the other party owes to the reporting entity against the debt. A valid right of setoff exists only when all the following conditions are met:
   a. Each of the two parties owes the other determinable amounts. An amount shall be considered determinable for purposes of this provision when it is reliably estimable by both parties to the agreement;
   b. The reporting party has the right to set off the amount owed with the amount owed by the other party;
   c. The reporting party intends to setoff; and
   d. The right of setoff is enforceable at law.

3. Assets and liabilities that meet the criteria for offset shall not be netted when prohibited by specific statements of statutory accounting principles. An example of such is in the case of reinsurance recoverables on paid losses and ceded premiums payable as provided for in SSAP No. 62R—Property and Casualty Reinsurance.

4. Netting of assets and liabilities for reporting purposes when no valid right of setoff exists shall be allowed only when provided for by specific statements of statutory accounting principles. An example of such is in the case of real estate investments required to be shown net of encumbrances as provided for in SSAP No. 40R—Real Estate Investments.

5. Amounts due to or from affiliates shall be offset and reported net only when the provisions of paragraph 2 are met.

Disclosures

6. The following quantitative information shall be disclosed (separately for assets and liabilities) at the end of each reporting period (interim and annual) when derivative, repurchase and reverse repurchase, and securities borrowing and securities lending assets and liabilities are offset and reported net in accordance with paragraph 2 (valid right to offset):
   a. The gross amounts of recognized assets and recognized liabilities
   b. The amounts offset in accordance with paragraph 2 (valid right to offset)
   c. The net amounts presented in the statement of financial positions.

7. Assets and liabilities that have a valid right to offset under paragraph 2, but are not netted as they are prohibited under paragraph 3, are not required to be captured in the disclosures in paragraph 6.

Relevant Literature

8. This statement adopts paragraphs 1, 7 and 13 of APB Opinion No. 10, Omnibus Opinion—1966 and FASB Interpretation No. 39, Offsetting of Amounts Related to Certain Contracts with modifications (1) to prohibit offsetting as provided in specific statements and require netting when provided in specific statements, and (2) to reject guidance in paragraphs 10, 10A, and 10B of FIN 39, as amended by FSP FIN 39-1, that permits a reporting entity election to offset fair value amounts recognized for derivative instruments and fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral arising from the derivative instruments with the same counterparty under a master netting agreement. Offsetting for statutory accounting purposes is limited to situations meeting the
conditions in paragraph 2 and 4 of this SSAP. This statement adopts FASB Emerging Issues Task Force No. 86-25, Offsetting Foreign Currency Swaps.

9. This statement rejects FSP FIN 39-1, Amendment of FASB Interpretation 39. This statement rejects FASB Interpretation No. 41, Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements. FIN 41 has an offsetting exception for repurchase and reverse repurchase agreements and permits offsetting when the reporting parties do not intend to set off. This guidance is rejected for statutory accounting, and payables under repurchase agreements may only be offset against amounts recognized as receivables under reverse repurchase agreements if there is a valid right to offset meeting all the conditions, including the intent to offset, detailed in paragraph 2. This statement rejects ASU 2011-11, Disclosures about Offsetting Assets and Liabilities and ASU 2013-01, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. Statutory disclosure requirements for assets and liabilities reported net under a valid right to offset are detailed in paragraph 6.

**SSAP No. 86—Derivatives**

11. 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).

**Disclosure Requirements**

12. Reporting entities shall disclose the following for all derivative contracts used:

   a. For derivative contracts with financing premiums:

      i. Disclose the aggregate, non-discounted total premium cost for these contracts and the premium cost due in each of the following four years, and thereafter. Include the aggregate fair value of derivative instruments with financing premiums excluding the impact of the deferred or financing premiums.

      ii. For each derivative contract with financing premiums:

         (a) Whether premium cost is paid throughout the contract, or at derivative maturity;

         (b) Next premium cost payment date;

         (c) Total premium cost;

         (d) Premium cost paid in prior years;

         (e) Current year premium cost paid;

         (f) Future unpaid premium cost;

         (g) Fair value of derivative, excluding impact of financing premiums; and

         (h) Unrealized gain/loss, excluding impact of financing premiums.
b. All derivatives are required to be shown gross on Schedule DB. However, derivatives may be reported net in the financial statements (pages 2 and 3 of the statutory financial statements) in accordance with SSAP No. 64—Offsetting and Netting of Assets and Liabilities when a valid right to offset exists. Derivatives offset in accordance with SSAP No. 64 and reported net in the financial statement shall follow the disclosure requirements in SSAP No. 64, paragraph 6. (Derivative Assets and Derivative Liabilities reported on the balance sheet shall agree to columns 5 and 6, respectively, after netting, on Schedule DB – Part D – Section 1.)

c. The disclosure requirements of paragraphs 59.a., 59.b., and 59.g. shall be included in the annual statement. Refer to the Preamble for further discussion regarding interim disclosure requirements. The disclosure requirements of paragraphs 59.a. through 59.g. shall be included in the annual audited statutory financial reports. The disclosure requirements in paragraph 59.h. shall be included in statutory financial statements (annual and quarterly). Paragraph 62 of the Preamble states that disclosures made within specific schedules or exhibits to the annual statement need not be duplicated in a separate note.

SSAP No. 100—Fair Value

Definition of Fair Value

4. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

5. Asset/Liability – A fair value measurement is for a particular asset or liability. Therefore, the measurement should consider attributes specific to the asset or liability, for example, the condition and/or location of the asset or liability and restrictions, if any, on the sale or use of the asset at the measurement date. The asset or liability might be a standalone asset or liability (for example, a financial instrument or an operating asset) or a group of assets and/or liabilities (for example, an asset group, a reporting unit, or a business).

6. Price – A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale). The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. Therefore, the objective of a fair value measurement is to determine the price that would be received to sell the asset or paid to transfer the liability at the measurement date (an exit price).

11. Application to Assets – A fair value measurement assumes the highest and best use of the asset by market participants, considering the use of the asset that is physically possible, legally permissible, and financially feasible at the measurement date. In broad terms, highest and best use refers to the use of an asset by market participants that would maximize the value of the asset or the group of assets within which the asset would be used. Highest and best use is determined based on the use of the asset by market participants, even if the intended use of the asset by the reporting entity is different.

14. Application to Liabilities – Consideration of non-performance risk (own credit-risk) should not be reflected in the fair value calculation for liabilities (including derivative liabilities) at subsequent measurement. At initial recognition, it is perceived that the consideration of own-credit risk may be inherent in the contractual negotiations resulting in the liability. The consideration of non-performance risk for subsequent measurement is inconsistent with the conservatism and recognition concepts as well as the assessment of financial solvency for insurers, as a decrease in credit standing would effectively decrease reported liabilities and thus seemingly increase the appearance of solvency. Furthermore, liabilities reported or disclosed at “fair value” shall not reflect any third-party credit guarantee of debt.
Fair Value at Initial Recognition

15. When an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price represents the price paid to acquire the asset or received to assume the liability (an entry price). In contrast, the fair value of the asset or liability represents the price that would be received to sell the asset or paid to transfer the liability (an exit price). Conceptually, entry prices and exit prices are different. Entities do not necessarily sell assets at the prices paid to acquire them. Similarly, entities do not necessarily transfer liabilities at the prices received to assume them.

16. In many cases, the transaction price will equal the exit price and, therefore, represent the fair value of the asset or liability at initial recognition. In determining whether a transaction price represents the fair value of the asset or liability at initial recognition, the reporting entity shall consider factors specific to the transaction and the asset or liability. For example, a transaction price might not represent the fair value of an asset or liability at initial recognition if:

   a. The transaction is between related parties.

   b. The transaction occurs under duress or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty.

   c. The market in which the transaction occurs is different from the market in which the reporting entity would sell the asset or transfer the liability, that is, the principal or most advantageous market. For example, those markets might be different if the reporting entity is a securities dealer that transacts in different markets, depending on whether the counterparty is a retail customer (retail market) or another securities dealer (inter-dealer market).

   d. For liabilities, differences may exist as non-performance risk (own credit risk) is not reflected in the fair value (i.e., exit price) determination of all liabilities (including derivatives).

Disclosures about Fair Value of Financial Instruments

54. A reporting entity shall disclose in the notes to the financial statements, as of each date for which a statement of financial position is presented in the quarterly or annual financial statements, the aggregate fair value or NAV for all financial instruments and the level within the fair value hierarchy in which the fair value measurements in their entirety fall. This disclosure shall be summarized by type of financial instrument, for which it is practicable to estimate fair value, except for certain financial instruments identified in paragraph 55. Fair value disclosed in the notes shall be presented together with the related admitted values in a form that makes it clear whether the fair values and admitted values represent assets or liabilities and to which line items in the Statement of Assets, Liabilities, Surplus and Other Funds they relate. Unless specified otherwise in another SSAP, the disclosures may be made net of encumbrances, if the asset or liability is so reported. A reporting entity shall also disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments. If it is not practicable for an entity to estimate the fair value of the financial instrument or a class of financial instruments, and the investment does not qualify for the NAV practical expedient, the aggregate carrying amount for those items shall be reported as “not practicable” with additional disclosure as required in paragraph 48.

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 2016-48 considered accounting and reporting revisions for derivatives with financing premiums. Although discussion occurred proposing a gross accounting and reporting approach, the revisions adopted within that agenda item incorporated aggregate disclosures and new electronic columns in Schedule DB to capture the impact of financing premiums in derivative reporting. With the disclosure adoptions, the Working Group directed NAIC staff to reassess this issue once the impact identified from the data-captured disclosures would be available for review, noting that the earliest for this re-assessment would be Summer 2019.
Agenda item 2013-07, which considered ASU 2013-01: Clarifying the Scope of Disclosures About Offsetting Assets and Liabilities, was finalized on August 24, 2013. This ASU was issued to clarify that the scope of ASU 2011-11 applies to derivatives (including embedded derivatives), repurchase and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either netted as they meet the right of setoff under ASC 210-20-45 or ASC 815-10-45, or are subject to a master netting agreement or similar agreement. The SAP adopted revisions allowed reporting entities to continue offsetting derivatives, repurchase and reverse repurchase agreements, and securities borrowing and securities lending transactions with a valid right of offset, but incorporated disclosures to illustrate the netting impact. This adoption action included a referral to the Blanks (E) Working Group for annual statement instruction revisions and to recommend development of additional schedules to reconcile the amount reported gross on DB to the amount reported net on the balance sheet.

Agenda item 2012-17, which considered ASU 2011-22, Disclosures about Offsetting Assets and Liabilities, was finalized by the Working Group on November 29, 2012. This agenda item adopted revisions to SSAPs No. 64, 86 and 103. The adopted revisions, effective January 1, 2013, 1) revise and clarify that offsetting is only allowed in accordance with SSAP No. 64, paragraphs 2-4; 2) modify the adoption of FIN 39 rejecting the ability to offset in accordance with master netting agreements and rejecting FSP FIN 39-1 and FIN 41; and 3) rejecting ASU 2011-11 for statutory accounting. The Working Group deferred adoption of the disclosures proposed to paragraphs 6-8 of SSAP No. 64 in the exposure as the FASB has recently exposed guidance to narrow the scope GAAP disclosures.

Overview of ASU 2011-11:

ASU 2011-11 was issued in December 2011 to require entities to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting agreement. This ASU was issued as the differences in the offsetting requirements between U.S. GAAP and IFRS accounted for a significant difference in the amounts presented under those standards. These differences reduce the comparability of between U.S. GAAP and IFRS, and the users of financial statements requested that these differences be addressed expeditiously. The objective of the ASU 2011-11 amendments is to facilitate comparison between entities that prepare financial statements under U.S. GAAP and those prepared under IFRS. Reporting entities are required to apply the ASU 2011-11 amendments for annual reporting periods beginning on or after Jan. 1, 2013, and interim periods within those annual periods. Entities are required to provide the disclosures required by those amendments retrospectively for all comparative periods presented.

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

Staff Recommendation:

NAIC staff recommends that statutory accounting revisions be considered to ensure consistency in the gross reporting of derivatives - without inclusion of financing components - and consistency in reporting amounts owed to / from the reporting entity from the acquisition or writing of derivatives. NAIC staff highlights that the concepts are consistent with existing statutory accounting guidelines but require clarification changes to ensure uniform application across the industry. **NAIC staff recommends that the Working Group move this item to the active listing, classified as nonsubstantive, and expose revisions to SSAP No. 86 to clarify the reporting of derivatives with financing premiums.** With the proposed revisions, NAIC staff is suggesting reporting revisions that would allow the present value of the derivative premium receivable (and payable) for financed derivatives to be factored into the counterparty risk assessment for life RBC.

In addition to the proposed revisions, comments are requested as to whether derivatives and related financing provisions would generally not meet the SSAP No. 64 right to offset criteria and if explicit guidance allowing offset should be considered. (Allowing offset only impacts the amount reported on balance
sheet and does not impact the gross amount reported on Schedule DB-A or DB-B. The offset provision would impact RBC for p/c and health companies but would not impact the RBC for life reporting entities.)

(Regulator Inquiry) - Derivative profile reports are only provided for life reporting entities. These reports provide assessments on the overall net derivative position (assets less liabilities). Would it be beneficial to regulators if derivative profile reports were available for p/c and health entities and if the reports completed assessments based on derivative assets and derivative liabilities separately? (For example, a life company with $2.1 billion in derivative assets and $2.0 billion in derivative liabilities would currently have a derivative profile report for the $100 million net derivative asset. This report would detail changes in the net asset, but if derivative assets increased to $3.1 assets and derivative liabilities increased to $3.0, the profile report would not detail the change as the net asset would still reflect $100 million) It is staff’s interpretation that the limits on derivative activity per NAIC Model 280 are anticipated to be “absolute value” of derivative assets and derivative liabilities (and not the net between assets and liabilities). The language in the Model is consistent with the Supplemental Investment Risk Interrogatory that requests “aggregate” amounts with a percentage of admitted assets, with identification that the amount should agree to Schedule DB. **NAIC staff requests regulator comment on the interpretation of the word “aggregate” (and whether it is intended to be “absolute value” and whether the information in the statutory financials or ISITE tools (profile reports) provide the information needed for regulator assessments of derivative activity.**

Excerpt from Model 280, Investments of Insurers Model Act (Defined Limits Version):

B.  Limitations on Hedging Transactions

An insurer may enter into hedging transactions under this section if, as a result of and after giving effect to the transaction:

1. The aggregate statement value of options, caps, floors and warrants not attached to another financial instrument purchased and used in hedging transactions does not exceed seven and one half percent (7.5%) of its admitted assets;

2. The aggregate statement value of options, caps and floors written in hedging transactions does not exceed three percent (3%) of its admitted assets; and

3. The aggregate potential exposure of collars, swaps, forwards and futures used in hedging transactions does not exceed six and one-half percent (6.5%) of its admitted assets.

As noted in the recommendation, the revisions are in line with existing SAP concepts. These concepts and excerpts are specifically detailed below:

1. **Gross Reporting** – SSAP No. 86, and the reporting instructions for Schedule DB, is explicit that derivatives are required to be shown gross on Schedule DB. Net reporting is permitted on the balance sheet when a valid right to offset exists, but derivatives offset under SSAP No. 64 are required to follow the disclosure requirements in SSAP No. 64:

   54.h. All derivatives are required to be shown gross on Schedule DB. However, derivatives may be reported net in the financial statements (pages 2 and 3 of the statutory financial statements) in accordance with **SSAP No. 64—Offsetting and Netting of Assets and Liabilities** (SSAP No. 64) when a valid right to offset exists. Derivatives offset in accordance with SSAP No. 64 and reported net in the financial statement shall follow the disclosure requirements in SSAP No. 64, paragraph 6. (Derivative Assets and Derivative Liabilities reported on the balance sheet shall agree to columns 5 and 6, respectively, after netting, on Schedule DB – Part D – Section 1.)
2. **Accounting at Date of Acquisition** – SSAP No. 86, and the reporting instructions for Schedule DB, is explicit that the premium paid or received for writing a derivative shall either be recorded as an asset (purchase) or liability (written) on the derivative line on the assets or liability page:

Exhibit C:

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

3. **Liability Recognition** - The deferred premium (or financing premium) is a cost to acquire / enter into the derivative contract and is not impacted by an underlying interest of the derivative agreement (the cost to acquire is not impacted by derivative instrument performance). Upon entering the derivative contract the financing premium owed by the reporting entity meets the definition of a liability under SSAP No. 5R:

   10. A liability is defined as certain or probable 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).

   11. 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 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.

**NOTE:** The deferred premium is a contractual element of the derivative contract and does not fluctuate or change as a result of the underlying derivative.

Recognizing the liability is also consistent with the Statutory Accounting Statement of Concept of Recognition detailed in the Preamble (paragraph 37):

**Recognition**

35. The principal focus of solvency measurement is determination of financial condition through analysis of the balance sheet. However, protection of the policyholders can only be maintained through continued monitoring of the financial condition of the insurance enterprise. Operating performance is another indicator of an enterprise’s ability to maintain itself as a going concern. Accordingly, the income statement is a secondary focus of statutory accounting and should not be diminished in importance to the extent contemplated by a liquidation basis of accounting.

36. 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 but rather should be charged against surplus when acquired or when availability otherwise becomes questionable.
37. **Liabilities require recognition as they are incurred.** Certain statutorily mandated liabilities may also be required to arrive at conservative estimates of liabilities and probable loss contingencies (e.g., interest maintenance reserves, asset valuation reserves, and others).

4. **Derivative Instrument** - The deferred premium (or financing premium) is the cost to acquire a derivative and is not a “derivative instrument” per the definition in SSAP No. 86:

4. “Derivative instrument” means an agreement, option, instrument or a series or combination thereof:

   a. To make or take delivery of, or assume or relinquish, a specified amount of one or more underlying interests, or to make a cash settlement in lieu thereof; or

   b. That has a price, performance, value or cash flow based primarily upon the actual or expected price, level, performance, value or cash flow of one or more underlying interests.

13. An “underlying” is a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, or other variable (including the occurrence or nonoccurrence of a specified event such as a scheduled payment under contract). An underlying may be a price or rate of an asset or liability but is not the asset or liability itself.

5. **Offsetting Disclosures:** Guidance exists in SSAP No. 64 for the offsetting when there is a valid right to offset, and this guidance specifically references derivative transactions. This disclosure was added to ensure effective comparability across reporting entities, and ensure that the gross information reported on Schedule DB could be agreed to the information reported on the balance sheet:

6. The following quantitative information shall be disclosed (separately for assets and liabilities) at the end of each reporting period (interim and annual) when derivative, repurchase and reverse repurchase, and securities borrowing and securities lending assets and liabilities are offset and reported net in accordance with paragraph 2 (valid right to offset):

   d. The gross amounts of recognized assets and recognized liabilities

   e. The amounts offset in accordance with paragraph 2 (valid right to offset)

   f. The net amounts presented in the statement of financial positions.

**Staff Review Completed by:**
Julie Gann – NAIC Staff – October 2019

**October 2019 - Proposed Revisions to SSAP No. 86:**

4. “Derivative instrument” means an agreement, option, instrument or a series or combination thereof:

   a. To make or take delivery of, or assume or relinquish, a specified amount of one or more underlying interests, or to make a cash settlement in lieu thereof; or

   b. That has a price, performance, value or cash flow based primarily upon the actual or expected price, level, performance, value or cash flow of one or more underlying interests.

5. Derivative instruments include, but are not limited to; options, warrants used in a hedging transaction and not attached to another financial instrument, caps, floors, collars, swaps, forwards, futures, structured notes with risk of principal/original investment loss based on the terms of the agreement (in addition to default risk), and any other agreements or instruments substantially similar thereto or any series or combination thereof.
a. “Caps” are option contracts in which the cap writer (seller), in return for a premium, agrees to limit, or cap, the cap holder’s (purchaser) risk associated with an increase in a reference rate or index. For example, in an interest rate cap, if rates go above a specified interest rate level (the strike price or the cap rate), the cap holder is entitled to receive cash payments equal to the excess of the market rate over the strike price multiplied by the notional principal amount. Because a cap is an option-based contract, the cap holder has the right but not the obligation to exercise the option. If rates move down, the cap holder has lost only the premium paid. A cap writer has virtually unlimited risk resulting from increases in interest rates above the cap rate.

b. “Collar” means an agreement to receive payments as the buyer of an option, cap or floor and to make payments as the seller of a different option, cap or floor.

c. “Floors” are option contracts in which the floor writer (seller), in return for a premium, agrees to limit the risk associated with a decline in a reference rate or index. For example, in an interest rate floor, if rates fall below an agreed rate, the floor holder (purchaser) will receive cash payments from the floor writer equal to the difference between the market rate and an agreed rate multiplied by the notional principal amount.

d. “Forwards” are agreements (other than futures) between two parties that commit one party to purchase and the other to sell the instrument or commodity underlying the contract at a specified future date. Forward contracts fix the price, quantity, quality, and date of the purchase and sale. Some forward contracts involve the initial payment of cash and may be settled in cash instead of by physical delivery of the underlying instrument.

e. “Futures” are standardized forward contracts traded on organized exchanges. Each exchange specifies the standard terms of futures contracts it sponsors. Futures contracts are available for a wide variety of underlying instruments, including insurance, agricultural commodities, minerals, debt instruments (such as U.S. Treasury bonds and bills), composite stock indices, and foreign currencies.

f. “Options” are contracts that give the option holder (purchaser of the option rights) the right, but not the obligation, to enter into a transaction with the option writer (seller of the option rights) on terms specified in the contract. A call option allows the holder to buy the underlying instrument, while a put option allows the holder to sell the underlying instrument. Options are traded on exchanges and over the counter.

g. “Structured Notes” in scope of this statement are instruments (often in the form of debt instruments), in which the amount of principal repayment or return of original investment is contingent on an underlying variable/interest. Structured notes that are “mortgage-referenced securities” are captured in SSAP No. 43R—Loan-backed and Structured Securities.

h. “Swaps” are contracts to exchange, for a period of time, the investment performance of one underlying instrument for the investment performance of another underlying instrument, typically, but not always, without exchanging the instruments themselves. Swaps can be viewed as a series of forward contracts that settle in cash and, in some instances, physical delivery. Swaps generally are negotiated over-the-counter directly between the dealer and the end user. Interest

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1 The “structured notes” captured within scope of this statement is specific to instruments in which the terms of the agreement make it possible that the reporting entity could lose all or a portion of its original investment amount (for other than failure of the issuer to pay the contractual amounts due). These instruments incorporate both the credit risk of the issuer, as well as the risk of an underlying variable/interest (such as the performance of an equity index or the performance of an unrelated security). Securities that are labeled “principal-protected notes” are captured within scope of this statement if the “principal protection” involves only a portion of the principal and/or if the principal protection requires the reporting entity to meet qualifying conditions in order to be safeguarded from the risk of loss from the underlying linked variable. Securities that may have changing positive interest rates in response to a linked underlying variable, or the passage of time, or that have the potential for increased principal repayments in response to a linked variable (such as U.S. Treasury Inflation-Indexed Securities) that do not incorporate risk of original investment /principal loss (outside of default risk) are not captured as structured notes in scope of this statement.
rate swaps are the most common form of swap contract. However, foreign currency, commodity, and credit default swaps also are common.

i. “Swaptions” are contracts granting the owner the right, but not the obligation, to enter into an underlying swap. Although options can be traded on a variety of swaps, the term “swaption” typically refers to options on interest rate swaps. A swaption hedges the buyer against downside risk, as well as lets the buyer take advantage of any upside benefits. That is, it gives the buyer the benefit of the agreed-upon rate if it is more favorable than the current market rate, with the flexibility of being able to enter into the current market swap rate if it is preferable. Conversely, the seller of swaptions assumes the downside risk, but benefits from the amount paid for the swaption, regardless if it is exercised by the buyer and the swap is entered into.

j. “Warrants” are instruments that give the holder the right to purchase an underlying financial instrument at a given price and time or at a series of prices and times outlined in the warrant agreement. Warrants may be issued alone or in connection with the sale of other securities, for example, as part of a merger or recapitalization agreement, or to facilitate divestiture of the securities of another business entity. Publicly traded stock warrants are captured in scope of SSAP No. 30R—Unaffiliated Common Stock. All other warrants, including non-publicly traded stock warrants, shall be captured in scope of SSAP No. 86.

6. “Derivative Premium” is the cost to acquire or write a derivative contract. Derivative premium is not an “underlying” in a derivative contract and is not impacted by changes in an underlying interest of the derivative agreement. A derivative with contract terms that finance the derivative premium, so that the cost is paid or received throughout the derivative term or at derivative maturity, does not result with an “embedded derivative” addressed in paragraph 16.

6.7. “Firm commitment” is an agreement with an unrelated party, binding on both parties and expected to be legally enforceable, with the following characteristics:

a. The agreement specifies all significant terms, including the quantity to be exchanged, the fixed price, and the timing of the transaction. The fixed price may be expressed as a specified amount of an entity’s functional currency or of a foreign currency. It may also be expressed as a specified interest rate or specified effective yield;

b. The agreement includes a disincentive for nonperformance that is sufficiently large to make performance probable; and

c. For investments in subsidiary, controlled, and affiliated entities (as defined by SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities (SSAP No. 97)) and investments in limited liability companies (as defined by SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies) it must be probable that acquisition will occur within a reasonable period of time.

7.8. A hedging transaction is defined as a derivative(s) transaction which is entered into and maintained to reduce:

a. The risk of a change in the fair value or cash flow of assets and liabilities which the reporting entity has acquired or incurred or has a firm commitment to acquire or incur or for which the entity has forecasted acquisition or incurrence; or

b. The currency exchange rate risk or the degree of foreign currency exposure in assets and liabilities which a reporting entity has acquired or incurred or has a firm commitment to acquire or incur or for which the entity has forecasted acquisition or incurrence.

8.9. “Income generation transaction” is defined as derivatives written or sold to generate additional income or return to the reporting entity. They include covered options, caps, and floors (e.g., a reporting entity writes an equity call option on stock that it already owns).
9.10. “Replication (Synthetic Asset) transaction” is a derivative transaction entered into in conjunction with other investments in order to reproduce the investment characteristics of otherwise permissible investments. A derivative transaction entered into by an insurer as a hedging or income generation transaction shall not be considered a replication (synthetic asset) transaction.

10.11. “Forecasted transaction” is a transaction that is expected to occur for which there is no firm commitment. Because no transaction or event has yet occurred and the transaction or event when it occurs will be at the prevailing market price, a forecasted transaction does not give an entity any present rights to future benefits or a present obligation for future sacrifices.

11.12. An "underlying" is a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, or other variable (including the occurrence or nonoccurrence of a specified event such as a scheduled payment under contract). An underlying may be a price or rate of an asset or liability but is not the asset or liability itself.

12.13. “Benchmark Interest Rate” is a widely recognized and quoted rate in an active financial market that is broadly indicative of the overall level of interest rates attributable to high-credit-quality obligors in that market. It is a rate that is widely used in a given financial market as an underlying basis for determining the interest rates of individual financial instruments and commonly referenced in interest-rate-related transactions. In theory, the benchmark interest rate should be a risk-free rate (that is, has no risk of default). In some markets, government borrowing rates may serve as a benchmark. In other markets, the benchmark interest rate may be an interbank offered rate. In the United States, the interest rates on direct Treasury obligations of the U.S. government, the London Interbank Offered Rate (LIBOR) swap rate, the Fed Funds Effective Rate Overnight Index Swap Rate, the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate, and the Secured Overnight Financing Rate (SOFR) Overnight Index Swap Rate are considered to be benchmark interest rates.

13.14. “Weather derivatives” are defined as a forward-based or option-based contract for which settlement is based on a climatic or geological variable. One example of such a variable is the occurrence or nonoccurrence of a specified amount of snow at a specified location within a specified period of time.

14.15. “Notional amount” is defined as the face value of a financial instrument in a derivatives transaction as of a reporting date which is used to calculate future payments in the reporting currency. Notional amount may also be referred to as notional value or notional principal amount. The notional amount reported should remain static over the life of a trade unless the instrument is partially unwound or has a contractually amortizing notional. The notional amount shall apply to derivative transactions as follows:

a. For derivative instruments other than futures contracts (e.g., options, swaps, forwards), the notional amount is either the amount to which interest rates are applied in order to calculate periodic payment obligations or the amount of the contract value used to determine the cash obligations. Non-U.S. dollar contracts must be multiplied or divided by the appropriate inception foreign currency rate.

b. For futures contracts, with a U.S. dollar-denominated contract size (e.g., Treasury note and bond contracts, Eurodollar futures) or underlying, the notional amount is the number of contracts at the reporting date multiplied by the contract size (value of one point multiplied by par value).

c. For equity index and similar futures, the number of contracts at the reporting date is multiplied by the value of one point multiplied by the transaction price. Non-U.S. dollar

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2 The definition in paragraph 14 is intended to be a principle for determining notional for all derivative instruments. To the extent a derivative type is not explicitly addressed in paragraph 14.a. through paragraph 14.c., notional should be reported in a manner consistent with this principle.
contract prices must be multiplied or divided by the appropriate inception foreign currency rate.

15. “Variation Margin” reflects the daily change in market value of derivative contracts (e.g., daily gain/loss on a derivative contract due to market movements). Amounts received/paid to adjust variation margin on derivative contracts that are both cleared and settled on an exchange shall be recognized as an adjustment to the carrying value of the derivative contract (e.g., futures). Amounts received/paid to adjust variation margin on all other derivative contracts shall be recognized on the balance sheet as an asset or liability separate from the carrying value of the derivative instrument. This treatment shall occur under statutory accounting regardless if the counterparty/exchange considers amounts exchanged for variation margin to be legal settlement or collateral. Changes in variation margin shall not be treated as realized gains or adjustments to the basis of the hedged item until the derivative contract has been sold, matured or expired.

Embedded Derivative Instruments

16. Contracts that do not in their entirety meet the definition of a derivative instrument, such as bonds, insurance policies, and leases, may contain “embedded” derivative instruments—implicit or explicit terms that affect some or all of the cash flows or the value of other exchanges required by the contract in a manner similar to a derivative instrument. The effect of embedding a derivative instrument in another type of contract (“the host contract”) is that some or all of the cash flows or other exchanges that otherwise would be required by the contract, whether unconditional or contingent upon the occurrence of a specified event, will be modified based on one or more underlyings. An embedded derivative instrument shall not be separated from the host contract and accounted for separately as a derivative instrument.

Impairment

17. This statement adopts the impairment guidelines established by SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5R) for the underlying financial assets or liabilities.

Derivative Premium (New Section – All Other Sections Renumbered Accordingly)

19. Derivative premium is the amount paid (acquired derivative) or received (written derivative) to enter into a derivative contract. At inception, the premium generally represents the fair value of the derivative. Derivative premium that is not paid or received at inception represents a liability or receivable for the reporting entity. Derivatives with premiums not remitted at acquisition are considered “financed derivatives.” Financed derivatives shall be reported in accordance with the following provisions:

a. At acquisition and subsequently, the gross reported fair value of the derivative shall exclude the impact of financing premiums. Only market changes in the actual fair value of the derivative shall be reflected as unrealized gains or losses.

b. At acquisition and subsequently, premiums payable (acquired derivative) and premiums receivable (written derivatives) shall be separately reported as “payable for securities” and “receivables for securities.”

c. If premium payable or receivable meet the requirement for a valid right of setoff with the derivative in accordance with SSAP No. 64, the derivative asset can be reduced by a premium payable, and a derivative liability can be reduced by a premium receivable for overall reporting on the balance sheet. This offset provision does not permit a derivative asset to be reported as a derivative liability (or vice versa) due to premium payable or receivable. Rather, once a derivative asset (or liability) is fully reduced by a premium

Footnote: This paragraph does not include derivative premium financing arrangements. Derivatives and financed premiums are subject to separate reporting as detailed in paragraph 19.
liability (or receivable), any remaining premium liability (or receivable) shall be reported as a “payable for security” or “receivable for security” pursuant to paragraph 19.b. This net balance sheet reporting does not impact the gross presentation of open derivatives on Schedule DB-A or Schedule DB-B. If reported net on the balance sheet due to a valid right to offset, the offsetting adjustment shall be shown on schedule DB-D and the SSAP No. 64 disclosures are required.

Recognition and Measurement of Derivatives Used in Hedging Transactions

48-20. Derivative instruments represent rights or obligations that meet the definitions of assets (SSAP No. 4—Assets and Nonadmitted Assets) or liabilities (SSAP No. 5R) and shall be reported in financial statements. In addition, derivative instruments also meet the definition of financial instruments as defined in SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures (SSAP No. 27). Should the cost basis of the derivative instrument be undefined (i.e., no premium is paid), the instrument shall be disclosed in accordance with paragraphs 44-47 of SSAP No. 100—Fair Value (SSAP No. 100). Derivative instruments are admitted assets to the extent they conform to the requirements of this statement.

49-21. 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).

Staff Note: Paragraphs 22-38 not duplicated.

Documentation Guidance

39. At inception of the hedge, documentation must include:

a. A formal documentation of the hedging relationship and the entity’s risk management objective and strategy for undertaking the hedge, including identification of the hedging instrument, the hedged item, the nature of the risk being hedged, and how the hedging instrument’s effectiveness in offsetting the exposure to changes in the hedged item’s fair value or variability in cash flows attributable to the hedged risk will be assessed. There must be a reasonable basis for how the entity plans to assess the hedging instrument’s effectiveness;

b. An entity’s defined risk management strategy for a particular hedging relationship may exclude certain components of a specific hedging derivative’s change in fair value, such as time value, from the assessment of hedge effectiveness, as discussed in paragraph 38 and Exhibit B;

c. Signature of approval, for each instrument, by person(s) authorized, either by the entity's board of directors or a committee authorized by the board, to approve such transactions; and

4 Pursuant to paragraph 19, the gross reported value of a derivative and the determination of unrealized gains or losses shall exclude the impact of financing premiums. Premiums payable or receivable from the acquisition or writing of a derivative shall not be reflected in the gross reporting of derivatives or in determining the fair value change in a derivative.
d. A description of the reporting entity’s methodology used to verify that opening transactions do not exceed limitations promulgated by the state of domicile.

**Staff Note: Paragraphs 40-58 not duplicated.**

Disclosure Requirements

59. Reporting entities shall disclose the following for all derivative contracts used:

h. For derivative contracts with financing premiums:

i. Disclose the aggregate, non-discounted total premium cost for these contracts and the premium cost due in each of the following four years, and thereafter. Also disclose include—the aggregate fair value of derivative instruments with financing premiums excluding the impact of the deferred or financing premiums.

ii. For each derivative contract with financing premiums:

   (a) Whether premium cost is paid throughout the contract, or at derivative maturity;
   (b) Next premium cost payment date;
   (c) Total premium cost;
   (d) Premium cost paid in prior years;
   (e) Current year premium cost paid;
   (f) Future unpaid premium cost;
   (g) Fair value of derivative, excluding impact of financing premiums; and
   (h) Unrealized gain/loss, excluding impact of financing premiums.

**Staff Note: With the proposed revisions to clarify gross reporting without financing premiums, these disclosures will not be considered necessary. Comments are requested whether it would be beneficial to retain these columns and capture the fair value of the derivative with the impact of financing premiums.**

i. All derivatives are required to be shown gross on Schedule DB. However, derivatives may be reported net in the financial statements (pages 2 and 3 of the statutory financial statements) in accordance with SSAP No. 64—Offsetting and Netting of Assets and Liabilities when a valid right to offset exists. Derivatives offset in accordance with SSAP No. 64 and reported net in the financial statement shall follow the disclosure requirements in SSAP No. 64, paragraph 6. (Derivative Assets and Derivative Liabilities reported on the balance sheet shall agree to columns 5 and 6, respectively, after netting, on Schedule DB – Part D – Section 1.)
**Proposed Revisions to Schedule DB-D – Counterparty Exposure**

As detailed in this agenda item, NAIC staff suggests consideration on whether premiums due to / from a counterparty should be used in determining the net derivative exposure. This approach would allow the clarifications for gross reporting (excluding financing derivatives) to not impact a life insurer’s RBC calculation for derivative activity as the financing premiums owed by the reporting entity would be considered similar to collateral received.

Below is a simplified version of Schedule DB-D with the potential column.

<table>
<thead>
<tr>
<th>1</th>
<th>2</th>
<th>4</th>
<th>New Column</th>
<th>5</th>
<th>6</th>
<th>7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Description of Exchange, Counterparty or Central Clearinghouse</td>
<td>Master Agreement (Y / N)</td>
<td>Fair Value of Acceptable Collateral</td>
<td>Present Value of Financing Premiums</td>
<td>Contracts with BACV &gt; 0</td>
<td>Contracts with BACV &lt; 0</td>
<td>Exposure Net of Collateral</td>
</tr>
<tr>
<td>Gross Totals</td>
<td>Offset Per SSAP No. 64</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Net After Right to Offset</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

If this column was added, and the derivatives reported in column 5 and 6 were gross of financing premiums, the amount reported in column 7 would be determined as follows:

Column 7 – Exposure Net of Collateral (Book/Adjusted Carrying Value)

For the aggregate reporting of Exchange-Traded Derivatives (Line 0199999999), show the amount in Column 5.

For OTC counterparties, if no master agreement is in place, show the sum of the Book/Adjusted Carrying Values of all derivative instruments with the counterparty that has a positive Book/Adjusted Carrying Value, less any Acceptable Collateral and the Present Value of Financing Premiums (Column 5 – Column 4 – New Column).

For OTC counterparties with a master agreement in place and central clearinghouses, show the net sum of the Book/Adjusted Carrying Values of all derivative instruments, less any acceptable collateral and the present value of financing premiums (Column 5 + Column 6 – Column 4 – New Column).

This amount should not be less than zero.

For life insurance entities, the positive amount reported in column 7 is then accessed RBC based on the NAIC designation of the counterparty. When reporting the gross fair value of derivatives with capturing the financing premiums, the premiums due from or owed to the counterparty is factored into the calculation to reflect net counterparty exposure. This reporting will not impact P/C or Health entities (regardless if they engage in financing derivatives), as their RBC is based on derivative assets as reported on the balance sheet.

**Status:**
On December 7, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to **SSAP No. 86—Derivatives**, as illustrated above, to clarify the reporting of derivatives with financing premiums. The reporting revisions propose allowing
the present value of the derivative premium receivable (and payable) for financed derivatives to be factored into the counterparty risk assessment for life RBC. (If supported, RBC changes would be subsequently referred to the Capital Adequacy (E) Task Force for consideration.) Comments are also requested as to whether derivatives and related financing provisions that would generally not meet the SSAP No. 64—Offsetting and Netting of Assets and Liabilities right to offset criteria and if explicit guidance allowing offset should be considered.

On March 18, 2020, the Statutory Accounting Principles (E) Working Group exposed this agenda item with slight revisions from the prior exposure (shaded) to delete the proposed new paragraph 19.c., as recommended by interested parties. The exposed revisions, as illustrated below, ensure consistency in the gross reporting of derivatives, without inclusion of financing components, and in reporting amounts owed to/from the reporting entity from the acquisition or writing of derivatives. With this exposure, a blanks proposal will be sponsored and notice of the proposed edits will be provided to the Capital Adequacy (E) Task Force. This item has a comment period deadline ending May 29, 2020.

Proposed Revisions to SSAP No. 86:

6. “Derivative Premium” is the cost to acquire or write a derivative contract. Derivative premium is not an “underlying” in a derivative contract and is not impacted by changes in an underlying interest of the derivative agreement. A derivative with contract terms that finance the derivative premium, so that the cost is paid or received throughout the derivative term or at derivative maturity, does not result with an “embedded derivative” addressed in paragraph 16.

Impairment

18. This statement adopts the impairment guidelines established by SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5R) for the underlying financial assets or liabilities.

Derivative Premium (New Section – All Other Sections Renumbered Accordingly)

19. Derivative premium is the amount paid (acquired derivative) or received (written derivative) to enter into a derivative contract. At inception, the premium generally represents the fair value of the derivative. Derivative premium that is not paid or received at inception represents a liability or receivable for the reporting entity. Derivatives with premiums not remitted at acquisition are considered “financed derivatives.” Financed derivatives shall be reported in accordance with the following provisions:

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   c. If premium payable or receivable meet the requirement for a valid right of setoff with the derivative in accordance with SSAP No. 64, the derivative asset can be reduced by a premium payable, and a derivative liability can be reduced by a premium receivable for overall reporting on the balance sheet. This offset provision does not permit a derivative asset to be reported as a derivative liability (or vice versa) due to premium payable or receivable. Rather, once a derivative asset (or liability) is fully reduced by a premium liability (or receivable), any remaining premium liability (or receivable) shall be reported as a “payable for security” or “receivable for security” pursuant to paragraph 19.b. This net balance sheet reporting does not impact the gross presentation of open derivatives on Schedule DB-A or Schedule DB-B. If reported net on the balance sheet due to a valid right to offset, the offsetting adjustment shall be shown on schedule DB-D and the SSAP No. 64 disclosures are required.
Recognition and Measurement of Derivatives Used in Hedging Transactions

19.20. Derivative instruments represent rights or obligations that meet the definitions of assets (SSAP No. 4—Assets and Nonadmitted Assets) or liabilities (SSAP No. 5R) and shall be reported in financial statements. In addition, derivative instruments also meet the definition of financial instruments as defined in SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures (SSAP No. 27). Should the cost basis of the derivative instrument be undefined (i.e., no premium is paid), the instrument shall be disclosed in accordance with paragraphs 44-47 of SSAP No. 100—Fair Value (SSAP No. 100). Derivative instruments are admitted assets to the extent they conform to the requirements of this statement.

20.21. 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).

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Proposed Revisions to Schedule DB-D – Counterparty Exposure

As detailed in this agenda item, NAIC staff suggests consideration on whether premiums due to / from a counterparty should be used in determining the net derivative exposure. This approach would allow the clarifications for gross reporting (excluding financing derivatives) to not impact a life insurer’s RBC calculation for derivative activity as the financing premiums owed by the reporting entity would be considered similar to collateral received.

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For OTC counterparties, if no master agreement is in place, show the sum of the Book/Adjusted Carrying Values of all derivative instruments with the counterparty that has a positive Book/Adjusted Carrying Value, less any Acceptable Collateral and the Present Value of Financing Premiums (Column 5 – Column 4 – New Column).

For OTC counterparties with a master agreement in place and central clearinghouses, show the net sum of the Book/Adjusted Carrying Values of all derivative instruments, less any acceptable collateral and the present value of financing premiums (Column 5 + Column 6 – Column 4 – New Column).

This amount should not be less than zero.

For life insurance entities, the positive amount reported in column 7 is then accessed RBC based on the NAIC designation of the counterparty. When reporting the gross fair value of derivatives with capturing the financing premiums, the premiums due from or owed to the counterparty is factored into the calculation to reflect net counterparty exposure. This reporting will not impact P/C or Health entities (regardless if they engage in financing derivatives), as their RBC is based on derivative assets as reported on the balance sheet.
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Update / Remove References to SVO Listings

Check (applicable entity):

<table>
<thead>
<tr>
<th>Modification of Existing SSAP</th>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Issue or SSAP</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interpretation</td>
<td></td>
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</tr>
</tbody>
</table>


1. The first proposal was to rename the “U.S. Direct Obligations/Full Faith and Credit Exempt List” to the “NAIC U.S. Government Money Market Fund List.” No revisions to the NAIC Accounting Practices and Procedures (AP&P) Manual would be required, as this list is not specifically identified. (Revisions would likely be needed in the Blanks and RBC filings / instructions.)

2. The second proposal was to discontinue the “NAIC Bond Fund List.” Items which were on this list would be eligible for consideration for the “NAIC Fixed Income-Like SEC Registered Funds List.” The discontinuance of usage of the NAIC Bond Fund List will require an update in the AP&P Manual. (Although the “bond list,” this listing requires 100% government securities in the fund.)

Edited excerpt from the VOSTF referral:
The NAIC Bond Fund List (Bond List), published monthly by the SVO, is a list limited to funds that maintain the highest credit quality rating, maintain the highest market risk rating, and invests 100% of its total assets in U.S. Government securities along with several other restrictive criteria. Only four funds qualify for this list and only four insurers invest in any of the funds. According to the SVO, a combined exposure of $11.8 million BACV was noted in any of the four qualifying funds as of December 31, 2018. Given the limited number of insurers investing in these specific funds, the SVO proposed eliminating this list when the four funds come up for renewal in 2020. Upon renewal, the funds on the NAIC Bond Fund List would be eligible for the “NAIC Fixed Income-Like SEC Registered Funds List.” Elimination of the “bond fund list” would result in migrating these funds over to the NAIC Fixed Income-Like SEC Registered Funds List, which will be reported on Schedule D, Part 2 under SSAP No. 30R – Unaffiliated Common Stock.

Existing Authoritative Literature:
The Bond List is specifically noted in two SSAP’s as detailed below:

SSAP No. 26R—Bonds

3. Bonds shall be defined as any securities representing a creditor relationship, whereby there is a fixed schedule for one or more future payments. This definition includes:
   a. U.S. Treasury securities;
   b. U.S. government agency securities;
   c. Municipal securities;
   d. Corporate bonds, including Yankee bonds and zero-coupon bonds;
e. Convertible bonds, including mandatory convertible bonds as defined in paragraph 11.b;

f. Fixed-income instruments specifically identified:
   i. Certifications of deposit that have a fixed schedule of payments and a maturity date in excess of one year from the date of acquisition;
   ii. Bank loans issued directly by a reporting entity or acquired through a participation, syndication or assignment;
   iii. Hybrid securities, excluding: surplus notes, subordinated debt issues which have no coupon deferral features, and traditional preferred stocks.
   iv. Debt instruments in a certified capital company (CAPCO)

4. The definition of a bond, per paragraph 3, does not include equity/fund investments, such as mutual funds or exchange-traded funds. However, the following types of SVO-identified investments are provided special statutory accounting treatment and are included within the scope of this statement. These investments shall follow the guidance within this statement, as if they were bonds, unless different treatment is specifically identified in paragraphs 23-29.

   a. Exchange traded funds (ETFs), which qualify for bond treatment, as identified in Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office and published on the SVO’s web page of www.NAIC.org. (SVO-identified ETFs are reported on Schedule D – Part 1.)
   b. Bond mutual funds which qualify for the Bond List, as identified in Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office and published on the SVO’s web page of www.NAIC.org. (SVO-identified bond mutual funds are reported on Schedule D – Part 1.)

SSAP No. 30R—Unaffiliated Common Stock

3. Common stocks (excluding investments in affiliates) are securities which represent a residual/subordinate ownership in a corporation. This definition includes:

   a. Publicly traded common stocks;
   b. Common stocks that are not publicly traded; and
   c. Common stocks restricted as to transfer of ownership

4. In addition, the following equity investments are captured within scope of this statement:

   a. Master limited partnerships trading as common stock and American deposit receipts only if the security is traded on the New York or NASDAQ exchange;
   b. Publicly traded common stock warrants;
   c. Shares of SEC registered Investment Companies captured under the Investment Company Act of 1940 (open-end investment companies (mutual funds), closed-end funds and unit investment trusts), regardless of the types or mix of securities owned by the fund (e.g., bonds or stocks), except for Bond Mutual Funds which qualify for bond treatment, as identified in Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office and published on the SVO’s web page of www.NAIC.org;
d. Exchange Traded Funds, except for those identified for bond or preferred stock treatment, as identified in Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office and published on the SVO’s web page of www.NAIC.org; and

e. Foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction. Other foreign funds are excluded from the scope of this statement.

f. Equity interests in certified capital companies in accordance with INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO).

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

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

Convergence with International Financial Reporting Standards (IFRS): N/A

Staff Recommendation:

NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to 1) SSAP No. 26R—Bonds and SSAP No. 30R—Unaffiliated Common Stock to eliminate references to the NAIC Bond Fund List (Bond List) and 2) add reference to the “NAIC Fixed Income-Like SEC Registered Funds List” in SSAP No. 30R.

Although the Working Group is recommended to proceed with exposure on this agenda item and solicit comments for consideration, final action and determination of an effective date will not occur until revisions have first been adopted by the Valuation of Securities (E) Task Force. NAIC SAPWG staff will coordinate with the VOSTF staff to stay current on their discussion and action on this item. NAIC staff also notes that referrals to the Blanks (E) Working Group and the Capital Adequacy (E) Task Force will be needed to reflect the title change in Blanks and RBC.

NAIC staff also highlights that the reference to the SVO “bond fund list” often causes confusion as this listing only includes funds with 100% of their investments in U.S. Government Securities. If the action to delete the listing does not occur at the Task Force, NAIC staff would recommend that the listing name be revised to reflect the “U.S. Government Fund” to eliminate confusion through reference as a “bond fund” listing.

Proposed Revisions to SSAP No. 26R—Bonds

4. The definition of a bond, per paragraph 3, does not include equity/fund investments, such as mutual funds or exchange-traded funds. However, the following types of SVO-identified investments are provided special statutory accounting treatment and are included within the scope of this statement. These investments shall follow the guidance within this statement, as if they were bonds, unless different treatment is specifically identified in paragraphs 23-29.

a. Exchange traded funds (ETFs), which qualify for bond treatment, as identified in Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office and published on the SVO’s web page of www.NAIC.org. (SVO-identified ETFs are reported on Schedule D – Part 1.)

b. Bond mutual funds which qualify for the Bond List, as identified in Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office and published.
Proposed Revisions to SSAP No. 30R—Unaffiliated Common Stock

4. In addition, the following equity investments are captured within scope of this statement:

   a. Master limited partnerships trading as common stock and American deposit receipts only if the security is traded on the New York or NASDAQ exchange;

   b. Publicly traded common stock warrants;

   c. Shares of SEC registered Investment Companies captured under the Investment Company Act of 1940 (open-end investment companies (mutual funds), closed-end funds and unit investment trusts), regardless of the types or mix of securities owned by the fund (e.g., bonds or stocks) including shares of funds referenced in the “NAIC Fixed Income-Like SEC Registered Funds List” as identified in Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office, except for Bond Mutual Funds which qualify for bond treatment, as identified in Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office and published on the SVO’s web page of www.NAIC.org;

   d. Exchange Traded Funds, except for those identified for bond or preferred stock treatment, as identified in Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office and published on the SVO’s web page of www.NAIC.org; and

   e. Foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction. Other foreign funds are excluded from the scope of this statement.

   f. Equity interests in certified capital companies in accordance with INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO).

Staff Review Completed by: Jim Pinegar, NAIC Staff – January 2020

Status:
On March 18, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 26R—Bonds and SSAP No. 30R—Unaffiliated Common Stock, as detailed above, to eliminate references to the NAIC Bond Fund List. The revisions also add reference to the “NAIC Fixed-Income Like SEC Registered Funds List” in SSAP No. 30R. This item has a shortened comment period deadline ending May 1, 2020.
Issue: Commissioner Discretion in the Valuation Manual

Check (applicable entity):  

<table>
<thead>
<tr>
<th>Modification of Existing SSAP</th>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
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Description of Issue:  
The Valuation Manual became operative on January 1, 2017 and is required to be used for all applicable products effective January 1, 2020. This agenda item has been drafted to maintain comparability by providing disclosures regarding the use of commissioner discretion pursuant to the Valuation Manual.

The Authoritative Literature section in the agenda item has examples of items that require commissioner approval in the Valuation Manual. The items involve making a voluntary choice between various acceptable methods, which is subject to commissioner approval. The identified instances in the Valuation Manual are consistent with a change in valuation basis. Examples identified may include characteristics similar to the following:

1. Voluntarily moving between different commonly accepted methods of determining an amount;
2. The change of method is generally infrequent;
3. Changing methods is a voluntary choice, not an automatic change required by the methodology;
4. Change in valuation which must be typically justified to the commissioner prior to approval.

Because these changes are voluntary and not required to change by the methodology, this agenda item recommends disclosing the use of commissioner discretion required for choosing between acceptable methods, consistent with a change in valuation basis.

Existing Authoritative Literature:  

SSAP No. 3—Accounting Changes and Corrections of Errors

Change in Accounting Principle

3. A change in accounting principle results from the adoption of an accepted accounting principle, or method of applying the principle, which differs from the principles or methods previously used for reporting purposes. A change in the method of applying an accounting principle shall be considered a change in accounting principle.

4. A characteristic of a change in accounting principle is that it concerns a choice from among two or more statutory accounting principles. However, a change in accounting principle is neither (a) the initial adoption of an accounting principle in recognition of events or transactions occurring for the first time or previously immaterial in their effect, nor (b) the adoption or modification of an accounting principle necessitated by transactions or events that are clearly different in substance from those previously occurring.

5. The cumulative effect of changes in accounting principles shall be reported as adjustments to unassigned funds (surplus) in the period of the change in accounting principle. The cumulative effect is the
difference between the amount of capital and surplus at the beginning of the year and the amount of capital and surplus that would have been reported at that date if the new accounting principle had been applied retroactively for all prior periods.

1 If additional changes are identified in subsequent quarters of a fiscal year related to a change in accounting principles recognized initially during the first quarter, such changes shall be considered part of the cumulative effect of the change in accounting principle. The cumulative effect is the difference between the amount of capital and surplus at the beginning of the year and the amount of capital and surplus that would have been reported at that date if the new accounting principle had been applied retroactively for all prior periods. For example, adjustments to an amount recorded as of January 1, 2001, would be recorded as changes in accounting principle rather than corrections of an error through the period of 2001.

SSAP No. 51R—Life Contracts

22. For life and annuity policies issued on or after the operative date of the Valuation Manual, reserves shall use the requirements of the Valuation Manual. As required by Appendix A-820, reserves are required to be determined using the methodologies and processes described in the Valuation Manual. For policies unable to meet the Valuation Manual criteria for exemption from deterministic or stochastic reserves, the Valuation Manual supplements formulaic life insurance policy reserve methodologies with more advanced deterministic and stochastic reserve methodologies to produce reserves that better reflect company experience, possible economic conditions and inherent policy risks.

Change In Valuation Basis

36. A change in valuation basis for reserves determined under paragraphs 18–21, except for reserves defined under Actuarial Guideline XLIII—CARVM: For Variable Annuities (AG 43), as detailed in Appendix C of this Manual, shall be defined as a change in the interest rate, mortality assumption, or reserving method (e.g., net level, preliminary term, etc.) or other factors affecting the reserve computation of policies in force and meets the definition of an accounting change as defined in SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3).

37. Changes in reserves developed under paragraph 22 or AG 43 shall be reviewed to determine whether the change represents a change in valuation basis and if it meets the definition of a change in accounting as defined in SSAP No. 3.

a. Changes in principle-based reserving assumptions are often the result of updating assumptions and other factors required by the existing reserving methodology. Reserve changes resulting from the application of principle-based reserving methodology including, but not limited to, updating assumptions based on reporting entity, industry or other experience, and having the reported reserve transition between net premium reserve, deterministic reserve or stochastic reserve, as required under existing guidance, shall not be considered a change in valuation basis. These types of changes also include, but are not limited to, periodic updates in Valuation Manual tables, such as industry valuation basic tables, asset spread tables and default cost tables.

b. A change in valuation basis for principle-based reserves shall include cases where the required reserve methodology has changed or the insurer makes a voluntary decision to choose one allowable reserving method over another. These types of changes include, but are not limited to, new standardized mortality tables such as Commissioners Standard Ordinary tables and regulatory changes in methodology.

38. Consistent with SSAP No. 3, any increase (strengthening) or decrease (destrengthening) in actuarial reserves resulting from such a change in valuation basis shall be recorded directly to surplus (under changes to surplus in the change in valuation basis annual statement line) rather than as a part of the reserve change recognized in the summary of operations.

39. The impact of a change in valuation basis on surplus is based on the difference between the reported reserve under the old and new methods as of the beginning of the year. This difference shall not
be graded in over time unless this statement prescribes a new method and a specific transition that allows for grading. Some changes will meet the definition of a change in accounting as defined in SSAP No. 3 and a change in valuation basis as described in paragraphs 36-38 of this statement, but the adjustment to surplus will be zero. This can happen when the change in valuation basis is prospective and only applies to new policies and reserves meaning that policies in force for the prior year-end are not affected, or situations in which the change in reserving methodology did not change the reserves reported in the financial statements. The changes remain subject to the disclosures prescribed in SSAP No. 3. The Valuation Manual is effective prospectively for policies written on or after the operative date. Therefore, upon the initial prospective adoption of principle-based reserving, the change in valuation basis reflected as an adjustment to surplus will be zero. After initial adoption of the Valuation Manual, changes in valuation basis will need to be evaluated to determine the amount of any surplus adjustments.

**SSAP No. 52—Deposit-Type Contracts**

**Change In Valuation Basis**

14. A change in valuation basis shall be defined as a change in the interest rate assumption or other factor affecting the reserve computation of policies in force and meets the definition of an accounting change as defined in **SSAP No. 3—Accounting Changes and Corrections of Errors**. Consistent with SSAP No. 3, any increase (strengthening) or decrease (destrengthening) in actuarial reserves resulting from such a change in valuation basis shall be recorded directly to surplus rather than as a part of the reserve change recognized in the summary of operations. The impact on surplus is based on the difference between the reserve under the old and new methods as of the beginning of the year. This difference shall not be graded in over time unless an actuarial guideline adopted by the NAIC prescribes a specific transition that allows for grading.

**SSAP No. 54R—Individual and Group Accident and Health Contracts**

12. The reserving methodologies and assumptions used in calculating individual and group accident and health reserves shall meet the provisions of Appendices A-010, A-641, A-820, A-822 (as applicable), the **Valuation Manual** and the actuarial guidelines found in Appendix C of this Manual (as applicable). Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.

**Change In Valuation Basis**

22. A change in valuation basis shall be defined as a change in the interest rate, mortality and morbidity assumptions, or reserving method (e.g., net level, preliminary term, etc.) or other factors affecting the reserve computation of policies in force and meets the definition of an accounting change as defined in **SSAP No. 3—Accounting Changes and Corrections of Errors** (SSAP No. 3). Changing morbidity assumptions regarding the length of claim continuance based on regularly updated credible experience as required for products subject to Actuarial Guideline XLVII—The Application of Company Experience in the Calculation of Claim Reserves Under the 2012 Group Long-Term Disability Valuation Table (AG 47) and Actuarial Guideline L—2013 Individual Disability Income Valuation Table (AG 50) are not considered a change in valuation basis. Other uses of regularly updated credible experience required to be used for morbidity assumptions by Appendix A-010 regarding continuing claim payments are generally not considered a change in valuation basis. Consistent with SSAP No. 3, any increase (strengthening) or decrease (destrengthening) in actuarial reserves resulting from such a change in valuation basis shall be recorded directly to surplus (under changes to surplus in the change in valuation basis annual statement line for life, accident and health, and health reporting entities) rather than as a part of the reserve change recognized in the summary of operations. The impact on surplus is based on the difference between the reserve under the old and new methods as of the beginning of the year. Some changes will meet the definition of a change in accounting as defined in SSAP No. 3 and a change in valuation basis as described in this paragraph, but the adjustment to surplus will be zero. This can happen when the change in valuation basis is prospective and only applies to new policies and reserves meaning that policies in force for the prior year-end are not affected, or situations in which the change in reserving methodology did not change the reserves reported in the financial statements. The changes remain subject to the disclosures prescribed in
SSAP No. 3. This difference shall not be graded in over time unless this statement prescribes a new method and a specific transition that allows for grading.

The Valuation Manual is referenced in the following places in the Accounting Practices and Procedures Manual:

- SSAP No. 51R—Life Contracts
- SSAP No. 54R—Individual and Group Accident and Health Contracts
- SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees
- Appendix A-010: Minimum Reserve Standards for Individual and Group Health Insurance Contracts
- Appendix A-820: Minimum Life and Annuity Reserve Standards
- Appendix C: Actuarial Guidelines—Multiple Places

The Valuation Manual provides the following instances of commissioner discretion (shading added for emphasis):

**VM-20**

Section 9C3d(iii)

iii. In taking into account factors that are not recognized in the Relative Risk Tool, a company may, to the extent it can justify, adjust the industry basic tables up or down two Relative Risk Tables from that determined by application of the Relative Risk Tool. Further adjustments to reflect risk characteristics not captured within the Relative Risk Tool may be allowed upon approval by the insurance commissioner.

Section 9C5a

For valuations in which the industry basic mortality table is the 2015 VBT, determine an aggregate level of credibility following either the Limited Fluctuation Method by amount, such that the minimum probability is at least 95% with an error margin of no more than 5% or Bühlmann Empirical Bayesian Method by amount. Once chosen, the credibility method must be applied to all business subject to VM20 and requiring credibility percentages. A company seeking to change credibility methods must request and subsequently receive the approval of the insurance commissioner. The request must include the justification for the change and a demonstration of the rationale supporting the change.

**VM-21 (Note that agenda item 2019-47 addresses this exercise of discretion).**

Section 2B

These requirements apply for valuation dates on or after Jan. 1, 2020. A company may elect to phase in these requirements over a 36-month period beginning Jan. 1, 2020. A company may elect a longer phase-in period, up to seven years, with approval of the domiciliary commissioner. The election of whether to phase in and the period of phase-in must be made prior to the Dec. 31, 2020, valuation. At the company’s option, a phase-in may be terminated prior to the originally elected end of the phase-in period; the reserve would then be equal to the unadjusted reserve calculated according to the requirements of VM-21 applicable for valuation dates on or after Jan. 1, 2020. If there is a material decrease in the book of business by sale or reinsurance ceded, the company shall adjust the amount of the phase-in provision. The phase-in amount \((C = R1 − R2, \text{ as described below})\) must be scaled down in proportion to the reduction in the excess reserve, measured on the effective transaction date as the reserve amount in excess of cash surrender value before and after the impact of the transaction. The company must obtain approval for any other modification of the remaining phase-in amount. The method to be used for the phase-in calculation is as follows

Section 2C - The Additional Standard Projection Amount

The additional standard projection amount is determined by applying one of the two standard projection methods defined in Section 6. The same method must be used for all contracts within a group of contracts that are aggregated together to determine the reserve, and the additional standard projection amount
excluding any contracts whose reserve is determined using the Alternative Methodology. The company shall elect which method they will use to determine the additional standard projection amount. The company may not change that election for a future valuation without the approval of the domiciliary commissioner.

Section 3E - Alternative Methodology

For a group of variable deferred annuity contracts that contain either no guaranteed benefits or only GMDBs—i.e., no VAGLBs—the reserve may be determined using the Alternative Methodology described in Section 7 rather than using the approach described in Section 3.C and Section 3.D. However, in the event that the approach described in Section 3.C and Section 3.D has been used in prior valuations for that group of contracts, the Alternative Methodology may not be used without approval from the domiciliary commissioner.

Section 4A4a(ii)b - Modeling of Hedges

a. For a company that does not have a CDHS:

i. The company shall not consider the cash flows from any future hedge purchases or any rebalancing of existing hedge assets in its modeling.

ii. Existing hedging instruments that are currently held by the company in support of the contracts falling under the scope of these requirements shall be included in the starting assets. The hedge assets may then be considered in one of two ways:

a) Include the asset cash flows from any contractual payments and maturity values in the projection model; or

b) No hedge positions – in which case the hedge positions held on the valuation date are replaced with cash and/or other general account assets in an amount equal to the aggregate market value of these hedge positions.

Guidance Note: If the hedge positions held on the valuation date are replaced with cash, then as with any other cash, such amounts may then be invested following the company’s investment strategy. A company may switch from method a) to method b) at any time, but it may only change from b) to a) with the approval of the domiciliary commissioner.

Section 6B2

The company shall determine the Prescribed Projections Amount by following either the CSMP Method or the CTEPA Method below. A company may not change the method used from one valuation to the next without the approval of the domiciliary commissioner.

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): Several updates to the Accounting Practices and Procedures Manual were adopted to address the operative date of the Valuation Manual.

- 2015-47: PBR SSAP
- 2016-10: Changes to A-820 Standard Valuation Law for Principle-based Reserving
- 2016-15: Change in Valuation Basis for Life Contracts
- 2016-34: Health Valuation Manual Updates
- 2016-17: A-010 Minimum Reserve Standards for Individual and Group Health Insurance Contracts

Information or issues (included in Description of Issue) not previously contemplated by the Working Group: None
Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 51R—Life Contracts, SSAP No. 52—Deposit-Type Contracts and SSAP No. 54R—Individual and Group Accident and Health Contracts as illustrated below. The proposed disclosure notes that voluntary decisions to choose one allowable reserving methodology over another, which require commissioner approval under the Valuation Manual shall be reported as a change in valuation basis. As part of the coordination process with the Valuation Manual, the Life Actuarial (A) Task Force should also be notified of the exposure.

Proposed revisions for Spring 2020 Discussion:

SSAP No. 51R—Life Contracts:

Change In Valuation Basis

36. A change in valuation basis for reserves determined under paragraphs 18-21, except for reserves defined under Actuarial Guideline XLIII—CARVM: For Variable Annuities (AG 43), as detailed in Appendix C of this Manual, shall be defined as a change in the interest rate, mortality assumption, or reserving method (e.g., net level, preliminary term, etc.) or other factors affecting the reserve computation of policies in force and meets the definition of an accounting change as defined in SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3).

37. Changes in reserves developed under paragraph 22 or AG 43 shall be reviewed to determine whether the change represents a change in valuation basis and if it meets the definition of a change in accounting as defined in SSAP No. 3.

a. Changes in principle-based reserving assumptions are often the result of updating assumptions and other factors required by the existing reserving methodology. Reserve changes resulting from the application of principle-based reserving methodology including, but not limited to, updating assumptions based on reporting entity, industry or other experience, and having the reported reserve transition between net premium reserve, deterministic reserve or stochastic reserve, as required under existing guidance, shall not be considered a change in valuation basis. These types of changes also include, but are not limited to, periodic updates in Valuation Manual tables, such as industry valuation basic tables, asset spread tables and default cost tables.

b. A change in valuation basis for principle-based reserves shall include cases where the required reserve methodology has changed or the insurer makes a voluntary decision to choose one allowable reserving method over another. These types of changes include, but are not limited to, new standardized mortality tables such as Commissioners Standard Ordinary tables and regulatory changes in methodology. Voluntary decisions to choose one allowable reserving methodology over another, which require commissioner approval under the Valuation Manual shall be reported as a change in valuation basis.

38. Consistent with SSAP No. 3, any increase (strengthening) or decrease (destrengthening) in actuarial reserves resulting from such a change in valuation basis shall be recorded directly to surplus (under changes to surplus in the change in valuation basis annual statement line) rather than as a part of the reserve change recognized in the summary of operations.

39. The impact of a change in valuation basis on surplus is based on the difference between the reported reserve under the old and new methods as of the beginning of the year. This difference shall not
be graded in over time unless this statement prescribes a new method and a specific transition that allows for grading. Some changes will meet the definition of a change in accounting as defined in SSAP No. 3 and a change in valuation basis as described in paragraphs 36-38 of this statement, but the adjustment to surplus will be zero. This can happen when the change in valuation basis is prospective and only applies to new policies and reserves meaning that policies inforce for the prior year-end are not affected, or situations in which the change in reserving methodology did not change the reserves reported in the financial statements. The changes remain subject to the disclosures prescribed in SSAP No. 3. The Valuation Manual is effective prospectively for policies written on or after the operative date. Therefore, upon the initial prospective adoption of principle-based reserving, the change in valuation basis reflected as an adjustment to surplus will be zero. After initial adoption of the Valuation Manual, changes in valuation basis will need to be evaluated to determine the amount of any surplus adjustments.

SSAP No. 52—Deposit-Type Contracts:

Change In Valuation Basis

14. A change in valuation basis shall be defined as a change in the interest rate assumption or other factor affecting the reserve computation of policies inforce and meets the definition of an accounting change as defined in SSAP No. 3—Accounting Changes and Corrections of Errors. Consistent with SSAP No. 3, any increase (strengthening) or decrease (destrengthening) in actuarial reserves resulting from such a change in valuation basis shall be recorded directly to surplus rather than as a part of the reserve change recognized in the summary of operations. The impact on surplus is based on the difference between the reserve under the old and new methods as of the beginning of the year. This difference shall not be graded in over time unless an actuarial guideline adopted by the NAIC prescribes a specific transition that allows for grading. Voluntary decisions to choose one allowable reserving methodology over another, which require commissioner approval under the Valuation Manual shall be reported as a change in valuation basis.

SSAP No. 54R—Individual and Group Accident and Health Contracts:

Change In Valuation Basis

22. A change in valuation basis shall be defined as a change in the interest rate, mortality and morbidity assumptions, or reserving method (e.g., net level, preliminary term, etc.) or other factors affecting the reserve computation of policies inforce and meets the definition of an accounting change as defined in SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3). Changing morbidity assumptions regarding the length of claim continuance based on regularly updated credible experience as required for products subject to Actuarial Guideline XLVII—The Application of Company Experience in the Calculation of Claim Reserves Under the 2012 Group Long-Term Disability Valuation Table (AG 47) and Actuarial Guideline L—2013 Individual Disability Income Valuation Table (AG 50) are not considered a change in valuation basis. Other uses of regularly updated credible experience required to be used for morbidity assumptions by Appendix A-010 regarding continuing claim payments are generally not considered a change in valuation basis. Voluntary decisions to choose one allowable reserving methodology over another, which require commissioner approval under the Valuation Manual shall be reported as a change in valuation basis. Consistent with SSAP No. 3, any increase (strengthening) or decrease (destrengthening) in actuarial reserves resulting from such a change in valuation basis shall be recorded directly to surplus (under changes to surplus in the change in valuation basis annual statement line for life, accident and health, and health reporting entities) rather than as a part of the reserve change recognized in the summary of operations. The impact on surplus is based on the difference between the reserve under the old and new methods as of the beginning of the year. Some changes will meet the definition of a change in accounting as defined in SSAP No. 3 and a change in valuation basis as described in this paragraph, but the adjustment to surplus will be zero. This can happen when the change in valuation basis is prospective and only applies to new policies and reserves meaning that policies inforce for the prior year-end are not affected, or situations in which the change in reserving methodology did not change the reserves reported in the financial statements. The changes remain subject to the disclosures prescribed in SSAP No. 3. This difference shall not be graded in over time unless this statement prescribes a new method and a specific transition that allows for grading.
Staff Review Completed by:
Robin Marcotte - NAIC Staff
February 2020

Status:
On March 18, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 51R—Life Contracts, SSAP No. 52—Deposit-Type Contracts and SSAP No. 54R—Individual and Group Accident and Health Contracts, as illustrated above, to note that voluntary decisions to choose one allowable reserving methodology over another, which requires commissioner approval under the Valuation Manual, shall be reported as a change in valuation basis. A notification of this exposure will be sent to the Life Actuarial (A) Task Force. This item has a comment period deadline ending May 29, 2020.
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Repeal of Affordable Care Act Section 9010 Assessment

Check (applicable entity):

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<tr>
<th>Modification of Existing SSAP</th>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
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<tr>
<td>Interpretation</td>
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Description of Issue:
SSAP No. 106—Affordable Care Act Section 9010 Assessment addresses the Affordable Care Act (ACA) Section 9010 assessment for entities that issue health insurance. This assessment was effective for calendar years beginning on January 1, 2014. This assessment is also known as the health insurer’s tax (HIT).

The Section 9010 assessment has had more than one moratorium, as addressed in INT 18-02: ACA Section 9010 Assessment Moratoriums. The following is a history of years in which the assessment was in effect and payable.

- 2014 – Paid
- 2015 – Paid
- 2016 – Paid
- 2017 – NOT Paid - Moratorium
- 2018 – Paid
- 2019 – NOT Paid - Moratorium
- 2020 – To Be Paid
- 2021 – Repealed

The assessment is required to be paid for calendar year 2020. In December 2019, the House of Representatives and Senate passed year-end spending bills which repealed the Section 9010 assessment for calendar years beginning January 1, 2021. This bill was subsequently signed into law. This agenda item addresses the impacts of the repeal for calendar years beginning on January 1, 2021 by recommending the following actions:

- Superseding SSAP No. 106—Affordable Care Act Section 9010 Assessment
- Nullifying INT 18-02: ACA Section 9010 Assessment Moratoriums

Existing Authoritative Literature:

- SSAP No. 106—Affordable Care Act Section 9010 Assessment
- INT 18-02: ACA Section 9010 Assessment Moratoriums

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): Although prior one-year moratoriums have been discussed by the Working Group, this is the first discussion of a repeal.

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

Staff Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as substantive and expose the intent to supersede SSAP No. 106—Affordable Care Act Section 9010 Assessment and nullify INT 18-02: ACA Section 9010 Assessment Moratoriums. Both actions are proposed to be effective January 1, 2021. With these actions, both SSAP No. 106 and INT 18-02 would be moved to Appendix H - Superseded Statements of Statutory Accounting Principles and Nullified Interpretations for the 2021 publication of the NAIC Accounting Practices and Procedures Manual

With these actions, NAIC staff should also be directed to coordinate the related impacts with the following NAIC Groups:

1. Blanks (E) Working Group – Ensure the annual statement disclosures related to SSAP No. 106 currently reported in Note 22 are removed from the annual statement instructions and annual statement blank beginning in reporting years 2021.


Staff Review Completed by:
Robin Marcotte - NAIC Staff
February 2020

Status:
On March 18, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed the intent to supersede SSAP No. 106—Affordable Care Act Section 9010 Assessment and nullify INT 18-02: ACA Section 9010 Assessment Moratoriums which would move both SSAP No. 106 and INT 18-02 to Appendix H—Superseded Statements of Statutory Accounting Principles and Nullified Interpretations, effective Jan. 1, 2021. This item has a comment period deadline ending May 29, 2020.

Referrals will be sent to the Blanks (E) Working Group, to ensure the annual statement disclosures related to SSAP No. 106 in Note 22 are removed from the annual statement instructions and annual statement blank beginning in reporting year 2021, and to the Health Risk Based Capital (E) Working Group for RBC implications related to the 2021 removal of the federal ACA adjustment sensitivity test which uses data from the SSAP No. 106 disclosures.
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Health Industry Request on 2020 Health Insurance Assessment

Check (applicable entity):

- Modification of Existing SSAP P/C X Life X Health X
- New Issue or SSAP P/C X Life X Health
- Interpretation P/C X Life X Health

Description of Issue:
This agenda item addresses an April 2020 request from America’s Health Insurance Plans (AHIP) to the Statutory Accounting Principles (E) Working Group regarding SSAP No. 106—Affordable Care Act Section 9010 Assessment. The ACA Section 9010 fee is also known as the health insurance tax (HIT). The payable amount is based on the volume of premium from 2019, and becomes due once the reporting entity provides health insurance in January 2020. Under SSAP No. 106, the amount payable which is based on prior year premium is disclosed in special surplus during the “data year” and reported as a liability during the “fee year.” The year 2020 is a fee year and the assessment based on 2019 premium is due to the U.S. Treasury in September 2020.

A previously unknown virus began transmitting between October 2019 and March 2020, with the first deaths in the U.S. reported in early March 2020. The disease caused by the virus is known as Coronavirus Disease 2019 (COVID-19). Several states and cities have issued “stay home” orders and forced all non-essential businesses to temporarily close. This has led to a significant increase in unemployment and, in certain states, mandatory closure of many businesses. NAIC staff agrees that the COVID-19 crisis is placing stress on the insurance industry and is supportive of some temporary relaxation of conservatism in statutory accounting such as the proposed relaxation of the 90-day rule as currently exposed interpretation related to COVID-19, such as: INT 20-02T: Extension of Ninety-Day Rule for the Impact of COVID-19.

The SSAP No. 106 request is noted as temporary surplus relief, which was requested in conjunction with many concessions that health plans are being asked to make due to the anticipated impacts on operations and surplus. The AHIP request notes that, “For some members, the HIT liability to be reported as a liability and expense in the first quarterly interim reports is estimated to be 10% of group-wide surplus.”

The key accounting changes requested in the AHIP letter are as follows:

- Amend SSAP No. 106 to permit insurers to accrue the tax liability on a monthly or quarterly basis. However, to the extent that health plans have recognized in 2019 earned premium amounts attributable to inclusion of the HIT in determining premium rates, that amount will be accrued as a liability and a corresponding expense at the beginning of 2020; the difference between that amount and the total estimated HIT to be paid in 2020 would then be accrued on a monthly or quarterly basis through September 2020.
- For first and second quarterly interim reporting in 2020, the portion of the estimated tax that has not yet been accrued will remain in special surplus to clearly document its designated purpose.
- Because the full amount of the HIT will be accrued when paid in September 2020, there will be no impact on year-end 2020 reporting or RBC filings.

NAIC staff notes that the Section 9010 fee due in September 2020 meets the definition of a liability under SSAP No.5R—Liabilities, Contingencies and Impairments of Assets for the full amount on January 1, 2020. It is a present

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duty payable in September 2020; there is no discretion to avoid payment, and the obligating events (providing health insurance in 2020 and writing premium in 2019) have already occurred.

Existing Authoritative Literature:

- **SSAP No. 5 – Revised—Liabilities, Contingencies and Impairments of Assets**

  2. 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\(^1\) 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.

\(^1\) 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.

- **SSAP No. 106—Affordable Care Act Section 9010 Assessment**

Determining timing of the recognition of the Section 9010 liability was a matter of extensive debate at the Statutory Accounting Principles (E) Working Group. This issue was initially discussed in November 2011 through June 2014 when SSAP No. 106 was adopted. As noted in Issue Paper No. 148—Affordable Care Act Section 9010 Assessment, this topic was discussed at the Statutory Accounting Principles (E) Working Group with input from the Financial Condition (E) Committee. In addition, the Health Insurance and Managed Care (B) Committee and the Accounting Practices and Procedures (E) Task Force were invited to participate in a number of the discussions via conference call.

The issue debated was whether to recognize the amount payable in the data year, which is the year the premium volume used to calculate the assessment payable is written, or in the fee year when the assessment is paid. Because this amount seemed to function similar to premium tax which is accrued when the premium is written, one side was supportive of accruing the liability in the data year. However, because of how the law was written, in that it applied to health insurers’ data year premium but was due from issuers that provided subject health business in the fee year, the other side believed the liability should be recognized in the fee year.

SSAP No. 106 ultimately delayed full recognition of the expense and liability until the Jan. 1 of the fee year, with the additional transparency of having the amount reflected in special surplus during the data year. In addition, the impact on risk-based capital as of January 1 of the fee year was disclosed in the data year financial statements. This following excerpt from SSAP No. 106 was part of an extensive compromise process.

**Affordable Care Act Section 9010 Assessment**

3. The Affordable Care Act (ACA) imposes an assessment on entities that issue health insurance for each calendar year beginning on or after January 1, 2014. Pursuant to Section 9010 of the ACA, a reporting entity’s portion of the assessment is paid no later than September 30 of the applicable calendar year (the fee year) beginning in 2014 and is not tax deductible. The amount of the assessment for the reporting entity is based on the ratio of the amount of an entity’s subject net health premiums written for any U.S. health risk during the preceding calendar year (data year) to the aggregate amount of subject net health premiums written by all subject U.S. health insurance providers during the preceding calendar year. The ACA includes some significant exclusions regarding which entities are required to pay the assessment. The guidance in this statement applies to all reporting entities that are subject to the fee. The guidance in this statement applies to the unique facts and circumstances in the ACA; accordingly, an entity should apply judgment
when evaluating the facts and circumstances of other assessments arrangements before analogizing the guidance for Section 9010 of the ACA.

4. Throughout this discussion of the Section 9010 assessment of the ACA, the following terms apply:
   a. The term “data year” means the calendar year immediately before the fee year. For example, 2014 is the data year for fee year 2015.
   b. The term “fee year” means the calendar year in which the assessment must be paid to the U.S. Treasury.

5. A reporting entity’s portion of the annual assessment becomes payable to the U.S. Treasury once the reporting entity provides health insurance (in the fee year) for any subject U.S. health risk for each calendar year beginning on or after January 1, 2014.

6. The liability related to the Section 9010 ACA assessment shall be estimated and recorded in full once the entity provides qualifying health insurance (typically January 1) in the applicable calendar year in which the assessment is paid (fee year) with a corresponding entry to expense. The Section 9010 ACA assessment shall be recognized in full on January 1 of the fee year, in the operating expense category of Taxes, Licenses and Fees (INT 18-02).

7. Liability recognition of the Section 9010 fee is not required in the data year. In the data year, the reporting entity is required to reclassify from unassigned surplus to special surplus an amount equal to its estimated subsequent fee year assessment. This segregation in special surplus is accrued monthly throughout the data year. The reclassification from unassigned surplus to special surplus does not reduce total surplus. On January 1 of the fee year, the prior year segregation in special surplus is reversed and the full current fee year assessment liability shall be accrued.

8. The Section 9010 ACA annual assessment does not represent a cost related to the acquisition of policies that is consistent with the definition of acquisition costs in SSAP No. 71—Policy Acquisition Costs and Commissions.

Disclosures

9. For the Section 9010 ACA assessment:
   a. For the annual reporting period ending December 31, 2013, and thereafter, a reporting entity subject to the assessment under section 9010 of the Affordable Care Act, shall provide a disclosure of the assessment payable in the upcoming year consistent with the guidance provided under SSAP No. 9—Subsequent Events (SSAP No. 9) for a Type II subsequent event. The disclosure shall provide information regarding the nature of the assessment and an estimate of its financial impact, including the impact on its risk-based capital position as if it had occurred on the balance sheet date. In accordance with SSAP No. 9, paragraph 9, the reporting entity shall also consider whether there is a need to present pro forma financial statements regarding the impact of the assessment, based on its judgment of the materiality of the assessment.
   b. Additionally, for annual reporting periods ending on or after December 31, 2014, the disclosure in paragraph 9.a. is expanded to include information on the amounts reflected in special surplus in the data year.
      i. The reporting entity shall disclose the amount of premium written for the current year that is the basis for the determination of the section 9010 fee assessment to be paid in the subsequent year (net assessable premium). Prior year amounts shall also be included for comparative purposes;
ii. Reporting entities shall provide information regarding the nature of the assessment, the estimated amount of the assessment payable in the upcoming year (current and prior year) and the amount of assessment paid (current and prior year), and;

iii. The disclosure shall also provide the Total Adjusted Capital (before and after adjustment as reported in its estimate of special surplus applicable to the 9010 fee) and Authorized Control Level (in dollars) to reflect the fee as of the annual reporting date as if it had been reported on the balance sheet date. The disclosure shall also provide a statement as to whether an RBC action level would have been triggered had the fee been reported as of the balance sheet date.

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 Section 9010 fee was repealed effective January 1, 2021. The Working Group currently has agenda item 2020-05: Repeal of Affordable Care Act Section 9010 Assessment exposed for comment, which would nullify SSAP No. 106 effective January 1, 2021.


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


Staff Review Completed by:
Robin Marcotte - NAIC Staff
April 7, 2020

Staff Recommendation:
AHIP requests an amendment to SSAP No. 106—Affordable Care Act Section 9010 Assessment to delay liability recognition of the Section 9010 fee payable in September 2020. The request would remove the requirement to recognize the full amount of liability on January 1, 2020 and instead recognize amounts not previously collected as a liability monthly or quarterly over 2020. NAIC staff has been proactive in drafting responses to requests to allow temporary relaxation of the statutory accounting conservative rules in response to COVID-19 including INT 20-02: Extension of Ninety-Day Rule for the Impact of COVID-19. However, NAIC staff is concerned with the material distortions to the financial statements that could occur by delaying liability recognition.

NAIC staff recommends that the Working Group reject the AHIP request to modify SSAP No. 106 for all reporting entities and move this item to the rejected listing for the following reasons:

1. The 2020 Section 9010 fee / HIT meets the definition of a liability requiring full recognition under SSAP No. 5R on January 1, 2020. It is a present duty payable in September 2020, there is no discretion to avoid payment, and the obligating events (writing premium in 2019 and providing health insurance in 2020) have already occurred. In addition, the amount can be reasonably estimated.

2. It would, therefore, be distorting to the financial statements to not recognize a liability. In the comment letter provided, it was noted that for one group the Section 9010 fee payable represents over 10% of surplus. In this instance, it would be materially distorting to the financial statements to not recognize the liability.
3. The 2020 Section 9010 fee payable amount was also disclosed in the notes at year end 2019 along with the impact on surplus and risk-based capital (RBC). So, it is a known and previously disclosed amount.

4. Recording a monthly amount is inconsistent with the cash flows. Almost all of this assessment should have been collected in 2019 as it was included in the 2019 health rates. The vast majority of the obligation would have been collected as part of 2019 premium and even if there was a delay, amounts related to 2019 should have been collected prior to the declaration of emergency.

As noted above, this request has the potential to materially distort the financial statements, as a known liability would not be fully recognized. In times of financial stress, it is important to be able to accurately assess the financial solvency of reporting entities. With the potential impact of the financial statements, any consideration for such a request warrants domiciliary state regulator review. Any state specific considerations would be either permitted practices (individual requests) or prescribed practices (state bulletins, etc.). If granted by the domestic state, such practices would be disclosed in the financial statements.

Status:

On April 17, 2020, the Statutory Accounting Principles (E) Working Group conducted an e-vote to expose this agenda item for a one-week comment period ending on April 24, 2020. The exposed recommendation is to reject the request to defer liability recognition of the federal ACA fee due in September 2020 and move the agenda item to the rejected listing. The exposure would not result in any statutory accounting revisions.
Maintenance updates provide revisions to the *Accounting Practices and Procedures Manual*, such as editorial corrections, reference changes and formatting.

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<td>SSAP No. 2R</td>
<td>1) Paragraph 9: Update reporting line instructions for qualified cash pools.</td>
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<td>2) Paragraph 14: Correct verbiage and sentence structure for ease of readability.</td>
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**Recommendation:**
NAIC staff recommends that the Statutory Accounting Principles (E) Working Group move this agenda item to the active listing, categorized as nonsubstantive, and expose editorial revisions, as illustrated below.

**SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments**

**Staff Note:** A separate agenda item is being proposed to clarify that “disclosure” of cash equivalents that remain on schedule E2 for more than one consecutive reporting period. This item will also clarify that this disclosure is satisfied by a code on the investment schedule. (These revisions are in line with comments received during the May 20 conference call but go beyond editorial revisions.)

9. Cash pooling is a technique utilized by some companies under common control by which several entities’ cash accounts are aggregated for numerous purposes, including liquidity management, optimizing interest or investment returns and reducing investment or banking transaction fees. Cash pools can have numerous functions and structures; however, only those that have obtained domiciliary regulator approval and meet the following requirements are in scope of this statement.

   a. Members or participants in the pool are limited to affiliated entities as defined in *SSAP No. 25—Affiliates and Other Related Parties*.

   b. Investments held by the pool are limited to non-affiliated entities investments (non-affiliated to the insurance reporting entity).

   c. The pool must permit each participant to withdraw, at any time, cash up to the amount it has contributed to the pool. Each participant must own an undivided interest in the underlying assets of the pool in proportion to the aggregate amount of cash contributed. All affiliates’ interests in the pool shall be of the same class, with equal rights, preferences, and privileges. All membership interests shall be fully paid and non-assessable and shall have no preemptive, conversion or exchange rights. The liability of a participant’s debts and obligations of the pool shall be limited to the amount of its contributions and no participant shall be obligated to contribute money to the pool for any reason other than to participate in the pool’s investments. Additionally, participants shall not cover the debits or credits of another participant (commonly referred to as notional cash pooling).

   d. A reporting entity shall receive monthly reports from the pool manager, which identifies the participant’ investment (share) in the cash pool and the dollar value of its share of cash, cash equivalents and short-term investments. The reporting entity shall report their total balances in the cash pool on Schedule E – Part 2, utilizing the line number as specified in the *Annual Statement Instructions for “Other Cash Equivalents.”* The reporting entity shall independently if the investments would have qualified as cash, cash equivalents or short-term investments had the entity independently acquired the investments. To the extent the pool holds investments that do not meet the definition of cash, cash equivalents, short-term investments, the pool does not qualify within scope of this statement.
14. Short-term investments are investments that do not qualify as cash equivalents with remaining maturities (or repurchase dates under reverse repurchase agreements) of one year or less at the time of acquisition, excluding derivatives and those investments specifically classified as cash equivalents as defined in this statement, shall be considered short-term investments. Short-term investments can include, but are not limited to, bonds, commercial paper, reverse repurchase agreements, and collateral and mortgage loans which meet the noted criteria. Short-term investments shall not include investments specifically classified as cash equivalents as defined in this statement, certificates of deposit, or derivatives. Regardless of maturity date, derivative instruments shall not be reported as short-term investments and shall be reported as derivatives on Schedule DB.

Status:
On June 15, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed the editorial maintenance revisions to SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments as detailed above. This item has a shortened comment period deadline ending July 15, 2020.
Statement of Statutory Accounting Principles No. 32R

Preferred Stock

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for preferred stock.

2. Investments in preferred stock of entities captured in SSAP No. 97—Investments in subsidiaries, controlled or affiliated entities or SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies, as well as

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1 Certain legal entities captured in SSAP No. 48, such as LLCs that are corporate like, do not issue preferred stock in legal form, but instead issue identical instruments labeled preferred units, interests, or shares. These instruments shall be captured in this statement provided they meet the structural characteristics as defined in paragraph 3. Additionally, these instruments shall not be in-substance common stock in which the holder has risk and reward characteristics that are substantially similar to common stock.
preferred stock interests of certified capital companies per INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO) are included within the scope of this statement. The requirement to file investments in preferred stock of certain subsidiaries, controlled or affiliated entities with the NAIC pursuant to SSAP No. 97 does not affect the application of the accounting, valuation or admissibility under this statement.

SUMMARY CONCLUSION

3. Preferred stock, which may or may not be publicly traded, is a security that represents ownership of a corporation and gives the holder a claim, prior to the claim of common stockholders on earnings and also generally on assets in the event of liquidation. Most preferred stock pays a fixed dividend that is paid prior to the common stock dividend, stated in a dollar amount or as a percentage of par value. Preferred stock does not usually carry voting rights. Preferred stock has characteristics of both common stock and debt. Preferred stock shall include:

   a. Redeemable preferred stock, which is preferred stock subject to mandatory redemption requirements or whose redemption is at the option of the holders. Redeemable preferred stock is any stock which 1) the issuer undertakes to redeem at a fixed or determinable price on the fixed or determinable date or dates, whether by operation of a sinking fund or otherwise; or 2) is redeemable at the option of the holders. Preferred stock which meet one or more of these criteria would be classified as redeemable preferred stock regardless of other attributes such as voting rights or dividend rights.

   b. Perpetual preferred stock, which is preferred stocks which are not redeemable or for which redemption is not at the option of the holder (non-redeemable preferred stock). Perpetual preferred stock is any preferred stock which does not meet the criteria to be classified as redeemable preferred stock pursuant to paragraph 3.a.

4. The definition of preferred stock, as defined in paragraph 3 does not include fund investments. However, the following types of SVO-identified investments are captured within scope of this statement.

   a. Exchange Traded Funds, which qualify for preferred stock treatment, as identified in Part Six, Section 2, of the Purposes and Procedures Manual of the NAIC Investment Analysis Office. SVO-Identified Preferred Stock ETFs shall follow the accounting provisions for perpetual preferred stock.

5. Restricted preferred stock is defined as either redeemable or perpetual preferred stock that must be traded in compliance with special Securities Exchange Commission (SEC) regulations concerning its purchase and resale. These restrictions generally result from affiliate ownership, merger and acquisition (M&A) activity and underwriting activity. Pursuant to the SEC, restricted securities are securities acquired in an unregistered, private sale from the issuing company or from an affiliate of the issuer. They typically bear a “restrictive” legend clearly stating that the holding may not resell the stock in the public marketplace unless the sale is exempt from the SEC’s registration requirements. Restricted preferred stock is generally considered an admitted asset; however, admittance may be limited based on the degree of restriction in accordance with SSAP No. 4—Assets and Nonadmitted Assets.

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2 Preferred stock shall be classified by its characteristics. For example, a preferred stock that is named “redeemable perpetual preferred stock” shall be reported as either “redeemable” or “perpetual” preferred stock based on whether the characteristics of paragraph 3a are met.

3 This definition of restricted stock does not preclude a “restricted asset” classification for any preferred stock that is restricted (e.g., not under the exclusive control of the entity) by actions of the reporting entity or others. For example, if a reporting entity has pledged preferred stock, or used preferred stock in securities lending / repo transactions, the preferred stock shall be coded and disclosed as restricted stock pursuant to SSAP No. 1.
Preferred Stock

Restricted preferred stock shall be coded as restricted in the investment schedule and disclosed pursuant to SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures.

6. Preferred stocks meet the definition of assets as defined in SSAP No. 4—Assets and Nonadmitted Assets and are admitted assets to the extent they conform to the requirements of this statement.

Acquisitions and Sales

7. At acquisition, preferred stock shall be reported at cost, including brokerage and other related fees. Preferred stock received as dividends shall be initially recorded at fair value. Acquisitions and dispositions shall be recorded on the trade date. Private placement stock transactions shall be recorded on the funding date.

8. A reporting entity can subscribe for the purchase of stock, but not be required to make payment until a later time. Transactions of this nature are common in the formation of corporations. Preferred stock acquired under a subscription represents a conditional transaction in which a preferred stock is authorized for issuance but not yet actually issued. Such transactions are settled if and when the actual preferred stock is issued and the exchange or National Association of Securities Dealers (NASD) rules that the transactions are to be settled. Preferred stock acquired under a subscription shall be recorded as an admitted asset when the reporting entity or its designated custodian or transfer agent takes delivery of the preferred stock and the preferred stock is recorded in the name of the reporting entity or its nominee, (i.e., the accounting for such preferred stock acquisitions shall be on the settlement date).

Amortization

9. Redeemable preferred stock purchased at a premium shall be amortized to reduce the carrying value to the call or redemption value over the period to the call or earliest redemption date, whichever produces the lowest asset value (yield to worst). Redeemable preferred stock purchased at a discount shall be accreted to increase the carrying value to the redemption price over the period to maturity or the latest redemption date. Amortization (and accretion) of the premium and discount arising at acquisition shall be calculated using the interest method and shall be reported through investment income.

Balance Sheet Amount

10. Preferred stock shall be valued based on (a) the underlying characteristics (redeemable, perpetual or mandatory convertible), (b) the quality rating expressed as an NAIC designation, and (c) whether an asset valuation reserve (AVR) is maintained by the reporting entity:

   a. For reporting entities that do not maintain an AVR:

      i. Highest-quality or high-quality redeemable preferred stocks (NAIC designations 1 and 2) shall be valued at amortized cost. All other redeemable preferred stocks (NAIC designations 3 to 6) shall be reported at the lower of amortized cost or fair value.

      ii. Perpetual preferred stocks shall be reported at fair value, not to exceed any currently effective call price.

      iii. Mandatory convertible preferred stocks (regardless if the preferred stock is redeemable or perpetual) shall be reported at fair value, not to exceed any currently effective call price, in the periods prior to conversion. Upon conversion to common stock, these securities shall be in scope of SSAP No. 30R.

      iv. For preferred stocks reported at fair value, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus).
b. For reporting entities that maintain an AVR:

i. Highest-quality, high-quality or medium quality redeemable preferred stocks (NAIC designations 1 to 3) shall be valued at amortized cost. All other redeemable preferred stocks (NAIC designations 4 to 6) shall be reported at the lower of amortized cost or fair value.

ii. Perpetual preferred stocks shall be valued at fair value, not to exceed any currently effective call price.

iii. Mandatory convertible preferred stocks (regardless if the preferred stock is redeemable or perpetual) shall be reported at fair value, not to exceed any currently effective call price, in the periods prior to conversion. Upon conversion to common stock, these securities shall be in scope of SSAP No. 30R.

iv. For preferred stocks reported at fair value, the accounting for unrealized gains and losses shall be in accordance with SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve (SSAP No. 7).

Impairment of Redeemable Preferred Stock

11. An other-than-temporary impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of the preferred stock in effect at the date of acquisition. An assessment of other-than-temporary impairment shall occur whenever mandatory redemption rights or sinking fund requirements do not occur. A decline in fair value which is other-than-temporary includes situations where the reporting entity has made a decision to sell the preferred stock prior to its maturity at an amount below its carrying value (i.e., amortized cost). If it is determined that a decline in the fair value of a redeemable preferred stock is other-than-temporary, an impairment loss shall be recognized as a realized loss equal to the entire difference between the redeemable preferred stock’s carrying value and its fair value, not to exceed any currently effective call price, at the balance sheet date of the reporting period for which the assessment is made. The measurement of the impairment loss shall not include partial recoveries of fair value subsequent to the balance sheet date. For reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7.

12. In periods subsequent to the recognition of other-than-temporary impairment loss for a redeemable preferred stock, the reporting entity shall account for the other-than-temporarily impaired preferred stock as if the preferred stock had been purchased on the measurement date of the other-than-temporary impairment. The fair value of the redeemable preferred stock on the other-than-temporary impairment measurement date shall become the new cost basis of the redeemable preferred stock and the new cost basis shall not be adjusted for subsequent recoveries in fair value. The discount or reduced premium recorded for the preferred stock, based on the new cost basis, shall be amortized over the remaining life of the preferred stock in the prospective manner based on the amount and timing of future estimated cash flows. The preferred stock shall continue to be subject to impairment analysis for each subsequent reporting period. Future declines in fair value which are determined to be other-than-temporary shall be recorded as realized losses.

Impairment of Perpetual Preferred Stock

13. For any decline in the fair value of perpetual preferred stock which is determined to be other-than-temporary, the perpetual preferred stock shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. For reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7. Subsequent fluctuations in fair value shall be recorded as unrealized gains or losses. Future declines which are determined to be other-than-temporary shall be recognized
as realized losses. A decline in fair value which is other-than-temporary includes situations where the reporting entity has made a decision to sell a preferred stock at an amount below its carrying value.

Income

14. Dividends on preferred stock shall be recorded as investment income for dividend eligible preferred stock on the ex-dividend date with a corresponding receivable to be extinguished upon dividend settlement. Dividends received shall be recognized in the form received (e.g., cash, preferred stock, common stock) at fair value with differences between fair value and the dividend receivable recognized as gains or losses. Subsequent treatment shall follow the statement that addresses the type of asset received. For example, dividends received in the form of common stock shall be accounted for and reported in accordance with SSAP No. 30R—Unaffiliated Common Stock.

Redemption of Preferred Stock

15. A reporting entity that sells or redeems preferred stock back to the issuer shall recognize consideration received in excess of the book/adjusted carrying value as a realized gain or loss. This recognition shall occur regardless of whether the issuer repurchases the preferred shares at market value, or if the shares are redeemed by the issuer at a predetermined set call price.

Exchanges and Conversions

16. If preferred stock is exchanged or converted into other securities, the fair value of the preferred stock surrendered at the date of the exchange or conversion shall become the cost basis for the new securities with any gain or loss realized at the time of the exchange or conversion. However, if the fair value of the securities received in an exchange or conversion is more clearly evident than the fair value of the preferred stock surrendered, then it shall become the cost basis for the new securities.

Disclosures

17. The following disclosures regarding preferred stocks shall be made in the financial statements:

   a. Fair values in accordance with SSAP No. 100R—Fair Value (SSAP No. 100R);

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

   c. Basis at which the preferred stocks are stated; and

   d. A description, as well as the amount, of preferred stock that is restricted and the nature of the restriction.

   e. For each balance sheet presented, all preferred stocks in an unrealized loss position for which other-than-temporary declines in value have not been recognized

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

      ii. The aggregate related fair value of preferred stocks with unrealized losses.

   f. The disclosures in (i) and (ii) above should be segregated by those preferred stocks that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer using fair values determined in accordance with SSAP No. 100R.
g. As of the date of the most recent balance sheet presented, additional information should be included describing the general categories of information that the investor considered in reaching the conclusion that the impairments are not other-than-temporary.

h. When it is not practicable to estimate fair value, the investor should disclose the following additional information, if applicable, as of each date for which a statement of financial position is presented in its annual financial statements:
   i. The aggregate carrying value of the investments not evaluated for impairment, and
   ii. The circumstances that may have a significant adverse effect on the fair value.

18. Refer to the Preamble for further discussion regarding disclosure requirements. The disclosure requirements of paragraphs 17.b., 17.e., 17.f., 17.g. and 17.h. shall be included in the annual audited statutory financial reports only.

Relevant Literature


Effective Date and Transition

20. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors. The guidance in paragraphs 23-26 was previously included within SSAP No. 99—Accounting for Securities Subsequent to an Other-Than-Temporary Impairment and was effective for reporting periods beginning on January 1, 2009, and thereafter, with early adoption permitted. In 2010, the guidance from SSAP No. 99 was incorporated within the impacted standards, with SSAP No. 99 superseded. The original impairment guidance included in this standard, and the substantive revisions reflected in SSAP No. 99 are retained for historical purposes within Issue Paper No. 131. The guidance in paragraphs 2 and 3 to SSAP No. 32 was originally superseded January 1, 2005, by guidance included in SSAP No. 88—Investments in Subsidiaries, Controlled and Affiliated Entities, A replacement of SSAP No. 46, and then subsequently reflected in SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities. In 2011, the guidance related to preferred stock of SCAs from SSAP No. 97 was incorporated into this statement and revised to reflect a definition of preferred stock. The original guidance included in this statement, and the substantive revisions reflected in SSAP No. 88 and SSAP No. 97 (including the title change already reflected in SSAP No. 32) are retained for historical purposes within Issue Paper Nos. 32 and 118. Guidance in paragraph 17 was originally contained in INT 99-29: Classification of Step-Up Preferred Stock and was effective December 6, 1999.

21. In ________, substantive revisions, as detailed in Issue Paper No. ________ were adopted. These revisions, effective __________, update definitions of preferred stock and reporting values based on characteristics of the preferred stock.
REFERENCES

Other

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

- NAIC Valuation of Securities product prepared by the Securities Valuation Office

Relevant Issue Papers

- *Issue Paper No. 32—Investments in Preferred Stock (excluding investments in preferred stock of subsidiary, controlled, or affiliated companies)*

- *Issue Paper No. 131—Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment*

- *Issue Paper No. 1XX—Preferred Stock*
EXHIBIT A – GLOSSARY

Callable Preferred Stock – A preferred stock in which the issuer has the right to call or redeem the stock at a preset price after a defined date. Callable preferred stock can be either redeemable preferred stock or perpetual preferred stock depending on other characteristics of the preferred stock. For example, callable preferred stock with a maturity or a specific buyback date would be redeemable preferred stock, whereas callable preferred stock electable at the discretion of the issuer is perpetual preferred stock.

Convertible Preferred Stock – A preferred stock that is convertible into another security based on a conversion rate. For example, convertible preferred stock that is convertible into common stock on a two-for-one basis (two shares of common for each share of preferred).

Cumulative Preferred Stock – A preferred stock with a provision that missed dividend payments must be paid to cumulative preferred shareholders before other classes of preferred stock shareholders and common shareholders can receive dividend payments. Cumulative preferred stock may have different levels, with a “first” or “senior” cumulative preferred, “regular” cumulative preferred and “subordinate” cumulative preferred that determines the priority in which accumulated unpaid dividends or asset liquidation occurs. (Under SSAP No. 32R, holders of cumulative preferred stock are not permitted to recognize a receivable for unpaid cumulative dividends until declared and the reporting entity is entitled to the divided.)

Dividend Declaration Date – The date a corporation declares a dividend payment to its shareholders.

Dividend Record Date – The date that identifies the shareholders that are entitled to a declared dividend.

Dividend Payment Date – The date the declared dividend will be paid.

Ex-Dividend Date – The cut-off date of holding stock to be captured as a shareholder on record entitled to the dividend. (A shareholder that sells their stock on the ex-dividend date would continue to be identified as a shareholder on record entitled to a declared dividend. Anyone who acquires a stock on the ex-dividend date would not be a shareholder on record entitled to a declared dividend.)

Mandatory Redeemable Preferred Stock – A preferred stock that embodies an unconditional obligation requiring the issuer to redeem the instrument by transferring its assets at a specified or determinable date (or dates) or upon an event that is certain to occur. (The existence of a mandatory redemption right does not convert the holder of a preferred stock into a creditor, and an issuer may be prohibited from redeeming shares when redemption would cause an impairment of capital.)

Noncumulative Preferred Stock – A preferred stock that does not entitle the stockholder to accumulated unpaid dividends. After missing dividend payments, a corporation only has to be make current dividend payments to preferred stock holders before providing dividends to common stock holders.

Participating Preferred Stock – A preferred stock that gives the holder participation in the additional earnings of a business or liquidation rights in addition to the normal preferred stock dividend. Pursuant to the terms of the preferred stock, the participation rights may only be activated when income or operations of the issuer exceeds a certain threshold level.

Payment-in-kind (PIK) – A term of the preferred stock prospectus that identifies that dividends may take the form of securities (e.g., common stock) rather than cash.
Perpetual Preferred Stock - Preferred stocks which are not redeemable or are redeemable solely at the option of the issuer. Perpetual preferred stock is any preferred stock which does not meet the criteria to be classified as redeemable preferred stock.

Preferred stock - A security, which may or may not be publicly traded, that shows ownership of a corporation and gives the holder a claim, prior to the claim of common stockholders on earnings and also generally on assets in the event of liquidation.

Redeemable Preferred Stock - Preferred stock subject to mandatory redemption requirements or whose redemption is outside the control of the issuer. Redeemable preferred stock is any stock which 1) the issuer undertakes to redeem at a fixed or determinable price on the fixed or determinable date or dates, whether by operation of a sinking fund or otherwise; 2) is redeemable at the option of the holders; or 3) has conditions for redemption which are not solely within the control of the issuer, such as stock which must be redeemed out of future earnings. Preferred stock which meet one or more of these three criteria is redeemable preferred stock regardless of other attributes such as voting rights or dividend rights.

Restricted Preferred Stock - Redeemable or perpetual preferred stock that must be traded in compliance with special SEC regulations concerning its purchase and resale. These restrictions generally result from affiliate ownership, M&A activity and underwriting activity. Pursuant to the SEC, restricted securities are securities acquired in an unregistered, private sale from the issuing company or from an affiliate of the issuer. They typically bear a “restrictive” legend clearly stating that the holding may not resell the stock in the public marketplace unless the sale is exempt from the SEC’s registration requirements.

Sinking Fund – A potential component of a preferred stock charter that requires the issuer to regularly set funds aside in a separate custodial account for the exclusive purpose of redeeming preferred stock shares. Failure of an issuer to provide to the sinking fund does not create an act of default. Rather, the stock charter may implement provisions for failing to provide to the sinking fund, which could include penalties, restrictions of providing common stock dividends or the repurchase of the preferred stock.

Step-Up Preferred Stock – A potential component of a preferred stock charter that identifies whether specific terms will increase over time or with stated provisions. For example, a “step-up dividend” is a feature that increases the dividend rate. A “step-up call” is a feature that increases the call price. A “step-up conversion” increases the conversion price.

Term Preferred Stock – Preferred stock with a mandatory redemption requirement (maturity date) captured in the definition of redeemable preferred stock.
Statutory Issue Paper No. 1XX

Preferred Stock

STATUS
Exposure Draft – March 18, 2020

Original SSAP: SSAP No. 32; Current Authoritative Guidance: SSAP No. 32R

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. The guidance within this issue paper introduces substantive revisions to SSAP No. 32—Preferred Stock pursuant to the Statutory Accounting Principles (E) Working Group’s (Working Group) Investment Classification Project. The Investment Classification Project reflects a comprehensive review to address a variety of issues pertaining to definitions, measurement and overall scope of the investment statements of statutory accounting principles (SSAPs).

2. The substantive revisions to SSAP No. 32 (illustrated in Exhibit A) under the Investment Classification Project, detailed within this issue paper, reflect the following key elements:
   
   a. Improves preferred stock definitions, with inclusion of information from U.S. generally accepted accounting principles (GAAP) for classifying preferred stock as redeemable or perpetual. The revisions also incorporate a new exhibit to capture various terms prevalent in preferred stock.

   b. Revises the measurement guidance to ensure appropriate, consistent measurement based on the type of preferred stock held and the terms of the preferred stock. The revisions also incorporate guidance for mandatory convertible preferred stock.

   c. Incorporates revisions to clarify impairment guidance as well as guidance for dividend recognition and redemption of preferred stock with the issuer.

DISCUSSION

3. This issue paper intends to provide information on discussions that occurred when considering revisions to SSAP No. 32 under the Investment Classification Project, as well as the adopted revisions.

Preferred Stock Definitions

4. The historical definition of preferred stock within SSAP No. 32 is “any class or shares of the holders which have any preference, either as to the payment of dividends or distribution of assets on liquidation, over the holder of common stock issued by an entity.” This definition has been identified as generally consistent with market terms, including the following NASDAQ and Financial Accounting Standards Board (FASB) definitions for common stock:

   a. NASDAQ Definition: A security that shows ownership in a corporation and gives the holder a claim, prior to the claim of common shareholders, on earnings and also generally on assets in the event of liquidation. Most preferred stock pays a fixed dividend that is paid prior to the common stock dividend, stated in a dollar amount or as a percentage of par
value. The stock does not usually carry voting rights. Preferred stock has characteristics of both equity and debt.

b. FASB Codification: A security that has preferential rights compared to common stock.

5. Comments received from interested parties in October 2019 indicated that the term “security” is not interchangeable as it pertains to preferred stock and requested all references be changed to “interest” or directly reference the type of stock under consideration. In review of the use of the term “security” in the issue paper, most instances represent existing references carried over from SSAP No. 32. NAIC staff recognizes that preferred stock is a “security” as demonstrated by the definitions from both the NASDAQ and FASB, but NAIC staff has proposed some revisions to limit the generic use of the term. The use of the term “security” in paragraph 8, paragraphs 10-13 and in Exhibit A (as it pertains to defining specific types of preferred stock) has been revised to “preferred stock.” The use of the term “security” in paragraph 3 has been retained as this usage mirrors the FASB definition for preferred stock.

5. Additional comments from interested parties suggested the removal of certain definitional language for differentiating between redeemable and perpetual preferred stock. The interested parties’ proposed edits included removing language indicating “redemption was outside the control of the issuer” or has “conditions for redemption which are not solely within the control of the issuer, such as stock which must be redeemed out of future earnings.” NAIC staff has not incorporated these edits, as the changes would result in differences from the FASB definitions. Although these definition aspects are written from the perspective of the issuer, the holder must classify preferred stock for accounting and reporting in a manner that is consistent with the asset issuer. As such, for consistency and to prevent confusion on whether there is intended to be a change in definitions from FASB, the FASB definition of preferred stock has been retained.

6. NAIC staff’s original intent was to align various investment definitions with common industry definitions or those specified by U.S. GAAP. As a part of the investment reclassification project, this practice began with unaffiliated common stock (SSAP No. 30R) and now has expanded into preferred stock (SSAP No. 32). The definition proposed by NAIC staff was made with the understanding that preferred stock is either redeemable or perpetual. While the issue paper does mention some stock labeled as “redeemable perpetual preferred stock,” distinctions are made in the prospectus as to its true underlying characteristics (thus being redeemable or perpetual).

In general, NAIC staff continue to believe that for a majority of preferred stock issuances, a share which is redeemable at the option of the holder is by definition redeemable outside (or not solely within) the control of the issuer – the actions are mutually exclusive. However, interested parties cited guidance for additional circumstances in which, through legal technicalities, could create a third class of preferred shares – those redeemable outside the control of the issuer and holder. Since the definition refers to “outside the control of the issuer” as a determination for classifying a preferred share as redeemable (reported at amortized cost), certain circumstances which are technically “not solely within the issuer’s control” could cause shares to be reclassified to redeemable which were originally categorized as perpetual (reported at fair value). ASC 480-10 provides a few of these examples as: change in state law, the issuer fails to achieve certain project milestones, the issuer fails to pay specified dividends, the issuer experiences a change in credit rating, etc.

As such, NAIC staff are supportive of the changes suggested by interested parties as they align with the original objective of preferred stock classification and reflect the expected economics of the investment.

6.7. Although the historical definition of preferred stock in SSAP No. 32 is comparable to current market terms, this issue paper recommends revisions to incorporate the NASDAQ definition as it is more encompassing of the characteristics of preferred stocks.

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Definitions and Classification as Redeemable or Perpetual Preferred Stock

7.8 The accounting guidance of SSAP No. 32 varies based on whether preferred stock is considered to be “redeemable” or “perpetual.” The historical definitions of redeemable and perpetual within SSAP No. 32R reflected the following:

a. Redeemable preferred stock is defined as preferred stock that must be redeemed by the issuing enterprise or is redeemable at the option of the reporting entity. It includes mandatory sinking fund preferred stock and payment-in-kind (PIK) preferred stock.

b. Perpetual preferred stock is defined as preferred stock with no redemption or sinking fund features or preferred stock redeemable at the option of the issuer.

8.9 In comparing these terms to current U.S. GAAP, the guidance in the FASB Accounting Standards Codification (ASC), which is also consistent with Securities Exchange Commission (SEC) guidance, is more detailed in identifying the requirements for classification as redeemable preferred stock:

a. Preferred Stock Subject to Mandatory Redemption Requirements or Whose Redemption is Outside the Control of the Issuer (“Redeemable Preferred Stock”). The term means any stock which (i) the issuer undertakes to redeem at a fixed or determinable price on the fixed or determinable date or dates, whether by operation of a sinking fund or otherwise; (ii) is redeemable at the option of the holders, or (iii) has conditions for redemption which are not solely within the control of the issuer, such as stocks which must be redeemed out of future earnings. Under this definition, preferred stock which meet one or more of the above criteria would be classified as redeemable preferred stock regardless of their other attributes such as voting rights, dividend rights or conversion features. (FASB ASC 480-10-S99)

b. Preferred Stocks Which Are Not Redeemable or Are Redeemable Solely at the Option of the Issuer (“Non-Redeemable Preferred Stock”). The term means any preferred stock which does not meet the criteria for classification as a "redeemable preferred stock." (FASB ASC 480-10-S99)

9.10 In reviewing these definitions, and preferred stock components that permit payment of dividends in stock instead of cash (known as payment-in-kind (PIK) stock), it was identified that preferred stock that incorporates PIK dividends is not limited to redeemable preferred stock as implied in the prior SSAP No. 32 definition for redeemable preferred stock.

10.11 To ensure classification of redeemable and perpetual preferred stock consistently with U.S. GAAP, the definitions from the FASB ASC have been incorporated into the revised SSAP No. 32.

Definition of Restricted Stock:

11.12 The historical accounting guidance in SSAP No. 32 included a definition of restricted stock as “a security for which sale is restricted by governmental or contractual requirement (other than in connection with being pledged as collateral) except where that requirement terminates within one year or if the holder has the power by contract or otherwise to cause the requirement to be met within one year.” This definition identified that “any portion of the security that can be reasonably expected to qualify for sale within one year is not considered restricted.”

12.13 In researching this restricted stock definition, it was identified that this guidance was included in the original codification of SSAP No. 32, however, there was no identification of the source of this
definition from the issue paper. In reviewing current market terms for restricted stock or restricted securities, definitions and information was noted from both NASDAQ and the SEC:

a. Restricted Stock (NASDAQ): Stock that must be traded in compliance with special SEC regulations concerning its purchase and resale. These restrictions generally result from affiliate ownership, merger and acquisition (M&A) activity, and underwriting activity.

b. Restricted Securities (SEC): Securities acquired in an unregistered, private sale from the issuing company or from an affiliate of the issuer. They typically bear a “restrictive” legend clearly stating that you may not resell them in the public marketplace unless the sale is exempt from the SEC’s registration requirements. Rule 144 under the Securities Act of 1933 provides the most commonly used exemption for holders to sell restricted securities. To take advantage of this rule, you must meet several conditions, including a six-month or one-year holding period.

13-14. Using the information from both NASDAQ and the SEC, a revised definition of restricted stock has been incorporated into the revised SSAP No. 32. Additionally, the revisions clarify that restricted stock is generally an admitted asset but highlights that nonadmittance could occur in accordance with SSAP No. 4—Assets and Nonadmitted Assets. Under SSAP No. 4, the restrictions limiting use of an asset can be determined to preclude the ability to consider the asset as available for policyholder claims. In such situations, the restricted asset would be considered nonadmitted.

Definitions or Preferred Stock Components / Characteristics

14-15. The historical guidance in SSAP No. 32 included definitions for a couple of preferred stock terms, including “mandatory sinking fund” and “step-up preferred stock,” but did not include definitions of other common preferred stock components or terms. Furthermore, in reviewing the previously included terms, it was identified that they were no longer current and should be revised or removed from SSAP No. 32. For example, the definition of “mandatory sinking fund” included references to preferred stock outstanding in 1978, and the definition of “step-up preferred stock” referred to the Purposes and Procedures Manual of the NAIC Investment Analysis Office, and there is no current accounting or valuation guidance for step-up preferred stock in that Manual.

15-16. Rather than include a variety of terms in the body of the SSAP, particularly as components may not impact overall accounting and reporting of the preferred stock, a new exhibit has been included to include a glossary of key preferred stock terms. The definitions intend to capture current market-terms for the noted components.

Accounting and Reporting of Preferred Stock

16-17. The historical guidance in SSAP No. 32 captured different accounting and reporting provisions based on whether the preferred stock was classified as redeemable or perpetual, and whether the reporting entity maintained an Asset Valuation Reserve (AVR). Although these classifications are still considered appropriate, it has been noted that additional guidance is needed for mandatory convertible preferred stock, and that a review of the various measurement methods permitted (by classification) should occur to ensure appropriate measurement in the financial statements. Specifically, the prior guidance in SSAP No. 32 explicitly permitted “cost” as an applicable measurement method, even for perpetual preferred stock. Consistent with prior conclusions from U.S. GAAP, as well as the Statutory Accounting Principles (E) Working Group, “historical cost” is generally not an acceptable measurement method. Particularly, this measurement method is not acceptable when liquidation of an asset would generally occur at market prices, such as a non-redeemable (perpetual) preferred stock.
The changes reflected in the revised SSAP No. 32 continue to differentiate accounting and reporting guidance by whether a reporting entity maintains an AVR and on the type of preferred stock (redeemable or perpetual). However, revisions have been incorporated to clarify the accounting and reporting of mandatory convertible preferred stock and to update the measurement basis for each type of preferred stock:

a. For redeemable preferred stock, the revisions continue to use NAIC designations in determining the measurement method. There was no change proposed to the measurement basis per designation. However, the revisions clarify that the measurement basis shall be either amortized cost or fair value based on NAIC designation, eliminating reference to “cost” as an measurement method that could be used by a reporting entity. For the amortization of redeemable preferred stock, revisions have also been incorporated to clarify that amortization (or accretion) of any discount or premium is reported through investment income, instead of impacting dividends collected. Recognizing this amortization through investment income is consistent with U.S. GAAP.

b. For perpetual preferred stock, the revisions have eliminated use of NAIC designations in determining measurement method and the guidance requires use of fair value, not to exceed any stated call price from the prospectus of the preferred stock. As there are no requirements for an issuer to redeem these securities, these securities can continue indefinitely until the issuing entity reacquires the preferred stock at current market rates or elects to buy-back the preferred stock in accordance with rates established in the preferred stock prospectus. In order to prevent overstatement of the securities in the financial statements, the measurement of these preferred stocks reflects fair value, not to exceed any currently effective buy-back rates (call prices) that the issuer can utilize to redeem the stock. This measurement guidance is not impacted by the type of reporting entity (AVR or non-AVR filer) and is not impacted by NAIC designation. Although not impacted by NAIC designation, this guidance does not change the requirement to report the NAIC designation as the NAIC designation impacts the risk-based capital (RBC) charge attributed to the preferred stock.

c. For mandatory convertible preferred stock, guidance has been incorporated to require measurement at fair value, not to exceed any stated call price, in the periods prior to conversion. This guidance is applicable regardless if the preferred stock would be classified as redeemable or perpetual and is applicable regardless of NAIC designation. This guidance requires the preferred stock to be measured at the same measurement basis that would be required once converted to common stock. This prevents overstatement in the financial statements at the time of conversion.

d. For exchange traded funds which qualify for preferred stock treatment from the NAIC SVO, the revisions clarify that these investments shall always be treated as perpetual preferred stock. This classification is appropriate as the fund would not qualify as a redeemable preferred stock with a stated term that allows for amortization.

Impairment of Preferred Stock

The prior guidance in SSAP No. 32 included different guidance for determining other-than-temporary impairment (OTTI) based on whether the preferred stock was redeemable or perpetual. Although this division has been retained, modifications have been reflected as follows:

Interested parties noted that call dates may not be effective for a period of time. As such, language regarding that only “currently effective” buy back rates (call prices) was added.
a. For redeemable preferred stock, guidance has been captured to require assessment of OTTI whenever mandatory redemption rights or sinking fund requirements do not occur. Although preferred stock may indicate “required” elements, failing to provide dividends, or contribute to a sinking fund, may not be considered an act of default or require liability recognition from the issuer. Not receiving preferred stock provisions does not turn the holder of preferred stock into a creditor, and a redemption right cannot force a company to redeem shares. However, if an issuer fails to comply with “required” components, reporting entities should assess whether the preferred stock is other-than-temporarily impaired.

b. For perpetual preferred stock, the other-than-temporary impairment guidance has been revised to mirror guidance for other equity investments (e.g., common stock). As perpetual preferred stock will be reported at fair value, upon recognition of an OTTI, any unrealized losses will be realized, and the-then current fair value will become the new cost basis. Subsequent variations in fair value are treated as unrealized gains or losses.

c. Comments received from interested parties noted that proposed impairment guidance for perpetual preferred stock could be enhanced if written similar to existing impairment guidance in SSAP No. 30R—Unaffiliated Common Stock. Final proposed language in Exhibit A mimics the language in SSAP No. 30R.

Preferred Stock Income / Redemption

49-20. The guidance in this issue paper incorporates revisions to clarify the reporting of dividend income from preferred stock. This guidance clarifies that dividends shall be recognized in the form received (cash, preferred stock, common stock), at fair value, with differences between fair value and the dividend receivable recognized as gains or losses. Subsequent to initial recognition, the asset received shall follow the applicable statutory accounting statement. For example, dividends received in the form of common stock shall be captured in SSAP No. 30—Unaffiliated Common Stock.

20.21. Additionally, this issue paper incorporates new guidance to clarify the reporting when preferred stock is reacquired or redeemed by the issuing entity. Pursuant to this guidance, regardless of how an issuer reacquires the stock (either at market value or pre-set call / redemption price), the reporting entity would recognize any difference between the book/adjusted carrying value and the consideration received as a realized gain or loss.

Disclosures

21-22. Although this issue paper incorporates various accounting and reporting changes for preferred stock, there have been no revisions incorporated to the existing disclosure requirements.

Effective Date

22-23. The adoption of this issue paper by the Statutory Accounting Principles (E) Working Group, and the substantively revised statement of statutory accounting principles (SSAP) occurred on ______. The substantive revisions to SSAP No. 32R are detailed in Exhibit A of this issue paper and reflected in the substantively-revised SSAP No. 32R—Preferred Stock. The effective date of the guidance will be identified in the SSAP. Users of the Accounting Practices & Procedures Manual should note that issue papers are not represented in the Statutory Hierarchy (see Section IV of the Preamble) and therefore the conclusions reached in this issue paper should not be applied until the corresponding SSAP has been adopted by the Plenary of the NAIC.

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RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

- SSAP No. 32R—Preferred Stock
EXHIBIT A - REVISIONS TO SSAP No. 32—Preferred Stock

Preferred Stock

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for preferred stock.

2. Investments in preferred stock of entities captured in SSAP No. 97—Investments of in Subsidiaries, controlled or affiliated entities or SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies, including as well as preferred stock interests of certified capital companies (CAPCO) per INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO) are included within the scope of this statement. The requirement to file investments in preferred stock of certain subsidiaries, controlled or affiliated entities with the NAIC pursuant to SSAP No. 97 does not affect the application of the accounting, valuation or admissibility under this statement.

SUMMARY CONCLUSION

3. Preferred stock, which may or may not be publicly traded, is a security that shows represents ownership of a corporation and gives the holder a claim, prior to the claim of common stockholders on earnings and also generally on assets in the event of liquidation. Most preferred stock pays a fixed dividend that is paid prior to the common stock dividend, stated in a dollar amount or as a percentage of par value. Preferred stock does not usually carry voting rights. Preferred stock has characteristics of both common stock and debt, defined as any class or series of shares the holders of which have any preference, either as to the payment of dividends or distribution of assets on liquidation, over the holder of common stock (as defined in SSAP No. 30R—Unaffiliated Common Stock) issued by an entity. Preferred stock shall include:

a. Redeemable preferred stock, which is preferred stock subject to mandatory redemption requirements or whose redemption is outside the control at the option of the holders or issuer. Redeemable preferred stock is any stock which 1) the issuer undertakes to redeem at a fixed or determinable price on the fixed or determinable date or dates, whether by operation of a sinking fund or otherwise; or 2) is redeemable at the option of the holders; or 3) has conditions for redemption which are not solely within the control of the issuer, such as stock which must be redeemed out of future earnings. Preferred stock which meet one or more of these three criteria would be classified as redeemable preferred stock regardless of other attributes such as voting rights or dividend rights, including mandatory sinking fund preferred stock and preferred stock redeemable at the option of the holder;

b. Perpetual preferred stock, which is preferred stocks which are not redeemable or for which redemption is not at the option of the holder are redeemable solely at the option of the issuer (non-redeemable preferred stock). Perpetual preferred stock is any preferred stock which does not meet the criteria to be classified as redeemable preferred stock pursuant to

1 Certain legal entities captured in SSAP No. 48, such as LLCs that are corporate like, do not issue preferred stock in legal form, but instead issue identical instruments labeled preferred units, interests, or shares. These instruments shall be captured in this statement provided they meet the structural characteristics as defined in paragraph 3. Additionally, these instruments shall not be in-substance common stock in which the holder has risk and reward characteristics that are substantially similar to common stock.

2 Preferred stock shall be classified by its characteristics. For example, a preferred stock that is named “redeemable perpetual preferred stock” shall be reported as either “redeemable” or “perpetual” preferred stock based on whether the characteristics of paragraph 3a are met.
paragraph 3.a including nonredeemable preferred stock and preferred stock redeemable at the option of the issuer; and

4. The definition of preferred stock, as defined in paragraph 3 does not include equity/fund investments. However, the following types of SVO-identified investments are captured within scope of this statement.

   a. Exchange Traded Funds, which qualify for preferred stock treatment, as identified in Part Six, Section 2, of the Purposes and Procedures Manual of the NAIC Investment Analysis Office. SVO-Identified Preferred Stock ETFs shall follow the accounting provisions for perpetual preferred stock.

5. Redeemable preferred stock is defined as preferred stock that must be redeemed by the issuing enterprise or is redeemable at the option of the reporting entity. It includes mandatory sinking fund preferred stock and payment-in-kind (PIK) preferred stock.

6. Mandatory sinking fund preferred stock is defined as redeemable preferred stock subject to a 100% mandatory sinking fund, annual installments of which will (a) commence not more than 10 years from the date of issue or December 31, 1978, if outstanding on that date; (b) be not less than 2% of the number of shares issued (or outstanding on December 31, 1978, if issued prior to that date); (c) provide for the redemption of the entire issue over a period not longer than 40 years from the date of issue, or December 31, 1978, if outstanding on that date. Redeemable preferred stock which is subject to a 100% mandatory sinking fund, but which does not, at date of issue or December 31, 1978, if outstanding at that time, meet one or more of the other requirements above, shall be considered as mandatory sinking fund preferred stock at the time the deficiency is cured through the passage of time or otherwise.

7. PIK preferred stock is defined as redeemable preferred stock on which, at the option of the issuer, dividends can be paid in additional securities rather than cash.

8. Perpetual preferred stock is defined as preferred stock with no redemption or sinking fund features or preferred stock redeemable at the option of the issuer.

9.5. Restricted preferred stock is defined as a security either redeemable or perpetual preferred stock that must be traded in compliance with special Securities Exchange Commission (SEC) regulations concerning its purchase and resale. These restrictions generally result from affiliate ownership, merger and acquisition (M&A) activity and underwriting activity. Pursuant to the SEC, restricted securities are securities acquired in an unregistered, private sale from the issuing company or from an affiliate of the issuer. They typically bear a “restrictive” legend clearly stating that the holding may not resell the stock in the public marketplace unless the sale is exempt from the SEC’s registration requirements. Restricted preferred stock is generally considered an admitted asset; however, admittance may be limited based on the degree of restriction in accordance with SSAP No. 4—Assets and Nonadmitted Assets. Restricted preferred stock shall be coded as restricted in the investment schedule and disclosed pursuant to SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures, for which sale is restricted by governmental or contractual requirement (other than in connection with being pledged as collateral) except where that requirement terminates within one year or if the holder has the power by contract or otherwise to cause the requirement to be met within one year. Any portion of the security that can be reasonably expected to qualify for sale within one year is not considered restricted.

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3 This definition of restricted stock does not preclude a “restricted asset” classification for any preferred stock that is restricted (e.g., not under the exclusive control of the entity) by actions of the reporting entity or others. For example, if a reporting entity has pledged preferred stock, or used preferred stock in securities lending / repo transactions, the preferred stock shall be coded and disclosed as restricted stock pursuant to SSAP No. 1.
Preferred stocks meet the definition of assets as defined in SSAP No. 4—Assets and Nonadmitted Assets and are admitted assets to the extent they conform to the requirements of this statement.

**Acquisitions and Sales**

At acquisition, preferred stock shall be reported at cost, including brokerage and other related fees. Preferred PIK stock received as dividends shall be initially recorded at fair value. Acquisitions and dispositions shall be recorded on the trade date. Private placement stock transactions shall be recorded on the funding date.

A reporting entity can subscribe for the purchase of stock, but not be required to make payment until a later time. Transactions of this nature are common in the formation of corporations. Preferred stock acquired under a subscription represents a conditional transaction in which a security—preferred stock is authorized for issuance but not yet actually issued. Such transactions are settled if and when the actual security-preferred stock is issued and the exchange or National Association of Securities Dealers (NASD) rules that the transactions are to be settled. Preferred stock acquired under a subscription shall be recorded as an admitted asset when the reporting entity or its designated custodian or transfer agent takes delivery of the security-preferred stock and the security-preferred stock is recorded in the name of the reporting entity or its nominee, (i.e., the accounting for such preferred stock acquisitions shall be on the settlement date).

**Amortization**

Redeemable preferred stock purchased at a premium shall be amortized to reduce the carrying value to the call or redemption value over the period to the call or earliest redemption date, whichever produces the lowest asset value (yield to worst). Redeemable preferred stock purchased at a discount shall be amortized-accreted to increase the carrying value to par value—the redemption price over the period to maturity or the latest redemption date.

PIK preferred stock shall be amortized to the lower of the call price or par value, measured in either case at the end of the stock dividend period and based on all of the shares expected to be held at the end of that period, including those received as dividends.

Amortization (and accretion) of the premium and discount arising at acquisition shall be calculated using the interest method and shall be reported as increases or decreases in dividends collected during the year through investment income.

**Balance Sheet Amount**

The NAIC Securities Valuation Office assigns preferred stocks NAIC designations (NAIC designation 1 through 6) in accordance with the Purposes and Procedures Manual of the NAIC Investment Analysis Office, and that NAIC designation is published in accordance with the SVO compilation instructions in the Purposes and Procedures Manual.

Preferred stock shall be valued based on (a) the underlying characteristics of the security (redeemable, or perpetual or mandatory convertible), (b) the quality rating of the security—expressed as an NAIC designation pursuant to paragraph 15, and (c) whether an asset valuation reserve (AVR) is maintained by the reporting entity:

- For reporting entities that do not maintain an AVR:

- Step-up preferred stock (a security with the structure of a preferred stock, that has the cash flow characteristics of a debt instrument) is considered a security with characteristics of
both debt and equity, and the accounting and valuation of such securities shall be consistent with SVO guidelines as stipulated in the Purposes and Procedures Manual of the NAIC Investment Analysis Office.

17. For reporting entities required to maintain an AVR, the accounting for unrealized gains and losses shall be in accordance with SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve (SSAP No. 7). For reporting entities not required to maintain an AVR, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus).

a. Reporting Entities That Do Not Maintain An AVR

i. Highest-quality or high-quality redeemable preferred stocks (NAIC designations 1 and 2) which have characteristics of debt securities, shall be valued at cost or amortized cost. All other redeemable preferred stocks (NAIC designations 3 to 6) shall be reported at the lower of cost, amortized cost, or fair value.

ii. Highest-quality or high-quality perpetual preferred stocks (NAIC designations 1 and 2) which have characteristics of equity securities, shall be reported at fair value, not to exceed any currently effective stated call price. All other perpetual preferred stocks (NAIC designations 3 to 6) shall be reported at the lower of cost or fair value.

iii. Mandatory convertible preferred stocks (regardless if the preferred stock is redeemable or perpetual) shall be reported at fair value, not to exceed any currently effective stated call price, in the periods prior to conversion. Upon conversion to common stock, these securities shall be in scope of SSAP No. 30R.

iv. For preferred stocks reported at fair value, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus).

b. For reporting entities that maintain an AVR:

Reporting Entities That Do Maintain An AVR

i. Highest-quality, high-quality or medium quality redeemable preferred stocks (NAIC designations 1 to 3), which have characteristics of debt securities, shall be valued at cost or amortized cost. All other redeemable preferred stocks (NAIC designations 4 to 6) shall be reported at the lower of cost, amortized cost, or fair value.

ii. Highest-quality, high-quality or medium quality perpetual preferred stocks (NAIC designations 1 to 3), which have characteristics of equity securities, shall be valued at fair value, not to exceed any currently effective stated call price. All other perpetual preferred stocks (NAIC designations 4 to 6) shall be reported at the lower of cost or fair value.

iii. Mandatory convertible preferred stocks (regardless if the preferred stock is redeemable or perpetual) shall be reported at fair value, not to exceed any currently effective stated call price, in the periods prior to conversion. Upon conversion to common stock, these securities shall be in scope of SSAP No. 30R.
Impairment of Redeemable Preferred Stock

48-11. An other-than-temporary (INT 06-07) impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of the security—preferred stock in effect at the date of acquisition. An assessment of other-than-temporary impairment shall occur whenever mandatory redemption rights or sinking fund requirements do not occur. A decline in fair value which is other-than-temporary includes situations where the reporting entity has made a decision to sell a security—the preferred stock prior to its maturity at an amount below its carrying value (i.e., amortized cost). If it is determined that a decline in the fair value of a redeemable preferred stock is other-than-temporary, an impairment loss shall be recognized as a realized loss equal to the entire difference between the redeemable preferred stock’s carrying value and its fair value, not to exceed any currently effective call price, at the balance sheet date of the reporting period for which the assessment is made. The measurement of the impairment loss shall not include partial recoveries of fair value subsequent to the balance sheet date. For reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7.

49-12. In periods subsequent to the recognition of other-than-temporary impairment loss for a redeemable preferred stock, the reporting entity shall account for the other-than-temporarily impaired preferred stock security as if the preferred stock security had been purchased on the measurement date of the other-than-temporary impairment, and in accordance with paragraph 19 or paragraph 21, as applicable. The fair value of the redeemable preferred stock on the other-than-temporary impairment measurement date shall become the new cost basis of the redeemable preferred stock and the new cost basis shall not be adjusted for subsequent recoveries in fair value. The discount or reduced premium recorded for the preferred stock security, based on the new cost basis, shall be amortized over the remaining life of the preferred stock security in the prospective manner based on the amount and timing of future estimated cash flows. The preferred stock security shall continue to be subject to impairment analysis for each subsequent reporting period. Future declines in fair value which are determined to be other-than-temporary shall be recorded as realized losses.

Impairment of Perpetual Preferred Stock

20-13. For any decline in the fair value of perpetual preferred stock which is determined to be other-than-temporary (INT 06-07), the then-current fair value shall reflect the new cost basis of the preferred stock, with prior unrealized losses recognized as realized losses. Subsequent fluctuations in fair value shall be recorded as unrealized gains or losses. Future declines which are determined to be other-than-temporary shall be recognized as realized losses. The perpetual preferred stock shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. An impairment loss shall be recognized as a realized loss equal to the entire difference between the perpetual preferred stock’s carrying value and its fair value at the balance sheet date of the reporting period for which the assessment is made. The measurement of the impairment loss shall not include partial recoveries of fair value subsequent to the balance sheet date. For reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7. Subsequent fluctuations in fair value shall be recorded as unrealized gains or losses. Future declines which are determined to be other-than-temporary shall be recognized as realized losses. A decline in fair value which is other-than-temporary includes situations where the reporting entity has made a decision to sell a preferred stock security at an amount below its carrying value.
21. In periods subsequent to the recognition of an other-than-temporary impairment loss for a perpetual preferred stock, the reporting entity shall account for the other-than-temporarily impaired security as if the security had been purchased on the measurement date of the other-than-temporary impairment, and in accordance with paragraph 20 or paragraph 22, as applicable. The fair value of the perpetual preferred stock on the measurement date shall become the new cost basis of the perpetual preferred stock and the new cost basis shall not be adjusted for subsequent recoveries in fair value. Future declines in fair value which are determined to be other-than-temporary, shall be recorded as realized losses.

Income

14. Dividends on preferred stock (whether cumulative or noncumulative), other than mandatorily redeemable preferred stock, shall be recorded as investment income for qualifying dividend eligible preferred stock on the ex-dividend date with a corresponding receivable to be extinguished upon receipt of cash dividend settlement (i.e., dividend income shall be recorded on preferred stock declared to be ex-dividend on or prior to the statement date). Dividends received shall be recognized in the form received (e.g., cash, preferred stock, common stock) at fair value with differences between fair value and the dividend receivable recognized as gains or losses. Subsequent treatment shall follow the statement that addresses the type of asset received. (For example, dividends received in the form of common stock shall be accounted for and reported in accordance with SSAP No. 30R—Unaffiliated Common Stock.)

Redemption of Preferred Stock

15. A reporting entity that sells or redeems preferred stock back to the issuer shall recognize consideration received in excess of the book/adjusted carrying value as a realized gain or loss. This recognition shall occur regardless of whether the issuer repurchases the preferred shares at market value, or if the shares are redeemed by the issuer at a predetermined set call price.

22. Dividends on mandatorily redeemable preferred stock shall be accrued to the redemption price, even if not declared, using the interest method over the period ending on the redemption date.

23. Cash dividends paid on PIK stock during the stock dividend period shall be accounted for as a reduction in the investment.

Exchanges and Conversions

24-16. If preferred stock is exchanged or converted into other securities, the fair value of the preferred stock surrendered at the date of the exchange or conversion shall become the cost basis for the new securities with any gain or loss realized at the time of the exchange or conversion. However, if the fair value of the securities received in an exchange or conversion is more clearly evident than the fair value of the preferred stock surrendered, then it shall become the cost basis for the new securities.

Disclosures

25-17. The following disclosures regarding preferred stocks shall be made in the financial statements:

a. Fair values in accordance with SSAP No. 100R—Fair Value (SSAP No. 100R);

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

c. Basis at which the preferred stocks are stated; and
d. A description, as well as the amount, of preferred stock that is restricted and the nature of the restriction.

e. For each balance sheet presented, all preferred stocks in an unrealized loss position for which other-than-temporary declines in value have not been recognized

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

ii. The aggregate related fair value of preferred stocks with unrealized losses.

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

g. As of the date of the most recent balance sheet presented, additional information should be included describing the general categories of information that the investor considered in reaching the conclusion that the impairments are not other-than-temporary.

h. When it is not practicable to estimate fair value, the investor should disclose the following additional information, if applicable, as of each date for which a statement of financial position is presented in its annual financial statements:

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

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

26.18 Refer to the Preamble for further discussion regarding disclosure requirements. The disclosure requirements of paragraphs 3417.b., 3417.e., 3417.f., 3417.g. and 3417.h. shall be included in the annual audited statutory financial reports only.

Relevant Literature


Effective Date and Transition

20. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors. The guidance in paragraphs 23-26 was previously included within SSAP No. 99—Accounting for Securities Subsequent to an Other-Than-Temporary Impairment and was effective for reporting periods beginning on January 1, 2009, and thereafter, with early adoption permitted. In 2010, the guidance from SSAP No. 99 was incorporated within the impacted standards, with SSAP No. 99 superseded. The original impairment guidance included in this standard, and the substantive revisions reflected in SSAP No. 99 are retained for historical purposes within
Issue Paper No. 131. The guidance in paragraphs 2 and 3 to SSAP No. 32 was originally superseded January 1, 2005, by guidance included in SSAP No. 88—Investments in Subsidiaries, Controlled and Affiliated Entities, A replacement of SSAP No. 46, and then subsequently reflected in SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities. In 2011, the guidance related to preferred stock of SCAs from SSAP No. 97 was incorporated into this statement and revised to reflect a definition of preferred stock. The original guidance included in this statement, and the substantive revisions reflected in SSAP No. 88 and SSAP No. 97 (including the title change already reflected in SSAP No. 32) are retained for historical purposes within Issue Paper Nos. 32 and 118. Guidance in paragraph 17 was originally contained in INT 99-29: Classification of Step-Up Preferred Stock and was effective December 6, 1999.

28.21. In _, substantive revisions, as detailed in Issue Paper No. _, were adopted. These revisions, effective _, update definitions of preferred stock and reporting values based on characteristics of the preferred stock.

REFERENCES

Other

• Purposes and Procedures Manual of the NAIC Investment Analysis Office

• NAIC Valuation of Securities product prepared by the Securities Valuation Office

Relevant Issue Papers

• Issue Paper No. 32—Investments in Preferred Stock (excluding investments in preferred stock of subsidiary, controlled, or affiliated companies)

• Issue Paper No. 131—Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment

• Issue Paper No. 1XX—Preferred Stock
EXHIBIT A – GLOSSARY

Callable Preferred Stock – A preferred stock security in which the issuer has the right to call or redeem the stock at a preset price after a defined date. Callable preferred stock can be either redeemable preferred stock or perpetual preferred stock depending on other characteristics of the preferred stock. For example, callable preferred stock with a maturity or a specific buyback date would be redeemable preferred stock, whereas callable preferred stock electable at the discretion of the issuer is perpetual preferred stock.

Convertible Preferred Stock – A preferred stock security that is convertible into another security based on a conversion rate. For example, convertible preferred stock that is convertible into common stock on a two-for-one basis (two shares of common for each share of preferred).

Cumulative Preferred Stock – A preferred stock security with a provision that missed dividend payments must be paid to cumulative preferred shareholders before other classes of preferred stock shareholders and common shareholders can receive dividend payments. Cumulative preferred stock may have different levels, with a “first” or “senior” cumulative preferred, “regular” cumulative preferred and “subordinate” cumulative preferred that determines the priority in which accumulated unpaid dividends or asset liquidation occurs. (Under SSAP No. 32R, holders of cumulative preferred stock are not permitted to recognize a receivable for unpaid cumulative dividends until declared and the reporting entity is entitled to the divided.)

Dividend Declaration Date – The date a corporation declares a dividend payment to its shareholders.

Dividend Record Date – The date that identifies the shareholders that are entitled to a declared dividend.

Dividend Payment Date – The date the declared dividend will be paid.

Ex-Dividend Date – The cut-off date of holding stock to be captured as a shareholder on record entitled to the dividend. (A shareholder that sells their stock on the ex-dividend date would continue to be identified as a shareholder on record entitled to a declared dividend. Anyone who acquires a stock on the ex-dividend date would not be a shareholder on record entitled to a declared dividend.)

Mandatory Redeemable Preferred Stock – A preferred stock security that embodies an unconditional obligation requiring the issuer to redeem the instrument by transferring its assets at a specified or determinable date (or dates) or upon an event that is certain to occur. (The existence of a mandatory redemption right does not convert the holder of a preferred stock into a creditor, and an issuer may be prohibited from redeeming shares when redemption would cause an impairment of capital.)

Noncumulative Preferred Stock – A preferred stock security that does not entitle the stockholder to accumulated unpaid dividends. After missing dividend payments, a corporation only has to be make current dividend payments to preferred stock holders before providing dividends to common stock holders.

Participating Preferred Stock – A preferred stock security that gives the holder participation in the additional earnings of a business or liquidation rights in addition to the normal preferred stock dividend. Pursuant to the terms of the preferred stock, the participation rights may only be activated when income or operations of the issuer exceeds a certain threshold level.

Payment-in-kind (PIK) – A term of the preferred stock prospectus that identifies that dividends may take the form of securities (e.g., common stock) rather than cash.
**Perpetual Preferred Stock** - Preferred stocks which are not redeemable or are redeemable solely at the option of the issuer. Perpetual preferred stock is any preferred stock which does not meet the criteria to be classified as redeemable preferred stock.

**Preferred stock** - A security, which may or may not be publicly traded, that shows ownership of a corporation and gives the holder a claim, prior to the claim of common stockholders on earnings and also generally on assets in the event of liquidation.

**Redeemable Preferred Stock** - Preferred stock subject to mandatory redemption requirements or whose redemption is outside the control of the issuer. Redeemable preferred stock is any stock which 1) the issuer undertakes to redeem at a fixed or determinable price on the fixed or determinable date or dates, whether by operation of a sinking fund or otherwise; 2) is redeemable at the option of the holders; or 3) has conditions for redemption which are not solely within the control of the issuer, such as stock which must be redeemed out of future earnings. Preferred stock which meet one or more of these three criteria is redeemable preferred stock regardless of other attributes such as voting rights or dividend rights.

**Restricted Preferred Stock** - Redeemable or perpetual preferred stock that must be traded in compliance with special SEC regulations concerning its purchase and resale. These restrictions generally result from affiliate ownership, M&A activity and underwriting activity. Pursuant to the SEC, restricted securities are securities acquired in an unregistered, private sale from the issuing company or from an affiliate of the issuer. They typically bear a “restrictive” legend clearly stating that the holding may not resell the stock in the public marketplace unless the sale is exempt from the SEC’s registration requirements.

**Sinking Fund** – A potential component of a preferred stock charter that requires the issuer to regularly set funds aside in a separate custodial account for the exclusive purpose of redeeming preferred stock shares. Failure of an issuer to provide to the sinking fund does not create an act of default. Rather, the stock charter may implement provisions for failing to provide to the sinking fund, which could include penalties, restrictions of providing common stock dividends or the repurchase of the preferred stock.

**Step-Up Preferred Stock** – A potential component of a preferred stock charter that identifies whether specific terms will increase over time or with stated provisions. For example, a “step-up dividend” is a feature that increases the dividend rate. A “step-up call” is a feature that increases the call price. A “step-up conversion” increases the conversion price.

**Term Preferred Stock** – Preferred stock with a mandatory redemption requirement (maturity date) captured in the definition of redeemable preferred stock.
Issue: Accounting for Bond Tender Offers

Check (applicable entity):

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

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Description of Issue: Questions have arisen regarding the accounting treatment for when a held bond is retired early through the acceptance of a “bond tender offer.” A bond tender offer occurs when the bond issuer repurchases some, or all, of a particular bond issuance prior to its scheduled maturity date. These offers are generally an attempt to retire a substantial amount of outstanding debt by making a one-time, special offer to bond holders. Generally, the purpose of a tender offer is to retire bonds that were originally issued at higher interest rates; however, some tender offers have occurred as a mechanism for capital restructuring. As expected, these activities are most common in a decreasing or depressed interest rate environment.

Tender offers typically share similar characteristics in that the offer is: 1) for a predetermined (finite) number of bonds, 2) a specified, nonnegotiable price, 3) available to the market as a whole – generally advertised through a press release, 4) only available for a limited period of time, and 5) contingent upon acceptance by a substantial percentage of debt holders – generally accepted by at least 25% of those eligible for early buyout.

From a bond holder’s perspective, the only material difference between a called and tendered bond is that with the tender offer, the bond holder must elect to accept the repurchase offer. If the tender offer is not accepted, the bond’s terms (including scheduled maturity date) remain unchanged. Bond tender offers are generally offered at rates slightly above market value, as an economic enticement for the holder to “sell” the bond. This increased compensation is reflective of prepayment penalties and/or acceleration fees noted in called bonds. The reinvestment risk assumed by holding a bond with a call option is generally compensation through a higher yield or a known prepayment penalty. Similarly, through a bond tender offer, increased compensation comes in the form of additional termination payout as compared to current market value.

Specific guidance for the reporting and allocation of investment income and/or capital gain/loss associated with callable bonds (where the issuer, at its sole discretion, can redeem a bond before it scheduled maturity date) is noted in SSAP No. 26R—Bonds; however guidance is not reflected for when a bond is retired early through a tender offer. As previously discussed, called bonds and bond tender offers are similar in the fact that the issuer can retire a bond early, however with a bond tender offer, the holder must elect to accept the offer. If the offer is not accepted, the original terms of the bond are not modified.

Existing Authoritative Literature:

The reporting of prepayment penalties or acceleration fees in the event a bond is liquidated prior to its scheduled termination date are detailed in SSAP No. 26R—Bonds.

Income

15. Interest income for any period consists of interest collected during the period, the change in the due and accrued interest between the beginning and end of the period as well as reductions for premium amortization and interest paid on acquisition of bonds, and the addition of discount accrual. In accordance with SSAP No. 34—Investment Income Due and Accrued, investment income shall be reduced for amounts
which have been determined to be uncollectible. Contingent interest may be accrued if the applicable provisions of the underlying contract and the prerequisite conditions have been met.

16. A bond may provide for a prepayment penalty or acceleration fee in the event the bond is liquidated prior to its scheduled termination date. Such fees shall be reported as investment income when received.

17. The amount of prepayment penalty and/or acceleration fees to be reported as investment income or loss shall be calculated as follows:

   a. For called bonds in which the total proceeds (consideration) received exceeds par:
      i. The amount of investment income reported is equal to the consideration received less the par value of the investment; and
      ii. Any difference between the book adjusted carrying value (BACV) and the par value at the time of disposal shall be reported as realized capital gains and losses, subject to the authoritative literature in SSAP No. 7.

   b. For called bonds in which the consideration received is less than par:
      i. To the extent an entity has in place a process to identify explicit prepayment penalty or acceleration fees, these should be reported as investment income. (An entity shall consistently apply their process. Once a process is in place, an entity is required to maintain a process to identify prepayment penalties for called bonds in which consideration received is less than par.)
      ii. After determining any explicit prepayment penalty or acceleration fees, the reporting entity shall calculate the resulting realized gain as the difference between the remaining consideration and the BACV, which shall be reported as realized capital gain, subject to the authoritative literature in SSAP No. 7.

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:
While bond tenders were not specifically discussed, the accounting and reporting of revenues as a result of early termination, was addressed in agenda item 2018-32: SSAP No. 26R—Prepayment Penalties. In this agenda item, authoritative guidance was adopted detailing the breakout of revenues between investment income and capital gains when the called bond consideration was less than par.

Convergence with International Financial Reporting Standards (IFRS): N/A

Staff Recommendation: NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 26R—Bonds to clarify that the accounting and reporting of investment income and capital gain/loss, due to the early liquidation either through a call or a tender offer, shall be similarly applied. NAIC staff believes this is in line with original intent as the initial SSAP No. 26 codification guidance (still reflected in paragraph 16 of SSAP No. 26R) is not specific to called bonds. Rather, the guidance refers to “prepayment penalties or acceleration fees in the event the bond is

1 This guidance applies to situations in which consideration received is less than par but greater than the book adjusted carrying value (BACV). Pursuant to the yield-to-worst concept, bonds shall be amortized to the call or maturity date that produces the lowest asset value. In the event a bond has not been amortized to the lowest value prior to the call (BACV is greater than the consideration received), the entire difference between consideration received and the BACV shall be reported to investment income.
liquidated prior to its scheduled termination date.” This guidance would seemingly include all dynamics in which an issuer provides a penalty / fee to the holder to terminate the bond.

A bond retired early through either a call or tender offer are functionally equivalent to a bond holder. The only potential additional consideration for the bond holder is that the yield-to-worst concept was likely not applied in relation to the bond tender offer (as the tender offer amount and date were not known/expected at the time of acquisition). However, this concern is negated as bond tender offers are generally at or above market value and the holder must elect to participate. If a bond tender offer is not economically beneficial to the holder, the holder would simply not participate.

SSAP No. 26R – Proposed Updates

16. A bond may provide for a prepayment penalty or acceleration fee in the event the bond is liquidated prior to its scheduled termination date. Such fees shall be reported as investment income when received.

17. The amount of prepayment penalty and/or acceleration fees to be reported as investment income or loss shall be calculated as follows:

a. For called or tendered bonds in which the total proceeds (consideration) received exceeds par:
   i. The amount of investment income reported is equal to the consideration received less the par value of the investment; and
   ii. Any difference between the book adjusted carrying value (BACV) and the par value at the time of disposal shall be reported as realized capital gains and losses, subject to the authoritative literature in SSAP No. 7.

b. For called or tendered bonds in which the consideration received is less than par:
   iii. To the extent an entity has in place a process to identify explicit prepayment penalty or acceleration fees, these should be reported as investment income. (An entity shall consistently apply their process. Once a process is in place, an entity is required to maintain a process to identify prepayment penalties for called bonds in which consideration received is less than par.)
   iv. After determining any explicit prepayment penalty or acceleration fees, the reporting entity shall calculate the resulting realized gain as the difference between the remaining consideration and the BACV, which shall be reported as realized capital gain, subject to the authoritative literature in SSAP No. 7.

Staff Review Completed by: Jim Pinegar, NAIC Staff – January 2020

Status:
On March 18, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 26R—Bonds, to clarify that the accounting and reporting of investment income and capital gain/loss, due to the early liquidation either through a call or a tender offer, shall be similarly applied. The current guidance refers to “prepayment penalties or acceleration fees in the event the bond is liquidated prior to its schedule termination date,” and includes all dynamics in which an issuer provides a penalty/fee to the holder to terminate the bond. This item has a comment period deadline ending May 29, 2020.

This guidance applies to situations in which consideration received is less than par but greater than the book adjusted carrying value (BACV). Pursuant to the yield-to-worst concept, bonds shall be amortized to the call or maturity date that produces the lowest asset value. In the event a bond has not been amortized to the lowest value prior to the call, or in cases of an accepted tender bond offer (BACV is greater than the consideration received), the entire difference between consideration received and the BACV shall be reported to investment income.
Interpretation of the Statutory Accounting Principles Working Group


INT 20-02 Dates Discussed

Email Vote to Expose March 26, 2020; April 15, 2020

INT 20-02 References

SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers (SSAP No. 6)
SSAP No. 47—Uninsured Plans (SSAP No. 47)
SSAP No. 51—Life Contracts (SSAP No. 51)
SSAP No. 65—Property and Casualty Contracts (SSAP No. 65)

INT 20-02 Issue

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

2. Should a temporary extension of the 90-day rule, extending the nonadmission guidance for premium receivables due from policyholders or agents and for amounts due from policyholders for high deductible policies, and for uncollected uninsured plan receivables (excluding Medicare and similar government plans) be granted for the March 31st and June 30th, 2020 (1st and 2nd quarter) financial statements, for policies in U.S. jurisdictions that have been impacted by COVID-19?

INT 20-02 Discussion

3. The Working Group reached a consensus for a one-time optional extension of the ninety-day rule for uncollected premium balances, bills receivable for premiums and amounts due from agents and policyholders and for amounts due from policyholders for high deductible policies and amounts due from non-government uninsured plans, as follows:

   a. For policies in effect and current prior to the date as of the declaration of a state of emergency by the U.S. federal government on March 13, 2020 and policies written or renewed on or after March 13, insurers may follow the timeline described in paragraph 5 before nonadmitting premiums receivable from policyholders or agents as required per SSAP No. 6, paragraph 9.

   b. For uncollected uninsured plan receivables (excluding Medicare and similar government plans) which were current prior to the date of the declaration of a state of emergency by the U.S. federal government on March 13, 2020 and policies written or renewed on or after March 13, insurers may follow the timeline described in paragraph 5 before nonadmitting these balances as required per SSAP No. 47, paragraph 10.a.

   c. For life premium due and uncollected which were current prior to the date of the declaration of a state of emergency by the U.S. federal government on March 13, 2020, and policies written or
renewed on or after March 13, insurers may follow the timeline described in paragraph 5 before nonadmitting these balances as required per SSAP No. 51R, paragraph 12.

d. For high deductible policies in effect and current prior to the date as of the declaration of a state of emergency by the U.S. federal government on March 13, 2020 and policies written or renewed on or after March 13, insurers may follow the timeline described in paragraph 5 before nonadmitting amounts due from policyholders for high deductible policies as required per SSAP No. 65, paragraph 37.

e. Existing impairment analysis remains in effect for these affected policies.

4. The Working Group noted that a 60-day extension had been granted previously for regionally significant catastrophes, including INT 13-01: Extension of Ninety-Day Rule for the Impact of Hurricane/Superstorm Sandy; and INT 05-04: Extension of Ninety-day Rule for the Impact of Hurricane Katrina, Hurricane Rita and Hurricane Wilma, INT 17-01: Extension of Ninety-Day Rule for the Impact of Hurricane Harvey, Hurricane Irma and Hurricane Maria, and INT 18-04: Extension of Ninety-Day Rule for the Impact of Hurricane Florence and Hurricane Michael. This recommendation is for a longer period than the extensions that have been granted in the past as COVID-19 is a nationally significant event due to the expected overall impact to the U.S. economy.

5. Due to the short-term nature of this extension, which is only applicable for the March 31st and June 30th, 2020 (1st and 2nd quarter) financial statements and only for the categories of assets listed in paragraph 3, this interpretation will be publicly posted on the Statutory Accounting Principles (E) Working Group’s website. This INT will allow assets that meet the definition of paragraph 3 to be admitted assets even if they are greater than 90 days past due. As the exceptions provided in this interpretation are not applicable in the September 30, 2020 (3rd quarter) financial statements, this interpretation will automatically expire as of September 29, 2020. This interpretation will be automatically nullified on September 29, 2020 and will be included as a nullified INT in Appendix H – Superseded SSAPs and Nullified Interpretations in the “as of March 2021” Accounting Practices and Procedures Manual.

INT 20-02 Status

6. The Statutory Accounting Principles (E) Working Group will subsequently review this interpretation to determine if an extension is needed to the effective date.
Interpretation of the Statutory Accounting Principles Working Group

INT 20-04: Mortgage Loan Impairment Assessment Due to COVID-19

INT 20-04 Dates Discussed

Email Vote to Expose March 26, 2020; April 15, 2020

INT 20-04 References

SSAP No. 26R—Bonds
SSAP No. 30—Common Stock
SSAP No. 37—Mortgage Loans
SSAP No. 43R—Loan-backed and Structured Securities
SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies

INT 20-04 Issue

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

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

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

4. This interpretation intends to address the impact of loan forbearance or prudent modifications on the statutory accounting and reporting requirements for bank loans, mortgage loans, as well as investments with underlying mortgage loans. Particularly, this interpretation considers whether a temporary, limited-time statutory exception for the assessment of impairment shall be granted for bank loans, mortgage loans and investment products with underlying mortgage loans. This exception would only defer the assessment of impairment due to situations caused by the forbearance or modification of mortgage loan payments and would not delay the recognition of other than temporary impairments if the entity made a decision to sell the investment and/or if provisions other than the limited-time forbearance or modifications of mortgage loans payments caused the entity to identify that they would not recover the reported carrying value of the investment.
INT 20-04 Discussion

5. Although a variety of structures have the potential to be impacted by the economic stimulus provisions, this interpretation is limited to investments specifically identified. Except for the specific inclusion of bank loans, this interpretation does not include investments captured in scope of SSAP No. 26R—Bonds or investments captured in the identified standards that are not predominantly impacted by underlying mortgage loans with forbearance or modification provisions in response to COVID-19. Investments in scope of this interpretation include:

   a. SSAP No. 26R—Bonds: Bank loans in scope of SSAP No. 26R

   b. SSAP No. 37—Mortgage Loans: All mortgage loans in scope of SSAP No. 37.

   c. SSAP No. 30—Common Stock: SEC registered investments with underlying mortgage loans (e.g., mortgage-backed mutual funds).

   d. SSAP No. 43R—Loan-backed and Structured Securities: Securities in scope of SSAP No. 43R with underlying mortgage loans. This includes residential and commercial mortgage backed securities (RMBS & CMBS), and credit risk transfers (CRTs) issued through government sponsored enterprises (GSEs). Other investments in scope of SSAP No. 43R are also captured within this interpretation if the underlying investments predominantly reflect mortgage loan products.

   e. SSAP No. 48—Joint Ventures, Partnerships and Limited Liabilities Companies: Investments in scope of SSAP No. 48 that have underlying characteristics of mortgage loans. These investments could include private equity mortgage loan funds.

Bank Loans

6. Bank loans, if meeting certain parameters, are in scope of SSAP No. 26R—Bonds. Bank loans per SSAP No. 26R, are defined as fixed-income instruments, representing indebtedness of a borrower, made by a financial institution. Bank loans can be issued directly by a reporting entity or acquired through an assignment, participation or syndication. The guidance in SSAP No. 26R states an other-than-temporary impairment shall be considered to have occurred if it is probable the reporting entity will be unable to collect amounts due according to the contract terms of a debt security in effect at the date of issue/acquisition. The measurement of the impairment loss shall not include partial recoveries of fair value subsequent to the balance sheet date. The impairment guidance applicable to bank loans states that if it is probable or if repayment does not occur according to the terms of the original contract (i.e. payment timing and amounts), an impairment shall be considered to have occurred.

Mortgage Loans

7. Mortgage loans are in scope of SSAP No. 37—Mortgage Loans and reported on Schedule B: Mortgage Loans. The guidance in SSAP No. 37, paragraph 16 identifies that a mortgage loan shall be considered impaired when mortgage loan payments are not received in accordance with the contractual terms of the mortgage agreement. As such, a deference or modification of mortgage loan payments (whether interest or principal) would ordinarily trigger an impaired classification and require impairment assessment under SSAP No. 37. The guidance in SSAP No. 37 utilizes a valuation allowance to recognize unrealized losses from impairment assessments and permits subsequent reversals of unrealized losses reflected in the valuation allowance based on subsequent assessments. If an impairment is deemed other than temporary, the unrealized loss is realized without the potential for subsequent recoveries.
SEC Registered Funds with Underlying Mortgage Loans

8. The scope of SSAP No. 30—Common Stock includes SEC registered open-end investment companies (mutual funds), closed-end funds and unit investment trusts, regardless of the types or mix of securities owned by the fund. Investments in scope of this statement include mortgage-backed mutual funds and other such investments. Items in scope of SSAP No. 30 are reported on Schedule D-2: Common Stock. These investments are reported at fair value, with changes in fair value recognized as unrealized gains or losses. The guidance in SSAP No. 30 requires recognition of an other than temporary impairment (OTTI) (realized loss) if a reporting entity decision has decided to sell the security at an amount below its carrying value or if the decline in fair value is determined to be other than temporary pursuant to INT 06-07: Definition of Phrase “Other Than Temporary.” As investments in scope of SSAP No. 30 are reported at fair value, subsequent recoveries (or losses) in fair value, after recognition of an OTTI, are recognized as unrealized gains or losses until sold or additional OTTI recognition.

Loan-Backed and Structured Securities with Underlying Mortgage Loans

9. The scope of SSAP No. 43R—Loan-backed and Structured Securities includes residential mortgage backed securities (RMBS), commercial mortgage backed securities (CMBS) and credit risk transfers (CRTs) issued through government sponsored enterprises (GSEs). (These are commonly referred as Structured Agency Credit Risk Securities (STACRs), which are issued by Freddie Mac, and Connecticut Avenue Securities (CAS), which are issued by Fannie Mae.) Other mortgage loan products that meet the structural requirements as a LBSS can also be captured in scope of SSAP No. 43R. Investments in scope of this statement securities are reported on Schedule D-1: Long-Term Bonds. Pursuant to the guidance in SSAP No. 43R, paragraphs 30-36, if a fair value of a LBSS is less than its amortized cost basis at the balance sheet date, an entity shall assess whether the impairment is other than temporary. Recognition of an OTTI is then contingent on the reporting entity intentions:

a. If the entity intends to sell the security, an OTTI shall be considered to have occurred. In these situations, the entity shall recognize a realized loss for the difference between the amortized cost basis and fair value. These realizes losses are not permitted to be reversed.

b. If the entity does not intend to sell the security, the entity shall assess whether it has the intent and ability to retain the investment in the security for a period of time sufficient to recover the amortized cost basis. If the entity does not have the intent and ability to retain the investment for the time sufficient to recover the amortized cost basis, an OTTI shall be considered to have occurred. In these situations, the entity shall recognize a realized loss for the difference between the amortized cost basis and fair value. These realizes losses are not permitted to be reversed.

c. Regardless if the entity does not have the intent to sell or has the intent and ability to hold, if the entity does not expect to recover the entire amortized cost basis of the security, an OTTI shall be considered to have occurred. In these situations, the entity shall recognize a realized loss for the difference between the amortized cost basis and fair value. These realizes losses are not permitted to be reversed.

Other Invested Assets with Underlying Mortgage Loans

10. The scope of SSAP No. 48—Joint Ventures, Partnerships and Limited Liabilities Companies includes investments that may have underlying characteristics of mortgage loans. These items are reported on Schedule BA: Other Long-Term Invested Assets. These investments could include private equity mortgage loan funds as well mortgage or hybrid real estate investment trusts (REITs). The guidance in SSAP No. 48, paragraph 19 requires recognition of an OTTI if it is probable that the reporting entity will be unable to recover the carrying amount of the investment or sustain earnings to justify the carrying amount of the investment. The existing
guidance already indicates that a depressed fair value below the carrying amount or the existence of operating losses are not necessarily indicators of a loss that is other than temporary.

INT 20-04 Consensus

11. The Working Group reached a consensus for limited time exceptions to defer assessments of impairment for bank loans, mortgage loans and investments which predominantly hold underlying mortgage loans, which are impacted by forbearance or modifications in response to COVID-19. These exceptions are applicable for the March 31st and June 30th, 2020 (1st and 2nd quarter) financial statements and only in response to mortgage loan forbearance or modifications granted in response to COVID-19. As such, the exceptions provided in this interpretation are not applicable in the September 30, 2020 (3rd quarter) financial statements.

12. For modification programs designed to provide temporary relief for borrowers current as of December 31, 2019, the reporting entities may presume that borrowers are current on payments are not experiencing financial difficulties at the time of the modification for purposes of determining impairment status and thus no further impairment analysis is required for each loan modification in the program. The exceptions granted in this interpretation are detailed as follows:

a. SSAP No. 26—Bonds: Provide a limited-time exception for assessing impairment under SSAP No. 26, paragraph 13, for bank loans with payments (either principal or interest) that have short-term deferrals or modifications in response to COVID-19. This interpretation shall not delay impairment assessments for reasons other than the short-term deferral or modification of interest or principal payments in response to COVID-19 and shall not delay recognition of realized losses if a reporting entity believes a bank loan is OTTI.

b. SSAP No. 37—Mortgage Loans: Provide a limited-time exception for assessing impairment under SSAP No. 37, paragraph 16, for mortgage loans with payments (either principal or interest) that have short-term deferrals or modifications in response to COVID-19. This interpretation shall not delay impairment assessments for reasons other than the short-term deferral or modification of interest or principal payments in response to COVID-19 and shall not delay recognition of realized losses if a reporting entity believes a mortgage loan is OTTI.

c. SSAP No. 30R—Common Stock: Provide a limited-time exception for assessing OTTI under SSAP No. 30, paragraph 10, and INT 06-07 due to fair value declines for SEC registered funds that have underlying mortgage loans that have been deferred or modified in response to COVID-19 unless the reporting entity intends to sell the security. If the entity has made a decision to sell the security, recognition of the OTTI shall continue to be required. As these investments are reported at fair value, declines in fair value would continue to be reported as unrealized losses.

d. SSAP No. 43R—Loan-backed and Structured Securities: Provide a limited-time exception for assessing OTTI under SSAP No. 43R, paragraphs 30-36, due to fair value declines in investments that have underlying mortgage loans deferred or modified in response to COVID-19 unless the reporting entity intends to sell the security. If the entity has made a decision to sell the security, then recognition of an OTTI shall continue to be required.

e. SSAP No. 48—Joint Ventures, Partnerships and Limited Liabilities Companies: Provide a limited-time exception for assessing OTTI under SSAP No. 48 due to fair value declines in investments that have underlying mortgage loans deferred or modified in response to COVID-19 unless the entity intends to sell the security. Additionally, an OTTI shall be assessed if factors other than the mortgage loan forbearance or modification have resulted with a decline that is considered other than temporary, or the reporting entity does not believe it is probable they will collect the carrying amount of the investment.
13. Subsequent to modifications or restructurings that impact original contractual terms of items in scope of this interpretation, future assessments of impairment shall be based on the modified terms.

14. As detailed in paragraph 11, the exceptions granted in this interpretation are applicable for the March 31st and June 30th, 2020 (1st and 2nd quarter) financial statements and only in response to bank and mortgage loan forbearance or modifications granted in response to COVID-19. As the exceptions provided in this interpretation are not applicable in the September 30, 2020 (3rd quarter) financial statements, this interpretation will automatically expire as of September 29, 2020. This interpretation will be publicly posted on the Statutory Accounting Principles (E) Working Group’s website. This interpretation will be automatically nullified on September 29, 2020 and will be included as a nullified INT in Appendix H – Superseded SSAPs and Nullified Interpretations in the “as of March 2021” Accounting Practices and Procedures Manual.

**INT 20-04 Status**

15. The Statutory Accounting Principles (E) Working Group will subsequently review this interpretation to determine if an extension is needed to the effective date.

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Interpretation of the Statutory Accounting Principles Working Group

INT 20-05: Investment Income Due and Accrued

INT 20-05 Dates Discussed

Email Vote to Expose May 5, 2020; May 20, 2020

INT 20-05 References

- SSAP No. 34—Investment Income Due and Accrue

INT 20-05 Issue

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

2. In response to COVID-19, temporary interpretations have been considered to provide exceptions to existing statutory accounting guidance with regards to the 90-day rule for various receivables, as well as guidance on the assessment of impairment and trouble debt restructurings. In response to these interpretations, a request to provide a temporary exception to SSAP No. 34—Investment Income Due and Accrued has been requested.

3. This interpretation intends to assess the requirements to review investment income due and accrued and consider whether temporary exceptions could be granted in response to COVID-19. Issues addressed within this interpretation include:
   a. Recognition and admittance of investment income under SSAP No. 34.
   b. Review of FASB staff technical inquiries and responses on investment income.

INT 20-05 Discussion

SSAP No. 34 Provisions

4. Investment income due is defined in SSAP No. 34 as the investment income earned and legally due to be paid to the reporting entity as of the reporting date. Investment income accrued is defined as investment income earned as of the reported date but not legally due to be paid to the reporting entity until subsequent to the reporting date.

5. Pursuant to SSAP No. 34, investment income due and accrued shall be recorded as an asset and assessed for impairment in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets. Amounts determined to be uncollectible shall be written off, and then an assessment shall be made of the remaining balance to determine nonadmitted amounts. SSAP No. 34 identifies this as a two-step process as follows:
   a. Investment income due and accrued is assessed for collectibility. If in accordance with SSAP No. 5R, it is probable the investment income due and accrued balance is uncollectible, the amount shall be written off and shall be charged against investment income in the period the determination was made.
b. Any remaining investment income due and accrued (amounts considered probable for collection) representing either 1) amounts that are over 90-days past due (generated by any assets except mortgage loans in default) or 2) amounts designated elsewhere in the *NAIC Accounting Practices and Procedures Manual* as nonadmitted shall be considered nonadmitted. These items shall be subject to continuing assessments of collectibility and, if determined to be uncollectible, a write-off shall be recorded in the period such determination is made.

6. Pursuant to SSAP No. 34, accrued interest on mortgage loans in default shall only be recorded if deemed collectible. If uncollectible, accrued interest shall not be recorded and any previously accrued amounts shall be written off. If a mortgage loan in default has interest 180-days past due, which is assessed as collectible, all interest shall be recorded as a nonadmitted asset.

**FASB Staff Technical Inquiry**

7. The FASB staff received a technical inquiry regarding the recognition of interest income in response to COVID-19 when a “loan payment holiday” is provided that allows the borrowers to temporarily stop payments. The FASB Staff technical inquiry on interest income recognition was discussed April 17, 2020. In the scenario considered by the FASB staff:

   a. Interest is not accrued when the loan payment holiday is in effect.
   b. The loan modification did not represent a troubled debt restructuring.
   c. The loan modification would be accounted for as a continuation of the original lending arrangement (not as an extinguishment with a new loan recognized).

8. With this inquiry two views were presented in how interest should be recognized when a payment holiday is given and interest is not accrued:

   a. View 1 – Upon modification, a new effective interest rate is determined that equates to the revised remaining cash flows to the carrying amount of the original debt and is applied prospectively for the remaining term. That is, interest income is recognized during the payment period holiday.
   b. View 2 – Upon modification, the institution should recognize interest income on the loan in accordance with the contractual terms. Under this view, the institution would not recognize interest income during the payment holiday and would resume recognizing interest income when the payment holiday.

9. The FASB staff reviewed the submission and concluded both views to be appropriate.

**INT 20-05 Consensus**

10. The Working Group considered limited time collectibility assessments and admittance exceptions for investment income due and accrued and reached the following consensus:

   a. Continue with existing guidance in SSAP No. 34 that investment income shall be recorded when due (earned and legally due) or accrued (earned but not legally due until after the reporting date). If investments have been impacted by forbearance or other modification provisions, a reporting entity shall assess whether the investment income has been earned in accordance with the modified terms. Investment income shall only be recognized when earned.
b. Continue with existing guidance in SSAP No. 34 to require an assessment of whether recorded investment income due and accrued is uncollectible.

i. For mortgage loans, bank loans and investment products with underlying mortgage loans impacted by forbearance or modification provisions, reporting entities may presume that borrowers and investments that were current as of Dec. 31, 2019, were not experiencing financial difficulties at the time of the forbearance or modification for purposes of determining collectibility. For these investments, further evaluation of collectibility is not required for the 1st and 2nd quarter 2020 financial statements unless other indicators that interest would not be collected are known (e.g., the entity has filed for bankruptcy).

ii. For investments not impacted by forbearance or modification provisions, this interpretation does not provide an assumption of collectibility and the provisions of SSAP No. 34 shall be followed in evaluating collectibility and assessing whether an impairment exists.

c. Provide an exception for the nonadmittance of recorded investment income due and accrued that is deemed collectible and over 90-days past due. With this exception, reported investment income interest due and accrued that becomes over 90-days past due in the 1st or 2nd quarter may continue to be admitted in the June 30th, 2020 (1st and 2nd quarter) financial statements. This exception does not encompass accrued interest on mortgage loans that are in default. Mortgage loans in default shall continue to follow the SSAP No. 34 guidance. SSAP No. 37—Mortgage Loans identifies that determining that a loan is in default is per the contractual terms of the loan. For mortgage loans modified, determination of default shall be based on the modified contractual terms.

11. The Working Group considered the FASB technical guidance and reached a consensus consistent with the FASB staff on how interest should be recognized when a payment holiday is given and interest is not accrued. With this guidance, either of the following methods could be applied:

a. A new effective interest rate is determined that equates the revised remaining cash flows to the carrying amount of the original debt and is applied prospectively for the remaining term. With this approach, interest income is recognized during the payment period holiday.

b. The reporting entity should recognize interest income on the loan in accordance with the contractual terms. Under this view, the reporting entity would recognize no interest income during the payment holiday and would resume recognizing interest income when the payment holiday ends.

12. The exceptions and provisions detailed in this interpretation are applicable for the June 30th, 2020 (2nd quarter) financial statements. As the exceptions provided in this interpretation are not applicable in the September 30, 2020 (3rd quarter) financial statements, as this interpretation will automatically expire as of September 29, 2020. This interpretation will be publicly posted on the Statutory Accounting Principles (E) Working Group’s website. This interpretation will be automatically nullified on September 29, 2020 and will be included as a nullified INT in Appendix H – Superseded SSAPs and Nullified Interpretations in the “as of March 2021” Accounting Practices and Procedures Manual.

INT 20-05 Status

13. The Statutory Accounting Principles (E) Working Group will subsequently review this interpretation to determine if an extension is needed to the effective date.
Interpretation of the Statutory Accounting Principles Working Group

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

INT 20-03 Dates Discussed

Email Vote to Expose March 26, 2020; April 15, 2020

INT 20-03 References

SSAP No. 36—Troubled Debt Restructuring

INT 20-03 Issue

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

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

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

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

INT 20-03 Discussion

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

6. On March 22, 2020, the Federal and state prudential banking regulators issued a joint statement that included guidance on their approach to the accounting for loan modifications in light of the economic impact of the coronavirus pandemic. The guidance was developed in consultation with the staff of the FASB who concur with
the approach and indicated that they stand ready to assist stakeholders with any questions. This interagency statement is provided below and is accessible through the FASB response via the following link:

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

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

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

Working with Customers

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

Accounting for Loan Modifications

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

Working with borrowers that are current on existing loans, either individually or as part of a program for creditworthy borrowers who are experiencing short-term financial or operational problems as a result of COVID-19, generally would not be considered TDRs. For modification programs designed to provide temporary relief for current borrowers affected by COVID-19, financial institutions may presume that borrowers that are current on payments are not experiencing financial difficulties at
the time of the modification for purposes of determining TDR status, and thus no further TDR analysis is required for each loan modification in the program.

Modification or deferral programs mandated by the federal or a state government related to COVID-19 would not be in the scope of ASC 310-40, e.g., a state program that requires all institutions within that state to suspend mortgage payments for a specified period.

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

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

Past Due Reporting

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

Nonaccrual Status and Charge-Offs

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

Discount Window Eligibility

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

7. On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief and Economic Security Act (CARES Act). The provisions in Section 4013 specifically address temporary relief from troubled debt restructurings:

SEC. 4013. TEMPORARY RELIEF FROM TROUBLED DEBT RESTRUCTURING.

(a) DEFINITIONS.—In this section:

(1) APPLICABLE PERIOD.—The term “applicable period” means the period beginning on March 1, 2020 and ending on the earlier of December 31, 2020, or the date that is 60 days after the date on which the national emergency concerning the novel coronavirus disease (COVID–19) outbreak declared by the President on March 13, 2020 under the National Emergencies Act (50 U.S.C. 1601 et seq.) terminates.
(2) APPROPRIATE FEDERAL BANKING AGENCY.—The term “appropriate Federal banking agency”—
(A) has the meaning given the term in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813); and
(B) includes the National Credit Union Administration.

(b) SUSPENSION.—

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

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

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

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

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

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

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

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

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


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

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

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

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

Working with Customers: General Safety and Soundness Considerations

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

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

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

Accounting and Reporting Considerations

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

Accounting for Loan Modifications under Section 4013

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

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

Accounting for Other Loan Modifications Not under Section 4013

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

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

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

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

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

Credit Risk

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

Regulatory Capital

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

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

Nonaccrual Status and Charge-Offs

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

Discount Window Eligibility

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

Working with Customers: Consumer Protection Considerations

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

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

INT 20-03 Consensus

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

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

**INT 20-03 Status**

11. The Statutory Accounting Principles (E) Working Group will subsequently review this interpretation to determine if an extension to the effective date is needed.
Interpretation of the Statutory Accounting Principles Working Group

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

INT 20-07 Dates Discussed

Email: Vote to Expose May 5, 2020; May 20, 2020

INT 20-07 References

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

INT 20-07 Issue

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

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

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

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

5. The issues addressed in this interpretation include:

   a. Should exceptions be provided to the determination of troubled debt restructurings and impairment for all debt securities in response to COVID-19?
b. Should exceptions be considered in the determination of troubled debt restructurings for non-public debt instruments in which the reporting entity is a direct, active, participant in the modification negotiations?

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

INT 20-07 Discussion

Consideration of Exceptions for All Debt Securities

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

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

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

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

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

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

Consideration of Provisions to Assist with Existing Troubled Debt Restructuring Guidance

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

a. The amount of the restructured payments subject to the delay is insignificant relative to the unpaid principal or collateral value of the debt and will result in an insignificant shortfall in the contractual amount due.
b. The delay in timing of the restructured payment period is insignificant to any one of the following:
   
i. frequency of payments due under the debt
   
ii. debt’s original contractual maturity,
   
iii. debt’s original expected duration.

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

**Practical Expedients to Assessing Concessions**

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

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

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

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

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

**Practical Expedients on Debt Extinguishments and Exchanges**

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

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

INT 20-07 Consensus

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

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

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

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

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

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

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

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

a. Modifications that reflect a 10% or less change in contractual cash flows considered insignificant under this interpretation do not need to be further evaluated to determine whether the modification is more than minor based on the specific facts and circumstances (and other relevant considerations) surrounding the modification. As such, these investments shall not be reported as an extinguishment and a new debt instrument.
b. Modifications in response to COVID-19 that exceed the practical expedient of a 10% shortfall in contractual cash flows permitted in this interpretation that were assessed and deemed insignificant under paragraph 10 of SSAP No. 36 shall not be considered an exchange of debt instruments with substantially different terms under SSAP No. 103, paragraph 22. (Under SSAP No. 103, an exchange of debt instruments (in a nontroubled debt situation) is accomplished with debt instruments that are substantially different if the present value of cash flows under the terms of the new instruments is at least 10% different from the present value of the remaining cash flows under the terms of the original instrument.) Reporting entities shall work with auditors and regulators with the application of paragraph 10 of SSAP No. 36 to confirm that a change in contractual cash flows in excess of 10% qualifies as insignificant.

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

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

INT 20-07 Status

21. The Statutory Accounting Principles (E) Working Group will subsequently review this interpretation to determine if an extension is needed to the effective date.

Application of the INT 20-07 Consensus

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

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

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

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

D. At the time of the restructuring, the reporting entity believes it is probable that the reporting entity will collect all amounts due in accordance with the modified terms of the debt instrument. Furthermore, the reporting entity does not intend to sell the instrument.
Example 1 - Application of INT 20-07

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

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

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

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

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

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

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

Example 2 - Application of INT 20-07

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

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

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

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

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

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

Example 3 - Application of INT 20-07

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

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

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

Issue: Related Parties, Disclaimers of Affiliation and Variable Interest Entities

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Description of Issue:
The intent of this agenda item is to clarify identification of related parties and affiliates in SSAP No. 25—Affiliates and Other Related Parties and to incorporate new disclosures to ensure regulators have the full picture of complicated business structures.

The proposed SSAP revisions intend to address the following key aspects:

- Clarify the identification of related parties and ensure that any related party identified under U.S. generally accepted accounting principles (GAAP) or Securities Exchange Commission (SEC) reporting requirements would be considered a related party under statutory accounting principles (SAP).

- 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.

- Proposes rejection of several U.S. GAAP standards addressing variable interest entities.

NAIC staff noted that the requirements for the SEC filings do not allow for a disclaimer of affiliation, as is allowed in the Insurance Holding Company System Regulatory Act (#440) and the Insurance Holding Company System Model Regulation (#450) and included in Appendix A-440. As a result, the statutory financial statements do not provide the full picture of some complicated business structures, which can be common among insurance companies. This agenda item intends to propose revisions to have the related party and affiliate reporting more closely match that of SEC filings. This will be done by adding language from SEC laws and regulation and clarifying the disclaimer of affiliation or control from a statutory reporting standpoint.

Additionally, this agenda item addresses the FASB Accounting Standards Updates (ASU) related to Variable Interest Entities (VIE) and Consolidation (Topic 810).

FASB defines a VIE as an entity (the investee) in which the investor holds a controlling interest that is not based on the majority of voting rights. This agenda item discusses several ASUs that established the initial guidance for VIEs and all subsequent ASUs to update and clarify this guidance. As a fundamental issue, the concept of consolidation has been rejected for statutory accounting. As such, the main concepts included in the ASUs that are discussed in this agenda item are proposed to be rejected for statutory accounting.

While this agenda item is not intended to change the concept of consolidation for statutory accounting,
NAIC staff believe that there is a need and justification for enhanced disclosures to supplement the reporting process of related parties and affiliates within a company structure. The proposed additions will ensure state insurance regulators have a full picture of the companies that they are regulating.

A brief description of the ASUs that are addressed in this agenda item are included below:

- **ASU 2009-17, Consolidations (Topic 810)—Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities** clarifies and establishes the basis of U.S. GAAP accounting for consolidation and VIEs. This ASU is a result of FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R).
- **ASU 2010-02, Consolidation (Topic 810)—Accounting and Reporting for Decreases in Ownership of a Subsidiary—a Scope Clarification** addresses implementation issues related to the changes in ownership provisions in Subtopic 810-10, originally issued as FASB Statement No. 160, Noncontrolling Interests in Consolidated Financial Statements, which establishes the accounting and reporting guidance for noncontrolling interests and changes in ownership interests of a subsidiary.
- **ASU 2010-10, Consolidations (Topic 810)—Amendments for Certain Investment Funds** defers consolidation requirements for a reporting entity’s interest in an entity that has all the attributes of an investment company or for which it is industry practice to apply measurement principles for financial reporting purposes that are consistent with those followed by investment companies.
- **ASU 2014-07, Consolidation (Topic 810)—Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements** permits a private company lessee (the reporting entity) to elect an alternative not to apply VIE guidance to a lessor entity in certain situations.
- **ASU 2015-02, Consolidation (Topic 810)—Amendments to the Consolidation Analysis** includes updates to limited partnerships and similar legal entities, evaluating fees paid to a decision maker or a service provider as a variable interest, the effect of fee arrangements on the primary beneficiary determination, the effect of related parties on the primary beneficiary determination, and certain investment funds.
- **ASU 2016-17, Consolidation (Topic 810)—Interests Held through Related Parties That Are under Common Control** provides that if a reporting entity satisfies the first characteristic of a primary beneficiary (such that it is the single decision maker of a VIE), these amendments require that reporting entity, in determining whether it satisfies the second characteristic of a primary beneficiary, to include all of its direct variable interests in a VIE and, on a proportionate basis, its indirect variable interests in a VIE held through related parties, including related parties that are under common control with the reporting entity.
- **ASU 2018-17, Consolidation (Topic 810)—Targeted Improvements to Related Party Guidance for Variable Interest Entities** includes updated VIE guidance for private companies and considers if indirect interests held through related parties under common control for determining whether fees paid to decision makers and service providers are variable interests.

**Existing Authoritative Literature:** Statutory accounting guidance is in SSAP No. 25—Affiliates and Other Related Parties, model law and regulation provisions are included in Insurance Holding Company System Regulatory Act (#440) and the Insurance Holding Company System Model Regulation (#450).

From Model #440

**Section 4. Registration of Insurers**

K. **Disclaimer.** Any person may file with the commissioner a disclaimer of affiliation with any authorized insurer or a disclaimer may be filed by the insurer or any member of an insurance holding company system. The disclaimer shall fully disclose all material relationships and bases for affiliation between the person and the insurer as well as the basis for disclaiming the affiliation. A disclaimer of affiliation shall be deemed to have been

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granted unless the commissioner, within thirty (30) days following receipt of a complete disclaimer, notifies the filing party the disclaimer is disallowed. In the event of disallowance, the disclaiming party may request an administrative hearing, which shall be granted. The disclaiming party shall be relieved of its duty to register under this section if approval of the disclaimer has been granted by the commissioner, or if the disclaimer is deemed to have been approved.

**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 2010, in response to the issuance of FAS 166, Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140 and FAS 167, Amendments to FASB Interpretation No. 46(R), the SAPWG formed the “SAPWG FAS 166/167 Subgroup. FAS 167 was issued in June 2009 and revised the scope of the FASB consolidation guidance to ensure that entities previously considered qualifying special purpose entities were included within the GAAP consolidation. Additionally, FAS 167 requires consolidation for entities (variable interest entities) in which the reporting entity has the “controlling financial interest”. Those situations are specific to when the entity is not controlled by contract, but the reporting entity has: (1) the power to direct the activities of the entity that most significantly impact the entity’s economic performance; and (2) the obligation to absorb losses or receive benefits of the entity that could be potentially significant to the entity. Although the concept of consolidation was not supported for SAP, the Subgroup discussion was focused on considering new disclosures for variable interest entities. The discussion of this Subgroup was deferred as Agenda Item 2011-16, Definition of a Related Party in SSAP No. 25 was considering changes to clarify the relationships that should be considered related parties. Discussion on this agenda item was halted in 2012 and 2015 as FASB issued new ASUs pertaining to VIEs. With the issuance of this new agenda item (2019-34), it is recommended that the 2011 agenda item be disposed.

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

**Convergence with International Financial Reporting Standards (IFRS):** None.

**Staff Recommendation:**
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 25—Affiliates and Other Related Parties, to clarify the types of entities or persons that are included as related parties, to clarify that a non-controlling ownership interest greater than 10% is a related party and is subject to the related party disclosures, to clarify the guidance for disclaimers of affiliation and control for statutory accounting, to clarify that the reporting entity must disclose if they knowingly engaged in any non-arms-length transactions with any entity, individual or company that has not been previously identified as a related party and to reject the seven FASB Accounting Standards Updates listed in the agenda item as not applicable for statutory accounting in SSAP No. 25.

**Staff Review Completed by:**
Jake Stultz, NAIC Staff – November 2019

**Status:**
On December 7, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 25—Affiliates and Other Related Parties, to clarify the following:

- The types of entities or persons that are included as related parties;
- That a non-controlling ownership interest greater than 10% is a related party and is subject to the related party disclosures; and
• The guidance for disclaimers of affiliation and control for statutory accounting.

This agenda item also rejects seven FASB Accounting Standards Updates, listed above, for statutory accounting. With exposure, an intent is included to dispose of agenda item 2011-16: Definition of Related Party, which is a historical item drafted to consider the SSAP No. 25 definition. The Working Group also directed notice of the exposure to be sent to the Group Solvency Issues (E) Working Group.

On March 18, 2020, the Statutory Accounting Principles (E) Working Group deferred discussion of this item for a subsequent call or meeting.

**Summer 2020**

Pursuant to the direction received Dec. 7, 2019, NAIC staff has drafted nonsubstantive revisions to SSAP No. 25. The current version is shown as tracked changes to SSAP No. 25 is attached as an exhibit to this agenda item. The updated draft revisions to SSAP No. 25 are discussed below.

• Based on the comments from the Group Solvency Issues (E) Working Group, NAIC staff have added a new disclosure that provides information on minority ownership interests, as well as significant relationships between minority owners and other U.S. domestic insurers/groups. This new disclosure is not intended to include passive fund owners, such as ETFs and mutual funds. This is in paragraph 22 in the exhibit to this agenda item.

• NAIC staff have removed the direct references to U.S. GAAP and SEC guidance that was included in the initial draft revisions. It was not intended to incorporate by reference the guidance from these sources but was instead intended to show that the revisions were going to be more consistent with the U.S. GAAP and SEC guidance. The language that was added to the description of related parties in paragraph 4 in the original expose draft are all language from either U.S. GAAP or from laws and regulations related to the SEC.

• With the proposed rejection of the U.S. GAAP VIE guidance for statutory accounting, our intention is to rely on SSAP No. 25, including the proposed revisions, to capture related parties for reporting. These updates are not intended to change reporting in Schedule BA or Schedule D for any investments.
## Statement of Statutory Accounting Principles No. 25

### Affiliates and Other Related Parties

#### STATUS

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### SCOPE OF STATEMENT

1. Related party transactions are subject to abuse because reporting entities may be induced to enter transactions that may not reflect economic realities or may not be fair and reasonable to the reporting entity or its policyholders. As such, related party transactions require specialized accounting rules and increased regulatory scrutiny. This statement establishes statutory accounting principles and disclosure requirements for related party transactions.

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2. This statement shall be followed for all related party transactions, even if the transaction is also governed by other statutory accounting principles. Furthermore, this statement shall be followed in all transactions which involve unrelated parties as intermediaries between related parties. In determining whether a transaction is a related party transaction, consideration shall be given to the substance of the agreement and the parties whose actions or performance materially impact the insurance reporting entity under the transaction. For example, an investment acquired from a non-related intermediary in which the investment return is predominantly contingent on the performance of a related party shall be considered a related party investment. As a general principle, it is erroneous to conclude that the mere inclusion of a non-related intermediary eliminates the requirement to assess and properly identify the related party transaction in accordance with the provisions of this statement. It is also erroneous to conclude that the presence of non-related assets in a structure predominantly comprised of related party investments eliminates the requirement to assess and identify the investment transaction as a related party arrangement.

3. If a company receives the stock of an affiliated company as a capital contribution rather than through a purchase, the transaction shall be accounted for according to SSAP No. 25—Affiliates and Other Related Parties, SSAP No. 95—Nonmonetary Transactions, or SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, based on the details of each transaction. The statutory purchase method within SSAP No. 68—Business Combinations is not applicable for stock received as a capital contribution.

SUMMARY CONCLUSION

4. Related parties are defined as entities that have common interests as a result of ownership, control, affiliation or by contract. Related parties shall include but are not limited to the following:

- Any person or entity that has been identified under U.S. GAAP or SEC reporting as a related party:
  - Affiliates of the reporting entity, as defined in paragraph 5;
  - Trusts for the benefit of employees, such as pension and profit-sharing trusts and Employee Stock Ownership Plans that are managed by or under the trusteeship of management of the reporting entity, its parent or affiliates;
  - The principal owners, directors, officers who are engaged directly or indirectly in the activities of the reporting entity;
  - Any immediate family member of a principal owner, director or executive officer of the reporting entity, which means any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, or individual related by blood or marriage whose close association is equivalent to a family relationship of such director, executive officer or nominee for director, or any person (other than a tenant or employee) sharing the household of such director, executive officer or nominee for director;
  - Companies and entities which share common control, such as principal owners, directors, or officers, including situations where a principal owners, directors, or officers have a controlling stake in another reporting entity;
  - Any non-controlling ownership greater than 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation.
  - The management of the reporting entity, its parent or affiliates (including directors);
Affiliates and Other Related Parties

e-h. Members of the immediate families of principal owners and management of the reporting entity, its parent or affiliates and their management;

f-i. Parties with which the reporting entity may deal if either party directly or indirectly controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interest;

g-j. A party which can, directly or indirectly, significantly influence the management or operating policies of the reporting entity, which may include a provider who is contracting with the reporting entity. This is not intended to suggest that all provider contracts create related party relationships;

h-k. A party which has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests;

i-l. Attorney-in-fact of a reciprocal reporting entity or any affiliate of the attorney-in-fact; and

j-m. A U.S. manager of a U.S. Branch or any affiliate of the U.S. manager of a U.S. Branch.

5. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies. Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments. An affiliate is any person that is directly or indirectly, owned or controlled by the same person or by the same group of persons, that, directly or indirectly, own or control the reporting entity.

6. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by contract for goods or nonmanagement services where the volume of activity results in a reliance relationship (d) by common management, or (e) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.

7. Control as defined in paragraph 6 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13%, and therefore, each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting securities of an investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. A non-controlling ownership interest greater than 10% is a related party and is subject to the related party disclosures within this statement. Examples of situations where the presumption of control may be in doubt include the following:

a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.
b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.

c. An entity where the insurer has given up participation rights\(^1\) as a shareholder to the investee.

d. Agreements where non-controlling ownership interest is less than 10% where the parties have structured the arrangement in this structure to avoid the 10% threshold in paragraph 4.f. and paragraph 7.

8. The Insurance Holding Company System Regulatory Act (#440) and the Insurance Holding Company System Model Regulation (#450) include a provision that allows for the disclaimer of affiliation and/or the disclaimer of control for members of an insurance holding company system. The disclaimer must be filed with the state insurance commissioner. Entities whose relationship is subject to a disclaimer of affiliation or a disclaimer of control are related parties and are subject to the related party disclosures within this statement. Such a disclaimer does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

8.9 Transactions between related parties must be in the form of a written agreement. The written agreement must provide for timely settlement of amounts owed, with a specified due date. Amounts owed to the reporting entity over ninety days from the written agreement due date shall be nonadmitted, except to the extent this is specifically addressed by other statements of statutory accounting principles (SSAPs). If the due date is not addressed by the written agreement, any uncollected receivable is nonadmitted.

**Related Party Loans**

9.10 Loans or advances (including debt, public or private) made by a reporting entity to its parent or principal owner shall be admitted if approval for the transaction has been obtained from the domiciliary commissioner and the loan or advance is determined to be collectible based on the parent or principal owner’s independent payment ability. An affiliate’s ability to pay shall be determined after consideration of the liquid assets or revenues available from external sources (i.e., determination shall not include dividend paying ability of the subsidiary making the loan or advance) which are available to repay the balance and/or maintain its account on a current basis. Evaluation of the collectibility of loans or advances shall be made periodically. If, in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. Pursuant to SSAP No. 72—Surplus and Quasi-Reorganization, forgiveness by a reporting entity of any debt, surplus note or other obligation of its parent or other stockholder shall be accounted for as a dividend.

10.11 Loans or advances by a reporting entity to all other related parties shall be evaluated by management and nonadmitted if they do not constitute arm’s-length transactions as defined in paragraph 144\(^4\). Loans or advances made by a reporting entity to related parties (other than its parent or principal owner) that are economic transactions as defined in paragraph 144\(^4\) shall be admitted. This includes financing arrangements with providers of health care services with whom the reporting entity contracts with from time to time. Such arrangements can include both loans and advances to these providers. Evaluation of the collectibility of loans or advances shall be made periodically. If, in accordance with SSAP No. 5R,

\(^1\) The term “participating rights” refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee's ordinary course of business and is distinguished from the more limited type of rights referred to as “protective rights”. Refer to the sections entitled: “Protective Rights” and “Substantive Participating Rights” in EITF 96-16, Investor’s Accounting for an Investor When the Investor Owns a Majority of the Voting Stock but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights. The term “participating rights” shall be used consistent with the discussion of substantive participating rights in this EITF.

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it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to
income in the period the determination is made.

14.12 Any advances under capitation arrangements made directly to providers, or to intermediaries that
represent providers, that exceed one month’s payment shall be nonadmitted assets.

14.13 Indirect loans are loans or extensions of credit to any person who is not an affiliate, where the
reporting entity makes loans or extensions of credit with the agreement or understanding that the proceeds
of the transactions, in whole or in substantial part, are to be used to make loans or extensions of credit to,
to purchase assets of, or to make investments in, any affiliate of the reporting entity making the loans or
extensions of credit. The admissibility of indirect loans made by a reporting entity for the benefit of its
parent or principal owner shall be determined in accordance with the guidelines in paragraph 10.10. Indirect
loans or advances made for the benefit of all other related parties shall be evaluated and accounted for
consistent with loans or advances to related parties as described in paragraph 11.10 and paragraph 12.11.

Transactions Involving the Exchange of Assets or Liabilities

14.14 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
declared 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.

14.15 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.
15.16. 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.

16.17. 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 16.15, 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.

17.18. 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 16.15);

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

18.19. 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.
Transactions involving services provided between related parties shall be recorded at the amount charged. 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.

Disclosures

The financial statements shall include disclosures of all material related party transactions. In some cases, aggregation of similar transactions may be appropriate. Sometimes, the effect of the relationship between the parties may be so pervasive that disclosure of the relationship alone will be sufficient. If necessary to the understanding of the relationship, the name of the related party should be disclosed. Transactions shall not be purported to be arm’s-length transactions unless there is demonstrable evidence to support such statement. The disclosures shall include:

a. The nature of the relationships involved;

b. A description of the transactions for each of the periods for which financial statements are presented, and such other information considered necessary to obtain an understanding of the effects of the transactions on the financial statements. Exclude reinsurance transactions, any non-insurance transactions which involve less than ½ of 1% of the total admitted assets of the reporting entity, and cost allocation transactions. The following information shall be provided if applicable:

   i. Date of transaction;
   ii. Explanation of transaction;
   iii. Name of reporting entity;
   iv. Name of affiliate;
   v. Description of assets received by reporting entity;
   vi. Statement value of assets received by reporting entity;
   vii. Description of assets transferred by reporting entity; and
   viii. Statement value of assets transferred by reporting entity.

c. The dollar amounts of transactions for each of the periods for which financial statements are presented and the effects of any change in the method of establishing the terms from that used in the preceding period;

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2 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.
d. Amounts due from or to related parties as of the date of each balance sheet presented and, if not otherwise apparent, the terms and manner of settlement;

e. Any guarantees or undertakings, written or otherwise, shall be disclosed in accordance with the requirements of SSAP No. 5R. In addition, the nature of the relationship to the beneficiary of the guarantee or undertaking (affiliated or unaffiliated) shall also be disclosed;

f. A description of material management or service contracts and cost-sharing arrangements involving the reporting entity and any related party. This shall include, but is not limited to, sale lease-back arrangements, computer or fixed asset leasing arrangements, and agency contracts, which remove assets otherwise recordable (and potentially nonadmitted) on the reporting entity’s financial statements;

g. The nature of the control relationship whereby the reporting entity and one or more other enterprises are under common ownership or control and the existence of that control could result in operating results or financial position of the reporting entity significantly different from those that would have been obtained if the enterprises were autonomous. The relationship shall be disclosed even though there are no transactions between the enterprises; and

h. The amount deducted from the value of an upstream intermediate entity or ultimate parent owned, either directly or indirectly, via a downstream subsidiary, controlled, or affiliated entity, in accordance with the Purposes and Procedure Manual of the NAIC Investment Analysis Office, “Procedures for Valuing Common Stocks and Stock Warrants.”

22. The financial statements shall include disclosures of ownership interest of the reporting entity and other significant relationships. The intent of this disclosure is to capture information related to active ownership and is not intended for passive fund owners to be reported.

   a. Disclosure is required for all owners with greater than 10% ownership of the reporting entity.

   b. Reporting entity must disclose each owner’s ultimate controlling party and must provide a listing of other U.S. insurance groups or entities under that ultimate controlling party’s control.

23-24. Refer to the Preamble for further discussion regarding disclosure requirements.

**Relevant Literature**

22-24. This statement adopts FASB Statement No. 57, Related Party Disclosures with a modification to paragraph 4 to require disclosure of compensation arrangements, expense allowances, and other similar items in the ordinary course of business.

24-25. This statement rejects ASU 2009-17, Consolidations (Topic 810)—Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities, ASU 2010-02, Consolidation (Topic 810)—Accounting and Reporting for Decreases in Ownership of a Subsidiary—a Scope Clarification, ASU 2010-10, Consolidations (Topic 810)—Amendments for Certain Investment Funds, ASU 2013-06, Not-For-Profit Entities, Services Received from Personnel of an Affiliate, ASU 2014-07, Consolidation (Topic 810)—Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements, ASU 2015-02, Consolidation (Topic 810)—Amendments to the Consolidation Analysis, ASU 2016-17, Consolidation (Topic 810)—Interests Held through Related Parties That Are under Common Control, ASU 2018-17, Consolidation (Topic 810)—Targeted Improvements to Related Party Guidance for Variable
Affiliates and Other Related Parties


24.26. Guidance in paragraph 98 was incorporated from SSAP No. 96 as discussed in Issue Paper No. 128—Settlement Requirements for Intercompany Transactions, An Amendment to SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties. SSAP No. 96 was nullified in 2011 with the guidance from that SSAP retained within this SSAP.

Effective Date and Transition

25.27. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors.

26.28. Guidance reflected in paragraph 98, incorporated from SSAP No. 96, is effective for reporting periods ending December 31, 2007. Early adoption is permitted. A change resulting from the application of this paragraph shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors. Guidance reflected in paragraph 3, incorporated from INT 03-16: Contribution of Stock, was originally effective December 7, 2003.

REFERENCES

Other

• Purposes and Procedures Manual of the NAIC Investment Analysis Office

Relevant Issue Papers

• Issue Paper No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties

• Issue Paper No. 128—Settlement Requirements for Intercompany Transactions, An Amendment to SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties
TO: Dale Bruggeman (OH), Chair of the Statutory Accounting Principles (E) Working Group  
FROM: Justin Schrader (NE), Chair of the Group Solvency Issues (E) Working Group  
DATE: February 11, 2020  
RE: Response to Referral on Agenda Item # 2019-34

The Group Solvency Issues (E) Working Group has recently noted several challenges in identifying and tracking the various affiliated/related parties within insurance groups, as well as the relationships an insurance group may have with other insurance groups. At the same time, regulators have noted an increased number of situations where the solvency and liquidity of insurers were negatively impacted by affiliated investments and relationships. Given the above-mentioned issues and concerns, the Working Group would like to express its support for the changes to SSAP No. 25—Affiliates and Other Related Parties that are proposed in agenda item 2019-34.

The Working Group agrees that each of the clarifications provided within the proposed revisions are valuable and will assist insurers and regulators in understanding the proper accounting treatment and disclosure requirements in this area. However, the Working Group notes that there may be additional disclosures necessary to clearly understand the nature of relationships across insurance groups. For example, Working Group members have found it difficult to understand and track relationships between insurers that are not affiliated (i.e., not under common control) but that share some level of common ownership. The Working Group recommends consideration of a new statutory disclosure that would provide information on minority ownership interests, as well as significant relationships between minority owners and other U.S. domestic insurers/groups.

Thank you for involving the Working Group in the review of this exposure and for your consideration of this additional disclosure request. Please feel free to contact me or NAIC staff support for the Working Group with any additional questions.
Issue: Enhanced Goodwill Disclosures

Check (applicable entity):

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Description of Issue: This agenda item was drafted to request additional goodwill information and to clarify reporting on Schedule D, Part 6, Section 1 – Valuation of Shares of Subsidiary, Controlled and Affiliated Companies.

1) With the adoption of agenda item 2017-18: Goodwill Limitations in SSAP No. 68—Business Combinations and Goodwill and SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, the information reported regarding goodwill, as provided in Annual Statement Footnote 3 – Business Combinations and Goodwill, has improved. This agenda item proposes additional disclosures to enhance the reporting of an SCA’s book adjusted carrying value (BACV). As goodwill is a significant component of many SCAs’ BACV, this agenda item will assist in facilitating review and disclosure of each balance.

2) During a review of SCA Sub 2 filings, it is noted that many companies do not calculate the amortization of goodwill correctly, which sometimes overstates the value of the SCA. Many companies also do not provide additional information to verify beginning goodwill and purchase price; as such NAIC staff rely on a review of Footnote 3 for these details. If the goodwill amount is not verifiable, it is not be allowed to be admitted as part of the SCA’s value.

3) The goodwill limitation of 10% of the insurance reporting entity’s goodwill capital and surplus is a calculation that all reporting entities who have goodwill must perform. While the admitted result is in the Annual Statement, the details of the calculation are not easily identifiable. This agenda item proposes the addition of a disclosure to capture the admissibility information, to ensure transparency in the admission of goodwill.

Additionally, feedback is requested in terms of the proposed edits to Schedule D – Part 6 – Sections 1 and 2. As detailed in the proposal below, two column headings and related Blanks instruction refer to “Intangible Assets,” however NAIC staff believe the original intent of these disclosures were to capture goodwill. FASB defines intangible assets as assets (not including financial assets) that lack physical substance and refer to assets other than goodwill. Feedback is requested from regulators and interested parties regarding what has historically been included in this disclosure and if changing the definition to articulate goodwill is warranted. Upon a sampled review by NAIC staff, it appears as though goodwill is the sole number currently being reported in these applicable columns.

Existing Authoritative Literature:

Goodwill calculation and admittance limitations are detailed in SSAP No. 68—Business Combinations and Goodwill. Relevant areas in relation to this agenda item have been bolded for emphasis.

Statutory Purchases of SCA Investments

3. The statutory purchase method of accounting is defined as accounting for a business combination as the acquisition of one entity by another. It shall be used for all purchases of SCA entities including partnerships, joint
ventures, and limited liability companies. The acquiring reporting entity shall record its investment at cost. Cost is defined as the sum of: (a) any cash payment, (b) the fair value of other assets distributed, (c) the fair value of any liabilities assumed, and (d) any direct costs of the acquisition.\(^{(INT\ 00-28)}\) Contingent consideration issued in a purchase business combination that is embedded in a security or that is in the form of a separate financial instrument shall be recorded by the issuer at fair value at the acquisition date.

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

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

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

7. Positive goodwill recorded under the statutory purchase method of accounting shall be admitted subject to the following limitation: **Positive goodwill from all sources, including life, accident and health, and deposit-type assumption reinsurance and goodwill resulting from the acquisition of an SCA by the insurance reporting entity that is reported on the SCA’s financial statements (resulting from the application of pushdown accounting), is limited in the aggregate to 10% of the acquiring\(^1\) entity’s capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for its most recently filed statement with the domiciliary state commissioner adjusted to exclude any net positive goodwill, EDP equipment and operating system software, and net deferred tax assets. Additionally, all positive goodwill shall be nonadmitted when the underlying investment in the SCA or partnership, joint venture and limited liability company is nonadmitted\(^2\).** When negative goodwill exists, it shall be recorded as a contra-asset.

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

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\(^1\) The “acquiring” entity is intended to reflect the insurance reporting entity that reports the investment resulting in goodwill. The goodwill limitation test shall be completed at the individual reporting company level.

\(^2\) This includes, but is not limited to, situations in which the investment is nonadmitted as the audited financial statements for the SCA, joint venture, partnership or limited liability company includes substantial doubt on the entity’s ability to continue as a going concern, or on the basis/contents of the audit opinion pursuant to paragraph 21 of SSAP No. 97.
Disclosures:

15. For business combinations accounted for under the statutory purchase method, the financial statements shall disclose the following for as long as unamortized goodwill is reported as a component of the investment:
   a. The name and brief description of the acquired entity;
   b. Method of accounting, that is the statutory purchase method;
   c. Acquisition date, cost of the acquired entity and the original amount of admitted goodwill; and
   d. The amount of amortization of goodwill recorded for the period; the admitted goodwill as of the reporting date, and admitted goodwill as a percentage of the SCA’s book adjusted carrying value (gross of admitted goodwill).

16. For business combinations taking the form of a statutory merger, the financial statements shall disclose:
   a. The names and brief description of the combined entities;
   b. Method of accounting, that is the statutory merger method;
   c. Description of the shares of stock issued or cancelled in the transaction;
   d. Details of the results of operations of the previously separate entities for the period before the combination is consummated that are included in the current combined net income, including revenue, net income, and other changes in surplus; and
   e. A description of any adjustments recorded directly to surplus for any entity that previously did not prepare statutory statements.

17. The financial statements shall disclose the following information regarding goodwill resulting from assumption reinsurance:
   a. The name of the ceding entity;
   b. The type of business assumed;
   c. The cost of the acquired business and the amount of goodwill; and
   d. The amount of amortization of goodwill recorded for the period.

18. A reporting entity that recognizes an impairment loss shall disclose the following in the financial statements that include the period of the impairment write-down:
   a. A description of the impaired assets and the facts and circumstances leading to the impairment; and
   b. The amount of the impairment charged to realized capital gains and losses and how fair value was determined.

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 2018, the Working Group adopted agenda item 2017-18: Goodwill Limitations in SSAP Nos. 68 and 97, requiring additional goodwill disclosures in Footnote 3 – Business Combinations and Goodwill (shown below).

Additional goodwill items under consideration by the Working Group relate to the currently exposed, agenda items:
1) Agenda item 2019-14: Attribution of Goodwill. This agenda item proposes the expansion of statutory guidance regarding the attribution of purchase price and goodwill from an acquisition and to add explicit language regarding the accounting treatment for situations in which an insurance company acquires a holding company that owns multiple companies.

2) Agenda item 2019-17: Pushdown Accounting. This agenda item reviewed the guidance in ASU 2014-17, Business Combinations – Pushdown Accounting and its applicability for statutory accounting. Three options were suggested for consideration which included complete rejection, allowance of pushdown for non-insurance entities, or allowance of pushdown only if previously elected (for SEC Registrants).

Also, in December 2019, the Working Group adopted an edit to SSAP No. 68—Business Combinations and Goodwill to clarify that all goodwill from an insurance entity’s acquisition of SCAs, regardless of whether pushdown accounting is applied, is subject to the existing 10% admittance limitation.

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

Convergence with International Financial Reporting Standards (IFRS): N/A

Staff Recommendation:

Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose this agenda item with nonsubstantive revisions to SSAP No. 68—Business Combinations and Goodwill, as detailed below, to add additional goodwill disclosures. The proposed disclosures will improve the validity and accuracy of numbers currently being reported and will assist with the regulators’ review of reported assets not readily available for the payment of policyholder claims.

Proposed additional disclosures in SSAP No. 68—Business Combinations and Goodwill:

Disclosures

19. For business combinations accounted for under the statutory purchase method, the financial statements shall disclose the following for as long as unamortized goodwill is reported as a component of the investment:

a. The name and brief description of the acquired entity;

b. Method of accounting, that is the statutory purchase method;

c. Acquisition date, cost of the acquired entity, the original amount of goodwill and the original amount of admitted goodwill; and

d. Each The SCA’s book value, the amount of amortization of goodwill recorded for the period; the SCA’s admitted goodwill as of the reporting date;

e. Total admitted goodwill as of the reporting date; and

d. Admitted goodwill as a percentage of the SCA’s book adjusted carrying value (gross of admitted goodwill).

20. For business combinations taking the form of a statutory merger, the financial statements shall disclose:

a. The names and brief description of the combined entities;

b. Method of accounting, that is the statutory merger method;

c. Description of the shares of stock issued or cancelled in the transaction;
d. Details of the results of operations of the previously separate entities for the period before the combination is consummated that are included in the current combined net income, including revenue, net income, and other changes in surplus; and

e. A description of any adjustments recorded directly to surplus for any entity that previously did not prepare statutory statements.

21. The financial statements shall disclose the following information regarding goodwill resulting from assumption reinsurance:

   a. The name of the ceding entity;
   b. The type of business assumed;
   c. The cost of the acquired business and the amount of goodwill; and
   d. The amount of amortization of goodwill recorded for the period.

22. A reporting entity that recognizes an impairment loss shall disclose the following in the financial statements that include the period of the impairment write-down:

   a. A description of the impaired assets and the facts and circumstances leading to the impairment; and
   b. The amount of the impairment charged to realized capital gains and losses and how fair value was determined.

23. A reporting shall disclose the subcomponents and calculation of adjusted surplus and total admitted goodwill as a percentage of adjusted surplus:

Proposed Blank updates related to SSAP No. 68 include the following:

**Footnote 3 (A) Illustration:**

<table>
<thead>
<tr>
<th>Purchased Entity</th>
<th>Acquisition Date</th>
<th>Cost of Acquired Entity</th>
<th>Original Amount of Goodwill</th>
<th>Original Amount of Admitted Goodwill</th>
<th>Admitted Goodwill as of the Reporting Date</th>
<th>Amount of Goodwill Amortized During the Reporting Period</th>
<th>Book Value of SCA</th>
<th>Admitted Goodwill as a % of SCA BACV, Gross of Admitted Goodwill</th>
</tr>
</thead>
<tbody>
<tr>
<td>XYZ Insurance Company</td>
<td>6/30/__</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td></td>
<td>%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>XXX</td>
</tr>
</tbody>
</table>

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New Footnote, proposed to be numbered 3(E):

<table>
<thead>
<tr>
<th>Calculation of Limitation using Prior Quarter Numbers</th>
<th>Current reporting period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital &amp; Surplus</td>
<td>XXX.</td>
</tr>
<tr>
<td>Less Admitted Positive Goodwill</td>
<td>&lt;XXX.&gt;</td>
</tr>
<tr>
<td>Less Admitted EDP Equipment &amp; Operating System Software</td>
<td>&lt;XXX.&gt;</td>
</tr>
<tr>
<td>Less Admitted Net Deferred Taxes</td>
<td>&lt;XXX.&gt;</td>
</tr>
<tr>
<td>Adjusted Capital and Surplus</td>
<td>XXX.</td>
</tr>
</tbody>
</table>

Limitation on amount of goodwill (adjusted capital and surplus times 10%)

Current period reported Admitted Goodwill

Current Period Admitted Goodwill as a % of prior period Adjusted Capital and Surplus

In addition to the above, changes are proposed for the following schedules which detail the Valuation of Shares of Subsidiary, Controlled of Affiliated Companies. As previously addressed, column clarifications regarding the reporting of Goodwill as opposed to Intangible Assets (as currently indicated).

Schedule D – Part 6 – Section 1 (Original) – Valuation of Shares of Subsidiary, Controlled or Affiliated Companies

<table>
<thead>
<tr>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>CUSIP Identification</td>
<td></td>
<td>Description Name</td>
<td>Foreign</td>
<td>ID</td>
</tr>
<tr>
<td></td>
<td>Of Subsidiary, Controlled or Affiliated Company</td>
<td></td>
<td>Of Subsidiary, Controlled or Affiliated Company</td>
<td></td>
<td></td>
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<tr>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Do Insurer's Assets Include Intangible Assets Connected with Holding of Such Company's Stock?</td>
<td>8</td>
<td>Total Amount of Such Intangible Assets</td>
<td>9</td>
<td>Nonadmitted Amount</td>
</tr>
<tr>
<td>8</td>
<td>Total Amount of Such Intangible Assets</td>
<td>9</td>
<td>Book / Adjusted Carrying Value</td>
<td>10</td>
<td>Nonadmitted Amount</td>
</tr>
<tr>
<td>9</td>
<td>Book / Adjusted Carrying Value</td>
<td>10</td>
<td>Nonadmitted Amount</td>
<td>11</td>
<td>Number of Shares</td>
</tr>
<tr>
<td>10</td>
<td>Nonadmitted Amount</td>
<td>11</td>
<td>Number of Shares</td>
<td>12</td>
<td>% of Outstanding</td>
</tr>
<tr>
<td>11</td>
<td>Number of Shares</td>
<td>12</td>
<td>% of Outstanding</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>% of Outstanding</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Schedule D – Part 6 – Section 1 (Proposed Tracked Changes) – Valuation of Shares of Subsidiary, Controlled or Affiliated Companies

<table>
<thead>
<tr>
<th>CUSIP Identification</th>
<th>Description Name Of Subsidiary, Controlled or Affiliated Company</th>
<th>Foreign</th>
<th>NAIC Company Code</th>
<th>ID Number</th>
<th>NAIC Valuation Method</th>
<th>Book / Adjusted Carrying Value</th>
<th>Do Insurer’s Assets Include Intangible Assets Connected with Holding of Such Company’s Stock?</th>
<th>Total Amount of Goodwill included in Book / Adjusted Carrying Value</th>
<th>Nonadmitted Amount</th>
<th>Stock of Such Company Owned by Insurer on Statement Date</th>
</tr>
</thead>
</table>

Note 1 in Schedule D-Part 6-Section 1 (below), is proposed for removal due to the addition of footnote 3 (D). It is anticipated that if adopted as exposed, both changed would occur simultaneously.

1. Amount of insurer’s capital and surplus from the prior period’s statutory statement reduced by any admitted EDP, goodwill and net deferred tax assets included therein: $.................................
2. Total amount of intangible assets-goodwill nonadmitted $ ...........................................................................................................................................

For brevity, only instructions for affected columns have been included. Remaining paragraph numbers will be renumbered accordingly.

**Column 7** — Do Insurer’s Assets Include Intangible Assets Connected with Holding of Such—Company’s Stock?

State whether the assets shown by the reporting entity in this statement include, through the carrying value of stock of the SCA company valued under the SSAP No. 97—Subsidiary, Controlled and Affiliated Entities, intangible assets arising out of the purchase of such stock by the reporting entity or the purchase by the SCA Company of the stock of a lower-tier company controlled by the SCA Company. For purposes of this question, intangible assets at purchase shall be defined as the excess of the purchase price over the tangible net worth (total assets less intangible assets and total liabilities) represented by such shares as recorded, immediately prior to the date of purchase, on the books of the company whose stock was purchased.

**Column 8** — Total Amount of Such Intangible Assets Goodwill

If the answer in Column 7 is “Yes,” give Report the total amount of intangible-goodwill assets involved whether admitted or nonadmitted. The intangible assets shown for the SCA Company should include any intangible assets that are included in the SCA Company’s carrying value of the stock of one or more lower-tier companies controlled by the SCA Company. In all cases,
the goodwill current intangible assets equals the goodwill calculated intangible assets at purchase, as defined above in SSAP No. 68—Business Combinations and Goodwill, minus any impairments/write-off thereof between the date of purchase and the statement date. If any portion of the total amount of intangible assets goodwill is required to be nonadmitted for all SCA companies combined in accordance with SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities and SSAP No. 68—Business Combinations and Goodwill state the total amount nonadmitted in the footnote at the bottom of the this section of the schedule.

Schedule D – Part 6 – Section 2 – Valuation of Shares of Subsidiary, Controlled or Affiliated Companies

<table>
<thead>
<tr>
<th>1</th>
<th>CUSIP Identification</th>
<th>2</th>
<th>Name of Lower-Tier Company</th>
<th>3</th>
<th>Name of Company Listed in Section 1 Which Controls Lower-Tier Company</th>
<th>4</th>
<th>Total Amount of Intangible Assets Goodwill Included in Amounts Shown in Column 8, Section 1</th>
<th>5</th>
<th>Stock in Lower-Tier Company Owned Indirectly by Insurer on Statement Date</th>
<th>6</th>
<th>Number of Shares</th>
<th>% of Outstanding</th>
</tr>
</thead>
</table>

For brevity, only instructions for affected columns have been included.

Column 4  –  Total Amount of Intangible Assets Goodwill Included in Amount Shown in Column 8, Section 1

As explained in the instructions for Section 1, this amount is based on the intangible assets goodwill purchase of the stock of the lower-tier company, reduced by any subsequent impairment/write-off. The reporting entity also bases the amount shown on the proportionate ownership of the lower-tier company.

Staff Review Completed by: Jim Pinegar & Fatima Sediqzad, NAIC Staff – January 2020

Status:
On March 18, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 68—Business Combinations and Goodwill, as illustrated above, to add additional goodwill disclosures. The proposed disclosures will improve the validity and accuracy of numbers currently being reported and will assist with the regulators’ review of reported assets not readily available for the payment of policyholder claims. Revisions to Schedule D, Part 6, Section 1 - Valuation of Shares of Subsidiary, Controlled and Affiliated Companies and Schedule D, Part 6, Section 2 - Valuation of Shares of Subsidiary, Controlled and Affiliated Companies primarily focus on the current reference to intangible assets. This item has a comment period deadline ending May 29, 2020.

G:\FRS\DATA\Stat Acctg\3. National Meetings\A. National Meeting Materials\2020Summer\Hearing\25 - 20-03 - Enhanced Goodwill Disclosures.docx
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Levelized and Persistency Commission

Check (applicable entity):

<table>
<thead>
<tr>
<th>Modification of existing SSAP</th>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Issue or SSAP</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interpretation</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Description of Issue:**
NAIC staff has received regulator inquiries on the application of the levelized commissions guidance in SSAP No. 71—Policy Acquisition Costs and Commissions. This agenda item is to recommend clarifications to the existing levelized commissions guidance and provide additional guidance regarding commission that is based on policy persistency. SSAP No. 71 describes that levelized commissions occur in situations in which a third party pays agents non-levelized commissions and the reporting entity pays a third party by levelized payments. The statement notes that it is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid to the third party from the reporting entity. SSAP No. 71 identifies such arrangements as funding agreements between the reporting entity and the third party. SSAP No. 71 then identifies that the use of a commission arrangement where commission payments are not linked to traditional elements (such as premium payments and policy persistency) requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions is required.

The questions received by NAIC staff relate to the use of levelized commission arrangements and when the liability for commission based on annual persistency is required to be recorded as a liability in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.

**Levelized Commission**

For the example in question, a third party is paying agent commissions and receiving periodic payments. Consistent with the guidance in SSAP No. 71, paragraph 4, the third party (funding agent) is paying the agents on behalf of the reporting entity and receiving levelized payments from the reporting entity which include additional fees or interest in excess of the commissions. The agreement between the reporting entity and the funding agent specifies that the funding agent will not be reimbursed by the reporting entity if the policies that generate the commission are cancelled prior to the policy anniversary date. The regulator noted that the reporting entity was not accruing the liability to the third-party funding agent, asserting that the payments to the funding agent were theoretically avoidable until the policy had passed the anniversary year-end date.

The accounting issue is whether levelized commission arrangements that are linked to traditional elements (such as premium payments and policy persistency) requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions.

**Persistency Commission**

Also, in the noted example, the reporting entity was also asserting that the levelized commission obligations related to policy persistency commission were not required to be accrued until the policy anniversary year end had been passed. The reporting entity asserts that the liability is not required until the persistency commission was fully earned by the agent and therefore unavoidable.
The accounting issue is if the persistency commission expense should be accrued proportionately over the policy period to which the commission relates, or if it is accrued only when fully earned and unavoidable.

Existing Authoritative Literature:

*Preamble* provides the following (**bolding added for emphasis**):

37. Liabilities require recognition as they are incurred. Certain statutorily mandated liabilities may also be required to arrive at conservative estimates of liabilities and probable loss contingencies (e.g., interest maintenance reserves, asset valuation reserves, and others).

38. Revenue should be recognized only as the earnings process of the underlying underwriting or investment business is completed. **Accounting treatments which tend to defer expense recognition do not generally represent acceptable SAP treatment.**

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

**Liabilities**

2. A liability is defined as certain or probable 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 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.

**Loss Contingencies or Impairments of Assets**

6. For purposes of implementing the statutory accounting principles of loss contingency or impairment of an asset described below, the following additional definitions shall apply:
   a. **Probable**—The future event or events are likely to occur;
   b. **Reasonably Possible**—The chance of the future event or events occurring is more than remote but less than probable;
   c. **Remote**—The chance of the future event or events occurring is slight.

7. A loss contingency or impairment of an asset is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an enterprise that will ultimately be resolved when one or more future event(s) occur or fail to occur (e.g., collection of receivables).

8. An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations if both of the following conditions are met:
   a. Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the statutory financial statements. It is implicit in this condition that it is probable...
that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and
b. The amount of loss can be reasonably estimated.

SSAP No. 71—Policy Acquisition Costs and Commissions provides the following (bolding added for emphasis):

SUMMARY CONCLUSION

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. These transactions are, in fact, funding agreements between a reporting entity and a third party. The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent’s license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions.

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 2019
Staff Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 71 as illustrated below. NAIC Staff recommends that revisions to the guidance clarify the following:

1. A levelized commission arrangement (whether linked to traditional or nontraditional elements) require the establishment of a liability for the full amount of the unpaid principal and accrued interest payable to a third party at the time the policy is issued.

2. The persistency commission is accrued proportionately over the policy period in which the commission relates to and is not deferred until fully earned.

These recommendations are consistent with the original intent of SSAP No. 71 as well as the Statutory Statement of Concepts focusing on Recognition (excerpts from Preamble, paragraphs 37 and 38):

- Liabilities require recognition as they are incurred.
- Accounting treatments which tend to defer expense recognition do not generally represent acceptable SAP treatment.

Proposed Revisions to SSAP No. 71:

SUMMARY CONCLUSION

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets. The recognition of commission expense for new and renewal insurance contracts meets the definition of a liability under SSAP No. 5R when the policy is issued or renewed. The issuance of the policy is the obligating event under SSAP No. 5R.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported. Commission contracts that include persistency (or other such components) shall not use these clauses to defer recognition of commission expense. If a commission is based on annual policy persistency (or similar components), the commission is accrued based on experience to date for the policy period (it is inappropriate to wait until the amount is fully earned and/or unavoidable). Actual policy cancellation would reverse the accrual of the related persistency commission.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. These transactions are, in fact, funding agreements between a reporting entity and a third party. The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link
between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions.

New Footnote – The guidance in this paragraph does not imply that levelized commissions that are linked to traditional elements do not require establishment of a liability. Rather, such levelized commissions are captured in paragraphs 3-4.

Status:
On August 3, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 71—Policy Acquisition Costs and Commissions, as illustrated above, to clarify levelized commissions guidance and provide additional direction regarding commissions that are based on policy persistency. The revisions also clarify that the recognition of commission expense is based on experience to date.

For Fall 2019 Discussion NAIC staff has proposed updates for exposure.

Paragraph 2 - Removed previously exposed revisions as unneeded.
Paragraph 3 - Added clarifying phrases regarding persistency commission accrual. The concept is that normal persistency commission is accrued for the period it relates to unless the policy is cancelled.
Paragraph 4 - Added two clarifying phrases to assist with identifying levelized commission funding agreements.
Paragraph 5 - Added clarifying phrases regarding funding agreements.
Footnote 1 - Redrafted to remove double negative wording.

SSAP No. 71:

SUMMARY CONCLUSION

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported. Commission contracts that include persistency (or other such components) shall not use these clauses to defer recognition of commission expense. If a commission is based on annual policy persistency (or other similar components), the commission shall be accrued based on experience to date for the policy period that the commission relates. In regard to persistency commission, it is inappropriate to wait until the amount is fully earned and/or unavoidable to accrue experience to date commission expenses. Actual policy cancellation would reverse the accrual of the related persistency commission.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid
to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. *(Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.)* These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent’s license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party to the agents requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions.

New Footnote – The guidance in this paragraph notes that levelized commissions which use a third party to pay agents that are linked to traditional elements require establishment of a liability for the amounts that have been paid to the agents and any interest accumulated to date.

On December 7, 2019, the Statutory Accounting Principles (E) Working Group exposed revisions to SSAP No. 71—*Policy Acquisition Costs and Commissions*, as illustrated above, to include additional NAIC staff modifications regarding persistency commission and levelized commission arrangements to address certain comments received and to allow for further discussion. With this exposure, the Working Group directed a notification of the exposure to be sent to the Life Actuarial (A) Task Force.

On March 18, 2020, the Statutory Accounting Principles (E) Working Group deferred discussion of this item for a subsequent call or meeting.
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May 29, 2020

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 During the NAIC Spring National Meeting Conference call with Comments due May 29

Dear Mr. Bruggeman:

Interested parties thank the NAIC Statutory Accounting Principles (E) Working Group (the “Working Group”) for your continuing effort to address the various statutory accounting issues arising from the ongoing pandemic caused by the novel coronavirus, COVID-19. We appreciate the opportunity to comment on the exposure drafts released for comment by the Working Group during its discussion on March 18, 2020. We offer the following comments:

**Ref #2019-04: SSAP No. 32 – Investment Classification Project**

The Working Group exposed the *Issue Paper No. 1XX—Preferred Stock* and substantively-revised draft *SSAP No. 32—Preferred Stock* with edits to reflect comments received from interested parties as well as a January 1, 2021 effective date.

Interested parties agree with the revisions made in response to our comments and the January 1, 2021 effective date.

Interested parties acknowledge the proposed footnote regarding preferred units issued by SSAP 48 entities. However, we suggest the wording changes in underline below so not to introduce a change in accounting or diversity in practice since the issuance of preferred units that are similar to preferred stock of a corporation generally occur in LLCs that are more corporate-like.

> “Certain legal entities captured in SSAP No. 48 such as LLCs that are corporate-like do not issue preferred stock in legal form, but instead issue identical instruments labeled preferred units, interests, or shares. These instruments shall be captured in this statement
provided they meet the structural characteristics as defined in paragraph 3. Additionally, these instruments shall not be in-substance common stock in which the holder has risk and reward characteristics that are substantially similar to common stock.”

Ref #2019-14: Attribution of Goodwill

The Working Group exposed this agenda item, with a revision from the prior exposure to exclude “pushdown” goodwill until the decision from the Working Group on that issue has been addressed. Additionally, the proposed disclosure included in the last exposure has been slightly modified to detail the downstream holding company application and the attribution of goodwill.

Interested parties thank the NAIC staff for meeting with a group of us to discuss this proposal and the circumstances it is intended to address. After discussing the proposal further with additional companies, we believe the draft guidance is complex and should be supplemented with illustrative guidance, i.e., a decision tree and an expansion of the examples in the proposal, to fully illustrate how the guidance is to be applied and improve consistency of application. To that end, we request a three-week extension during which we can develop the illustrative guidance and bring it back to the Working Group for consideration.

Ref #2019-38: Financing Derivatives

The Working Group exposed this agenda item with slight revisions from the prior exposure to delete the proposed new paragraph 19.c., as recommended by interested parties. The exposed revisions are intended to ensure consistency in the gross reporting of derivatives, without inclusion of financing components, and in reporting amounts owned to/from the reporting entity from the acquisition or writing of derivatives. With this exposure, a blanks proposal will be sponsored and notice of the proposed edits will be provided to the Capital Adequacy (E) Task Force.

Interested parties have no comments on this item.

Ref #2020-02: Accounting for Bond Tender Offers

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 26R—Bonds, to clarify that the accounting and reporting of investment income and capital gain/loss, due to the early liquidation either through a call or a tender offer, shall be similarly applied. The current guidance refers to “prepayment penalties or acceleration fees in the event the bond is liquidated prior to its schedule termination date,” and includes all dynamics in which an issuer provides a penalty/fee to the holder to terminate the bond.

Interested parties request that the effective date for the updated guidance be set at January 1, 2021, so that insurers have sufficient time to make necessary systems changes to treat the excess compensation over market as a prepayment penalty as described in the updated guidance.
Ref #2020-03: Enhanced Goodwill Disclosures

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 68—*Business Combinations and Goodwill*, as illustrated above, to add additional goodwill disclosures. The proposed disclosures will improve the validity and accuracy of numbers currently being reported and will assist with the regulators’ review of reported assets not readily available for the payment of policyholder claims. Revisions to Schedule D, Part 6, Section 1 - Valuation of Shares of Subsidiary, Controlled and Affiliated Companies and Schedule D, Part 6, Section 2 - Valuation of Shares of Subsidiary, Controlled and Affiliated Companies primarily focus on the current reference to intangible assets.

Interested parties request that the proposal be revised (similar to Ref #2019-14) to exclude “pushdown” goodwill until the Working Group concludes on that issue. We also note that item 3 of the Description of the Issue on page 1 should be corrected as follows:

The goodwill limitation of 10% of the insurance reporting entity’s *goodwill, capital and surplus* is a calculation.

Ref #2020-04: Commissioner Discretion in the Valuation Manual

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 51R—*Life Contracts*, SSAP No. 52—*Deposit-Type Contracts* and SSAP No. 54R—*Individual and Group Accident and Health Contracts* to note that voluntary decisions to choose one allowable reserving methodology over another, which requires commissioner approval under the *Valuation Manual*, shall be reported as a change in valuation basis. A notification of this exposure will be sent to the Life Actuarial (A) Task Force.

Interested parties have no comment on this item.

Ref #2020-05: Repeal of the Affordable Care Act Section 9010 Assessment

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed the intent to supersede SSAP No. 106—*Affordable Care Act Section 9010 Assessment* and nullify INT 18-02: ACA Section 9010 Assessment Moratoriums which would move both SSAP No. 106 and INT 18-02 to Appendix H—Superseded Statements of Statutory Accounting Principles and Nullified Interpretations, effective Jan. 1, 2021.

Referrals will be sent to the Blanks (E) Working Group, to ensure the annual statement disclosures related to SSAP No. 106 in Note 22 are removed from the annual statement instructions and annual statement blank beginning in reporting year 2021, and to the Health Risk Based Capital (E) Working Group for RBC implications related to the 2021 removal of the federal ACA adjustment sensitivity test which uses data from the SSAP No. 106 disclosures.
Interested parties support the conclusion reached for this item. We note, however, that annual statement disclosures in the 2020 blanks would apparently still be required and recommend that the disclosures be simplified considering the repeal of the Assessment. Specifically, the disclosures should be moved to note 21.C as Other Disclosures for year-end 2020 (since not a subsequent event) and then removed entirely for year-end 2021 as proposed; the disclosures should be limited to the amount of the assessment paid in the current and prior year, the amount of premium written for the prior year that is the basis for the determination of the section 9010 fee assessment paid in the current year (net assessable premium), and the estimated amount of the assessment that was payable in the current year as of the end of the prior year.

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
April 27, 2020

Dale Bruggeman, Chairman  
Statutory Accounting Principles (E) Working Group  
c/o National Association of Insurance Commissioners

Attn: Robin Marcotte  
Via e-mail: RMarcotte@NAIC.org

Ref: 2020-13 – Request on 2020 Health Insurance Assessment

Dear Chairman Bruggeman:

To confirm our recent email transmission, after discussion with members and review of the referenced exposure and the NAIC staff’s recommendation that SAPWG reject our request, please consider this letter as AHIP’s withdrawal of that request.

We appreciate NAIC Staff’s view (as expressed in SAPWG exposure 2020-13) that the subject of SSAP No. 106 interim reporting relief is a matter that could warrant domiciliary state regulator review for consideration as either a permitted or prescribed practice. We would be grateful if you would share with SAPWG members our concerns that the dynamic nature of the pandemic might make such action appropriate in some states, and that other issues may yet arise that would require involvement by SAPWG at the NAIC level.

As always, we appreciate the courtesies, accessibility, and candor extended to AHIP by you, Ms. Marcotte, and Ms. Gann.

Sincerely,

America’s Health Insurance Plans

Bob Ridgeway
July 23, 2020

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: INT 20-09T – Basis Swaps – LIBOR Transition

Dear Mr. Bruggeman:

Thank you for the opportunity to comment and provide suggested edits to INT 20-09, Basis Swaps – LIBOR Transition. We appreciate the ongoing collaboration with NAIC staff, in particular their efforts to bring this matter to the forefront so quickly.

Interested parties support the staff’s recommendation.

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: Interested Parties
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January 31, 2020

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 During the NAIC Winter National Meeting with Comments due January 31

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the exposure drafts released for comment by the Statutory Accounting Principles (E) Working Group (the “Working Group”), during the NAIC Fall National Meeting in Austin. We offer the following comments:

Ref #2018-26: SCA Loss Tracking – Accounting Guidance

The Working Group exposed revisions, with modifications suggested by interested parties to SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets to expand guidance regarding financial guarantees and the use of the equity method for when losses exceed the equity value of an SCA investment. With the revisions, the equity value of an SCA would not go negative, and guaranteed liabilities would be reported to the extent that there is a financial guarantee or commitment. The “Illustration of the Application of INT 00-24” will also be inserted into SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities.

Interested parties have no comment on this item.

Ref #2018-38: Prepayments to Service and Claims Adjusting Providers

NAIC Staff recommended that the Working Group expose revisions incorporating the majority of interested parties’ comments to SSAP No. 55 (rather than the changes reflected in the draft for the Summer 2019 exposure). Interested parties’ comments primarily delete the exposed guidance and move the same or similar concepts into the broad product guidance for property and casualty, life and health or health in SSAP No. 55. These revisions are to reinstate annual statement references by entity type and to adjust scoping language and make the SSAP No. 29
prepaid guidance consistent. (Staff proposed variations in wording are shaded to differentiate from the interested parties proposed wording that accomplishes a similar intent.)

The exposed revisions to SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses incorporate interested parties’ previous recommendations to separate the guidance by product type and emphasize guidance that loss and loss adjusting expense liabilities are established regardless of payments to third parties (except for capitated health claim payments). The revisions emphasize existing guidance that claims related liabilities are not recognized as paid until the losses are paid to claimants or claims are adjusted.

Interested parties have no comment on this item.

Ref #2019-04: SSAP No. 32 – Investment Classification Project

The Working Group exposed a revised Issue Paper No. 1XX—Preferred Stock and a substantively-revised draft SSAP No. 32—Preferred Stock as part of the Investment Classification Project.

Interested parties substantially agree with the objectives of the proposal and appreciate Staff’s inclusion of revisions for previously communicated comments. We have the following additional comments related to the issue paper:

Scope

Interested parties note that the scope retains, albeit edited, the guidance that preferred stock of subsidiary, controlled and affiliated entities is included and therefore accounted for under the guidance for preferred stock regardless of their SCA character. We acknowledge the current exposure added the requirement to file investments in response to our request. The existing wording in SSAP No. 32 and the exposed language for SSAP No. 32 is below with interested parties suggested clarifying sentence and additional wording (underlined).

Existing language in SSAP No. 32:

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for preferred stock.

2. Investments in preferred stock of subsidiaries, controlled or affiliated entities, including preferred stock interests of certified capital companies (CAPCO) per INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO) are included within the scope of this statement.

Exposed language in SSAP No. 32 and interested parties suggested additional sentence (underlined):
SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for preferred stock.

2. Investments in preferred stock of entities captured in SSAP No. 97—*Investments in Subsidiaries, Controlled or Affiliated Entities* or SSAP No. 48—*Joint Ventures, Partnerships and Limited Liability Companies*, as well as preferred stock interests of certified capital companies per INT 06-02: *Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)* are included within the scope of this statement. The requirement to file investments in preferred stock of certain subsidiaries, controlled or affiliated entities with the NAIC pursuant to SSAP No. 97 does not affect the application of the accounting, valuation or admissibility under this statement.

Definitions

We are opposed to the proposed edits to the definitions of redeemable and perpetual preferred stock for the following reasons:

a. The change would create a divergence from GAAP that does not exist under the current definitions. Both the definition and accounting for redeemable securities under the current definition aligns with the GAAP definition and accounting for debt securities. Preferred stock accounted for as debt securities under GAAP are those where ability for the holder to collect repayment is assured by the contract terms. We have not identified any benefit to diverging from this view for statutory reporting. The NAIC guidance is different from the GAAP ASC 480 guidance for issuers in multiple ways:

- Preferred stock redeemable at the option of the holder for GAAP is classified as equity (mezzanine equity for SEC filers) but under statutory reporting currently (and proposed) is classified as debt-like in valuation. This conflicts with GAAP ASC 480 guidance for issuers and so it is more straight forward to use the GAAP ASC guidance for holders.
- Alignment of statutory accounting with the ASC 320 guidance for holders results in more equity-like classification in the valuation of preferred stock which is generally more conservative than debt-like classification in valuation.
- Preferred stock redeemable for other reasons outside of issuer’s control is equity (mezzanine equity for SEC filers) for GAAP but equity-like in valuation under current statutory reporting and debt-like in valuation under the proposed statutory reporting.

b. The definition that the NAIC staff has proposed to align to is used in GAAP only for compliance with SEC Regulation S-X, Rule 5-02, which is relevant only to the issuer of preferred stock and does not apply to nonpublic companies. Further, the definitions under Rule 5-02 were designed to include preferred stock with redemption features outside of the control of the issuer in order to provide investors information regarding
potential future cash obligations. This is not a relevant consideration for the holder of preferred stock, which is why GAAP does not consider this from the holder’s perspective. From the holder’s perspective, the only relevant consideration is whether the holder is able to redeem its investment, either through a fixed and determinable date, or through a redemption option that the holder can control.

c. Evaluation of whether there are any features that are outside the control of the issuer is a very complex and cumbersome analysis, even on an infrequent basis as is the case under GAAP (as it only applies to issuers). This is because there are a vast number of potential features that could be outside the control of the issuer (i.e., change in control, lapse in SEC registration, failure to pay dividend, etc.). Insurance companies frequently invest in preferred stock and often purchase many such securities each reporting period. Evaluating every preferred stock investment at this level of detail would be operationally burdensome and would provide no additional benefit as the investor is often economically indifferent to many of these low-probability redemption features that are outside of the control of both the issuer and investor.

As a result, we propose the following edits to the proposed definitions:

a. Redeemable preferred stock, which is preferred stock subject to mandatory redemption requirements or whose redemption is outside the control at the option of the issuer holders. Redeemable preferred stock is any stock which 1) the issuer undertakes to redeem at a fixed or determinable price on the fixed or determinable date or dates, whether by operation of a sinking fund or otherwise; or 2) is redeemable at the option of the holders; or 3) has conditions for redemption which are not solely within the control of the issuer, such as stock which must be redeemed out of future earnings. Preferred stock which meet one or more of these three—two criteria would be classified as redeemable preferred stock regardless of other attributes such as voting rights or dividend rights;

b. Perpetual preferred stock, which is preferred stocks which are not redeemable or for which redemption is not at the option of the holder are redeemable solely at the option of the issuer (non-redeemable preferred stock). Perpetual preferred stock is any preferred stock which does not meet the criteria to be classified as redeemable preferred stock pursuant to paragraph 3.a.

Balance Sheet Amount

The issue paper discusses carrying perpetual preferred at fair value capped by any stated call price. However, it did not provide guidance on timing for application of the cap. Because the call may not be effective for a period of time, and to ensure that purchases of perpetual preferred stock could still be carried at values greater than par (assuming market values remain above par), we recommend the following revisions to paragraph 10.a.ii, 10.b.ii and the correspondingly to paragraph 11 (underlined):

Paragraphs 10.a.ii and 10.b.ii:
i. Perpetual preferred stocks shall be valued at fair value, not to exceed any currently effective call price.

Paragraph 11:

11. An other-than-temporary (INT 06-07) impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of the preferred stock in effect at the date of acquisition. An assessment of other-than-temporary impairment shall occur whenever mandatory redemption rights or sinking fund requirements do not occur. A decline in fair value which is other-than-temporary includes situations where the reporting entity has made a decision to sell the preferred stock prior to its maturity at an amount below its carrying value (i.e., amortized cost). If it is determined that a decline in the fair value of a redeemable preferred stock is other-than-temporary, an impairment loss shall be recognized as a realized loss equal to the entire difference between the redeemable preferred stock’s carrying value and its fair value, not to exceed any currently effective call price, at the balance sheet date of the reporting period for which the assessment is made. The measurement of the impairment loss shall not include partial recoveries of fair value subsequent to the balance sheet date. For reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7.

Income

The issue paper clarifies the guidance on dividends on preferred stock. Specifically, paragraph 14 states:

“14. Dividends on preferred stock shall be recorded as investment income for qualifying preferred stock on the ex-dividend date with a corresponding receivable to be extinguished upon dividend settlement.”

Interested parties request clarification on the use of the term “qualifying” preferred stock as the term is not defined within the issue paper or within the new glossary of terms. If the inclusion of the word “qualifying” was unintentional, interested parties recommend deleting the word from paragraph 14 to avoid confusion.

Ref #2019-08: Update Reporting Deposit-Type Contracts

The Working Group exposed this agenda item to: 1) request feedback on the inclusion of a footnote excerpt for Exhibit 5 to disclose cases when a mortality risk is no longer present or a significant factor – i.e., due to a policyholder electing a payout benefit, 2) request feedback on circumstances where a morbidity risk is no longer present or a significant factor for Exhibit 6 items and whether a similar footnote disclosure would be appropriate, and 3) requested industry and regulator input for instruction clarifications regarding the classifications of deposit-type
contracts captured in Exhibit 7. With this exposure, there are no proposed edits for statutory accounting. The Working Group directed NAIC staff to notify the Financial Stability (Ex) Task Force of this exposure.

Interested parties support the proposed Exhibit 5 footnote which, among other things, would provide clarification on contracts where a mortality risk is no longer present or a significant factor.

With respect to the implementation of additional disclosures for Exhibit 6, interested parties believe that the current product disaggregation in Exhibit 6 is sufficient to analyze the risks present in the subject contracts, and would suggest no changes.

Interested parties have no additional clarifications for Exhibit 7 instructions—we believe the current instructions are sufficiently clear for deposit type contracts

Ref #2019-12: ASU 2014-17, Business Combinations – Pushdown Accounting, a Consensus of the FASB Emerging Issues Task Force

The Working Group adopted, as final, a clarification edit to SSAP No. 68—Business Combinations and Goodwill to clarify that all goodwill from an insurance entity’s acquisition of SCAs, regardless of whether pushdown accounting is applied, is subject to the existing 10% admittance limitation. (With adoption of this edit, paragraph 9 was split into two separate paragraphs with the additional wording shown below.) The remainder of this agenda item was re-exposed to allow additional time for specific examples of pushdown accounting to be provided by interested parties, as well as consider comments received on pushdown.

9. Positive goodwill recorded under the statutory purchase method of accounting shall be admitted subject to the following limitation: Positive goodwill from all sources, including life, accident and health, and deposit-type assumption reinsurance and goodwill resulting from the acquisition of an SCA by the insurance reporting entity that is reported on the SCA’s financial statements (resulting from the application of pushdown accounting), is limited in the aggregate to 10% of the acquiring 1 entity’s capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for its most recently filed statement with the domiciliary state commissioner adjusted to exclude any net positive goodwill, EDP equipment and operating system software, and net deferred tax assets. Additionally, all positive goodwill shall be nonadmitted when the underlying investment in the SCA or partnership, joint venture and limited liability company is nonadmitted. When negative goodwill exists, it shall be recorded as a contra-asset.

Interested parties is working on developing examples to illustrate the various ways in which goodwill can be generated and suggested approaches to how the statutory limitations could be applied. As a result of these efforts, we request an extension for this and the following item.
Ref #2019-14: Attribution of Goodwill

The Working Group re-exposed this agenda item to clarify that the “assignment” of goodwill is a disclosure element. The Working Group directed NAIC staff to prepare revisions to the Sub 1 Acquisition Overview template to capture this information for new SCA acquisitions.

Please see the comments on the preceding item.

Ref #2019-20: Rolling Short-Term Investments

The Working Group exposed revisions to SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments and SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, as shown in the “Proposed Revisions for Fall 2019 Discussion” to incorporate additional principle concepts in classifying investments as cash equivalents or short-term investments to prevent the “rolling” of certain investments. Fall revisions to the prior Summer National Meeting exposure incorporate guidance to exclude qualifying cash pools from the short-term rolling provisions.

With the Fall exposure, comments were requested from regulators and industry representatives on whether other investments should be included / excluded from the short-term rolling provisions. In particular, comments are requested on whether short-term lending (both collateral loans and affiliated loans) should be permitted to be continuously rolled/renewed as short-term, whether non-affiliated SSAP No. 26R investments should be subject to the short-term rolling restrictions, and whether an assessment of “re-underwriting” could be used as support to allow the rolling of short-term investments.

Interested parties appreciate the staff’s exclusion of qualifying cash pools from the provisions of the short-term rolling re-exposure. There remain two types of short-term lending arrangements within the scope of the re-exposure that should be addressed separately. We respectfully request that the Working Group give consideration to the broader implications discussed below prior to moving forward with this proposal. Specifically, it might be advantageous to split the exposure into two work streams – one for affiliated investments and another for unaffiliated investments.

Non-affiliate Short-Term Lending

In the case of non-affiliated loans (i.e., Schedule BA Other Invested Assets), in order to provide appropriate flexibility to both the lender and the borrower, a loan facility may be structured as a short-term obligation. Such short-term obligations permit an insurer to more efficiently deploy its capital and streamline its underwriting process. Specifically, short term, non-affiliated loans: (a) provide the insurer with the ability to review and consider credit and collateral on a regular basis, (b) allow the insurer to reevaluate each investment at maturity and make new investments based on current market conditions if desired, and (c) allow the insurer to consider a renewal with an existing base of knowledge about the borrower and collateral, making the underwriting
process more streamlined and allowing for better informed credit decisions. As with any investment, diligent underwriting of the borrower and the collateral, and structuring of the investment with appropriate safeguards is critical and should not deviate from standards used for longer-term investments. These facilities fill a market need for borrowers that require short-term or warehouse-type financings on assets prior to reaching the window for securitization and provide the insurer with attractive risk-adjusted returns relative to other short-term investments.

In this context, interested parties propose that all non-affiliated short-term obligations, obligations in scope of either SSAP No. 26 or SSAP No. 43R, where the counterparty is not an affiliate or related party of the reporting entity, including collateral loans, which meet certain objective criteria should be defined, reported, and monitored in the existing Schedule DA as a non-affiliated short-term investment. In order for a non-affiliated transaction to qualify as short term for reporting purposes, such investment must include the following features:

1) The loan includes a maturity date less than one year from closing at which the borrower has an unconditional repayment obligation and on which the lender has a reasonable expectation that the investment can be terminated and repaid if so desired by the insurer; and
2) Any subsequent renewal is only completed in the sole discretion of BOTH the borrower and the lender.

Given that the transaction is between unaffiliated counterparties, interested parties believe the terms of these transactions, including the interest rate and advance rate, are on arms’ length terms.

Finally, with no obligation at any time to renew a transaction, the reporting entity is required to re-evaluate and re-underwrite the transaction at maturity. If any of the relevant underwriting criteria have changed, the insurer can require repayment or can request adjustments to the terms and conditions to conform to market conditions. If, but only if, both the borrower and lender agree to renew the transaction on the same or adjusted terms, the transaction may be renewed. This process, however, requires an independent credit decision and results in a new transaction.

Interested parties acknowledges the NAIC staff’s concern about the ability of auditors and regulators to discern between renewals that have been re-underwritten and those that have not; however, without an appreciation for the nuanced economic differences of these transactions, interested parties have concerns about unintended consequences of the re-exposure. Consider a transaction in which an entity purchases a GNMA with less than a one-year maturity, which was classified as a short-term investment or cash equivalent and matures/is settled as expected. Shortly after, that entity decides to purchase another GNMA with less than a one-year maturity. As proposed, the guidance precludes short-term investment or cash equivalent reporting for reacquired investments (or substantially similar investments) when purchased within one year from the initial investment. Without further clarification regarding substantially similar investments, or alternative objective criteria like those proposed above, we anticipate that diversity in practice could result. Additionally, regarding the example described, operationally burdensome tracking requirements would be required for entities to ensure appropriate reporting.
Therefore, we believe that unaffiliated SSAP No. 26 investments should be excluded from the scope of this exposure for the reasons discussed above. The scope of this exposure should also continue to exclude other unaffiliated SSAP No. 26 investments such as treasury bills, commercial paper, certificates of deposits and other similar short-term investments since such investments are used for short-term liquidity and do not have long-term investment risk.

**Affiliate Short-Term Lending**

Interested parties believe that the same principles discussed above and in our previous letter apply to affiliated short-term investments to merit continued classification as short term in nature, even when a subsequent short-term investment is re-underwritten to the same borrower within a year. We believe there is already sufficient regulatory oversight on the fundamental objectives, usage and risks of material affiliated transactions to validate the alignment of these vehicles with the fundamental characteristics implied by the statutory short-term investment classification. In this case, prudently managed, governed and executed liquidity optimization across an insurance holding company system can be observed with the current regulatory oversight mechanisms. While re-underwriting may be warranted based on liquidity needs, the risk profile continues to be commensurate with that of short-term investments.

**NAIC Guidance should not supersede regulatory oversight.** The domiciliary commissioners already have authority to disapprove of material affiliated transactions as deemed necessary. The NAIC Model Holding Company Act (the “Act”), which has been broadly incorporated into state laws, requires filing and domiciliary commissioner approval of affiliated transactions over certain materiality thresholds. As the Act was promulgated by the NAIC, interested parties believe that through use of the Act, commissioners put in place filing and approval requirements they deemed satisfactory to address their regulatory needs. Through these filings, state regulators have oversight over both the risk elements considered and the methodology utilized by companies in underwriting each material extension of credit within the holding company system. It would run counter to state authority to implement requirements resulting in NAIC guidance that would effectively supersede the authority of domiciliary commissioners or cast doubt, even implicitly, upon states’ ability to appropriately regulate the domiciled insurers with which they are intimately familiar. Principally, the Act allows regulators to verify the appropriateness of the short-term classification of material affiliated investments, providing oversight to ensure consistency in classification between affiliated and unaffiliated short-term investments.

Prudent and appropriately governed liquidity management within a holding company structure enhances insurance company solvency. Appropriately managed, governed and regulator-approved affiliate lending programs create opportunities for liquidity optimization across a holding company system, essentially sharing objectives similar to that of affiliated liquidity pools. This management is necessary due to diversification of product offerings as timing of cash receipts and disbursements will vary across such products and different entities within a holding company system. The ability to prudently draw upon excess liquidity surplus within one entity at a time when another entity has a short-term need for liquidity serves as an immediate buffer against uneconomic alternatives such as forced asset sales or relatively costly external short-term
financing. If adopted as written, the exposed guidance could result in entities foregoing this powerful in-house liquidity tool, which enables companies within a holding company system to more effectively manage inherent cash flow timing mismatches, and instead resort to alternatives that would result in an unnecessary drain on capital available to support policyholder obligations.

**SSAP 43R—Loan-backed and Structured Securities**

Investments in the scope of SSAP 43R, *Loan-backed and Structured Securities*, have payments that are driven by underlying collateral with modifications that are driven by the performance of the underlying assets and typically overseen by a collateral manager or otherwise laid out in deal documents. In many cases, these instruments also have clean-up call provisions that would remove the investment from the market while the remaining underlying collateral may be repackaged into a re-securitization. The concept of rolling a short-term investment that would be in the scope of SSAP 43R is often-times outside the control of investors in these instruments and possibly part of the normal life cycle of a small portion of the underlying collateral. Because of these characteristics, the interested parties propose that any non-affiliated investment that would qualify within SSAP 43R—Loan-backed and Structured Securities be exempt from the proposed new concepts like what is proposed for non-affiliated investment that would qualify within SSAP 26R—Bonds. Further consideration of affiliated investments that fall within SSAP 43R is recommended, given the underlying assets drive these investments and the other considerations for affiliate short-term lending outlined previously in this response.

Interested parties respectfully requests that the Working Group give consideration to these broader implications prior to moving forward with this proposal. If the Working Group has lingering concerns or appetite for additional elaboration as to the character and traditional efficacy of existing regulatory oversight mechanisms, interested parties would request that staff work with industry to draft materials for future dialogue and examination of this topic.

**Ref #2019-24: Levelized and Persistency Commission**

The Working Group exposed revisions to *SSAP No. 71—Policy Acquisition Costs and Commissions*, to include additional NAIC staff modifications regarding persistency commission and levelized commission arrangements to address certain comments received and to allow for further discussion. With this exposure, the Working Group directed a notification of the exposure to be sent to the Life Actuarial (A) Task Force.

Interested parties appreciate staff’s availability to discuss the proposed revisions. Based on that discussion and the discussion at the Fall Meeting, interested parties propose suggested edits that we believe achieve the goal of a nonsubstantive change and clarify the original intent of SSAP 71. (Note: the *NAIC Accounting Practices and Procedures Manual-Life* which was in force prior to the effective date of current SAP includes the same wording as current SSAP No. 71). The suggested edits add a clear definition of a funding agreement. This will clarify the distinction between funding agreements and persistency-based commissions, without unintentionally changing the existing accounting. We welcome the opportunity to discuss the suggested edits further with the Working Group.
Ref #2019-25: Working Capital Finance Notes (WCFN)

The Working Group exposed substantive revisions to SSAP No. 105—Working Capital Finance Investments (SSAP No. 105) to incorporate industry revisions to program requirements, as previously directed by the Working Group during the Summer National Meeting. The Working Group directed NAIC staff to prepare an issue paper.

In 2016, the American Council of Life Insurers (ACLI) advised the NAIC that the implementation of SSAP No. 105 was not successful and that adoption had been low. ACLI began a dialogue with staff and regulators about both the shortcomings of the 2013 adopted rules and outlined required changes to make the rules suitable. As part of that process, ACLI marked up both the SSAP and NAIC SVO Purposes and Procedures Manual (P&P Manual) with the suggested changes which have subsequently been characterized as "10 required items", which staff have in turn opined on, and noted that four of the items are not supported by staff. Absent all 10 required items, WCFI adoption will remain low. Staff have noted an immaterial number of programs have been filed with only a subset of those approved, resulting in limited investments made. The existing Exposure provided to staff and regulators by ACLI and was utilized by staff to produce the current proposal, without addressing the proposed language by ACLI on the four required items not supported by staff.

Objections to the four required changes are:

1) evaluating non-rated subsidiaries of obligors (even though the existing SSAP already provides guidance to do).
2) expanding covered investment credit quality to include NAIC 3 and 4 investments,
3) requiring domiciliary regulator authorization for investment, and
4) requiring reporting on Schedule BA even though the asset class qualifies for look through RBC treatment.

In the ACLI draft provided to the NAIC, ACLI proposed an evaluation mechanism that is suitable for NAIC implementation on unrated subsidiaries. With regard to NAIC objection on lower rated investments, such position is inexplicable as statutory RBC requirements reflect investment quality decisions in capital calculations limiting Industry investments to compliant assets. Domiciliary regulator prior approval for investment is a transfer of transaction review from staff to state insurance departments when, if regulators are concerned about the asset class, they can uniformly limit investment as a whole. Finally, Schedule BA reporting is both cumbersome and expensive for industry further exacerbating adoption without useful purpose. Regulators can track any specific asset class or investment by requiring the use of a specific investment code on the appropriate accounting schedule, which in the case of WCFI is Schedule DA).

Interested parties note that private placements, as opposed to public investments, are typically available only to large industry participants and that the economic impact of a $10,000 industry filing fee per issue per filing entity has an operating impact on a $1,000,000 investment in
WCFI, which for the avoidance of doubt would be sizable for most industry investors, of 1% of the investment income in year 1 of that investment. Current investment yields for NAIC 1 and 2 investments in WCFI offer gross returns of 2 – 2.5%. Such a high cost to a small industry investor, coupled with the fact that dealers would unlikely choose to document such investments bilaterally with small industry investors, limits access to the assets to large industry investors. In summary, interested parties request that regulators re-consider ACLI markup with the additional four requirements as originally submitted by ACLI and ultimately, after appropriate exposure and review, to direct staff to implement these changes.

**Ref #2019-32: Look-Through with Multiple Holding Companies**

The Working Group moved this agenda item to the active listing and exposed revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, to clarify that a more-than-one holding company structure is permitted as a look-through if each of the holding companies within the structure complies with the requirements in SSAP No. 97.

Interested parties have no comment on this item.

**Ref #2019-33: SSAP No. 25 – Disclosures**

The Working Group moved this agenda item to the active listing and exposed the proposed data-capture templates. This exposure does not propose revisions to SSAP No. 25.

Interested parties believe that clarifications to paragraph 20 of SSAP No. 25 are necessary. We believe that the aggregation of similar transactions may result in immaterial transactions becoming material, meeting the threshold of 1/2 of 1% of the total admitted assets of the reporting entity. Therefore, we propose the edits highlighted below to ensure that aggregation occurs subsequent to the application of the criteria in paragraph 20.b. for materially identified transactions.

**Proposed Edits to the exposure**

**Disclosures**

20. The financial statements shall include disclosures of **all material related-party transactions**. In some cases, aggregation of similar transactions, that on a stand-alone basis are not material, may be appropriate. Sometimes, the effect of the relationship between the parties may be so pervasive that disclosure of the relationship alone will be sufficient. If necessary to the understanding of the relationship, the name of the related party should be disclosed. Transactions shall not be purported to be arm’s-length transactions unless there is demonstrable evidence to support such statement. The disclosures shall include:

   a. **The nature of the relationships involved**;
   b. A description of the transactions for each of the periods for which financial statements are presented, and such other information considered necessary to obtain an understanding of the effects of the
transactions on the financial statements. Exclude reinsurance transactions, any non-insurance transactions which involve less than ½ of 1% of the total admitted assets of the reporting entity, and cost allocation transactions. The following information shall be provided if applicable:

Ref #2019-34: Related Parties, Disclaimers of Affiliation and Variable Interest Entities

The Working Group Staff exposed revisions to SSAP No. 25—Affiliates and Other Related Parties. Key elements for discussion in the exposure draft are to:

- Clarify the identification of related parties and ensure that any related party identified under U.S. generally accepted accounting principles (GAAP) or Securities Exchange Commission (SEC) reporting requirements would be considered a related party under statutory accounting principles (SAP).

- 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.

- Incorporate a new disclosure of known non-arm’s-length transactions with any entity not identified as a related party.

- Propose rejection of several U.S. GAAP standards addressing variable interest entities.

Interested parties understand and agree with the need for transparency in disclosures of related party transactions. However, we have significant concerns with the proposal as it is not very clear based on the proposed changes to SSAP No. 25 what it is that will be required going forward based on the expansion of the definition of a related party. We include some of our observations below.

Interested parties would like clarity around the new proposed wording that states that non-controlling ownership over 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation. One of our concerns in this area relates to limited partnership/joint ventures/limited liability company (LPs/JVs/LLCs) investments where the insurer owns more than 10% of the equity of the investee but has no affiliation to the investee’s general partner/asset manager. SSAP No. 97 currently includes a possible scope exception in paragraph 6 for these types of investments so that they are not considered affiliated or controlled investees of the insurer. It is not clear from the proposal what the expected impact is from now having to consider all investments in unaffiliated LPs/JVs/LLCs where the insurer owns more than 10% of the equity but has no other affiliation, as related parties. If the intent is just to have insurers disclose material transactions with these entities other than the equity
investment held in each entity, we believe that this needs to be more clearly stated in the proposal so that there is no misrepresentation of what needs to be disclosed or whether these investments need to be reported in a different section of Schedule BA (i.e., affiliated vs. non-affiliated).

Another, but similar concern relates to certain entities consolidated under U.S. GAAP based on the Variable Interest Entity (VIEs) guidance. For some of these consolidated VIEs, the insurer has no control or affiliation with the VIE other than its debt investment in the entity. The insurer is simply a passive investor in the structure. However, under the VIE rules, the insurer must consolidate the entity as the insurer may be able to make decisions for the VIE if there is ever an event of default of the assets at some point in the future. These rights are given to certain classes of bonds issued by the securitization as a protection to the investors, but do not give the investors any type of power or control over the VIE at inception or on a day-to-day basis. It is important to note that consolidation rules under FASB Codification Topic 810 are very complex with some insurers concluding consolidation is required under a set of fact and circumstances and others concluding consolidation is not required under the same set of facts and circumstances. In the example just shared, some insurers have concluded consolidation is required because when no day-to-day decisions are being made for the VIE, decisions upon the occurrence of a certain event which may be unlikely to occur, rise to the point where they are the decisions that have the most significant impact on the economic results of the VIE. We believe that even though insurers have to consolidate these entities, there is no true related party affiliation. The proposal requires that any entity identified as a related party under U.S. GAAP will also be considered a related party for statutory reporting. Since these entities are consolidated for GAAP, the presumption would be that they are a related party of the insurer. If these entities will be considered related parties on a statutory basis going forward, the exposure needs to clarify that the inclusion of these types of entities only impacts related party disclosures for any material transactions held with these entities other than the debt investment held by the insurer in the VIE and that the debt instrument is still reported on Schedule D as unaffiliated.

Interested parties also have concerns with SSAP No. 25 including references to U.S. GAAP and SEC reporting for mutual insurers that do not prepare U.S. GAAP financial statements and do not file with the SEC. Therefore, interested parties recommend that the specific guidance from the GAAP and SEC be stated in SSAP No. 25 (rather than incorporated by reference) so that any future changes in GAAP and SEC guidance are subject to NAIC review prior to being applicable. Also, it is important to note that even when an entity is considered a related party under U.S. GAAP, disclosure of that relationship is only required when there are material transactions with that party. U.S. GAAP allows reporting entities to evaluate the significance of a relationship and determine when disclosure of that relationship is material/significant enough for disclosure to a user of the financial statements. As a result, we suggest this be clarified in the exposure as well so that it is clear that the reference to related parties under GAAP and SEC rules is only relevant if the insurer has material transactions with such parties outside of the insurer’s investment in the entity.
Ref #2019-35: Update Withdrawal Disclosures

The Working Group moved this agenda item to the active listing and exposed revisions to SSAP No. 51R—Life Contracts, SSAP No. 52—Deposit-Type Contracts, and SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance, as illustrated in the staff recommendation, to:

- Add a consistency revision to SSAP No. 51R to ensure separate account guaranteed products are referenced in all applicable paragraphs of the withdrawal characteristics disclosures;
- Correct an identified inconsistency in one of the new disclosures that was added regarding products that will move from the reporting line of having surrender charges at 5% or more to the reporting line of surrender charges at less than 5%. A clarification is being recommended to ensure consistency in annual statement reporting; and
- Add a cross-reference from SSAP No. 56 to the existing disclosures by withdrawal characteristics in SSAP No. 51R and SSAP No. 61R as the disclosure include separate account products.

Interested parties have no comment on this item.

Ref #2019-36: Expand MGA and TPA Disclosures

The Working Group moved this agenda item to the active listing and exposed revisions to SSAP No. 51R—Life Contracts, paragraph 50, SSAP No. 53—Property Casualty Contracts—Premises, paragraph 19, SSAP No. 54R—Individual and Group Accident and Health Contracts, paragraph 33 and SSAP No. 59—Credit Life and Accident and Health Insurance Contracts, paragraph 19, as illustrated in the staff recommendation above, to expand the MGA/TPA note as follows:

- Aggregate direct written premium and total premium written by MGA/TPA;
- Aggregate dollar amount of claims process / total claims processed by MGA/TPA; and
- Information on related party / affiliate status and if the MGA/TPA is independently audited and / or bonded.

Interested parties note that the proposal does not define a TPA. It just states that TPAs “that write direct policies or provide claims adjusting or other services”. That is overly broad and could include a variety of entities that provide services. The NAIC model (NAIC Third Party Administrator Act, or NAIC model) guidelines define TPAs as it relates to life/health and workers compensation. Also, the NAIC model definition has a long list of activities that are excluded from the definition, such as self-insured employers administering its own workers’ compensation, insurers administering coverage, producers engaged in selling insurance, attorneys handling claims, MGAs, etc. We recommend that the proposed disclosure reference the NAIC model so that there is consistency in the definition used in applying the guidance.
Additionally, it is unclear how the reporting threshold should be applied. The reporting applies to TPAs if “the claims adjusting services are greater than 5% of annual average claims volume”. Is that threshold based on the amount of claim dollars paid or the number of claims handled? Is that measured across all lines of business for the company? Would claims paid within insureds’ deductibles/SIRs be included? Depending on how this is defined, it could be quite burdensome for insurers to monitor. We recommend that the threshold be based on written premium, consistent with how other thresholds have been applied.

**Ref #2019-37: Surplus Notes – Enhanced Disclosures**

During the 2018 Spring National Meeting, the Working Group exposed revisions to *SSAP No. 41R – Surplus Notes* (“SSAP No. 41R”) to indicate that surplus notes, where the proceeds from the issuance of the surplus note were used to purchase an asset directly or indirectly from the holder of the surplus note, are not subordinate and do not qualify for reporting as surplus and should be classified as debt. Furthermore, the exposure draft stated that these assets were not considered available for policyholder claims and should be non-admitted. The exposure was the result of a referral from a Subgroup of the Reinsurance Task Force that was more narrowly focused on whether specific securities could be considered Primary Securities.

At the 2019 Summer National Meeting, the Working Group agreed to have an industry data call, due by December 31, 2019, to determine what financing structures existed that utilized the types of surplus notes described above.

At the 2019 Fall National Meeting, the Working Group exposed additional disclosures that should be captured in *SSAP No. 41R*. The Working Group does intend, later in 2020, to continue discussions on how to treat surplus notes where an associated asset is received by the surplus note issuer. This discussion will occur after a review and analysis of the data call.

**General Comments**

Interested parties understand regulators’ concerns that the details of certain transactions involving surplus notes may not be transparent to regulators who were not involved in the initial approval or ongoing review of such transactions. However, these transactions and the related pricing represent confidential information that we believe is inappropriate for public disclosure and may be misleading if presented in the proposed format.

Our concerns with the proposed disclosures are outlined in detail below, followed by our suggested revisions.

*The proposed disclosures may not provide the desired transparency or consistency*

Throughout the discussion on any potential revisions to *SSAP No. 41R* over the past twenty-two months, interested parties have agreed that robust disclosures should be added to *SSAP No. 41R* to fully reflect situations where a reporting entity receiving proceeds from the issuance of surplus notes used those proceeds to purchase an asset directly or indirectly from the holder of the
surplus note. However, we also believe that these disclosures should be included in the financial statements of a ceding company, which would provide a much greater level of transparency and consistency in disclosure. We believe that in most situations where a surplus note issuer uses proceeds from the issuance to purchase an asset directly or indirectly from the holder of the surplus note, the surplus note issuer is an affiliated captive reinsurer. As some captive financial statements are not provided to the NAIC, we believe disclosure in the financial statements of the ceding company would provide a much greater level of transparency and consistency in disclosure for these transactions. Our proposed revisions include suggested language for this disclosure requirement.

The proposed disclosure goes beyond the stated regulatory concern and requires additional information that may be incorrectly interpreted.

We believe that the proposed disclosure departs from the original regulatory concern expressed in the public meetings of the Working Group, namely that a reporting entity should not be permitted to circumvent regulatory authority as it relates to the preservation of capital at a regulated entity by contractually linking the cash outflows associated with a surplus note to cash inflows from another financial instrument held by the surplus note issuer. However, rather than identify such transactions, the proposed disclosure would require detailed information about surplus note interest regardless of whether cash flows are contractually linked. We are concerned that the operational burden of compiling this information for all surplus notes with netting provisions exceeds the benefit to regulators of providing information on the few transactions of concern.

Interested parties note that the scope of the proposed disclosure is substantially identical to that of the recent surplus note data call issued by the NAIC. The stated intent of this data call was to obtain information on surplus note transactions without regard to whether offsetting of cash flows was due to: a) contractual linkage or b) administrative offset provisions. While we agree that this scope was appropriate to assess the universe of affected transactions, we do not believe it is the appropriate scope for an Annual Statement disclosure and could be misleading in certain cases as outlined below.

The proposed disclosure includes confidential information that is not appropriate for public filings.

The proposal would require the disclosure of surplus note interest paid, net of any payments made by the surplus note holder. As a practical matter, for many captive structures, this amount often corresponds to the fees paid to the financing provider(s) to provide liquidity in the event of adverse experience or other conditions with respect to the subject policies, as defined in the applicable agreement.

The pricing and terms of the subject transactions were heavily vetted, negotiated, and submitted to state regulators for approval with the reasonable understanding that this information was subject to robust confidentiality protections. We do not object to this information being made available to regulators in the context of a confidential data call or regulator communication.
However, we are concerned with its inclusion in public filings. The primary focus should be on whether the surplus note issuer is statutorily solvent rather than its surplus note pricing terms.

**The net presentation of interest paid could be misleading for some transactions**

We also believe that the change to the current disclosure to replace surplus note interest paid with interest paid net of amounts offset is problematic. We believe this disclosure could be misleading for many of the transactions in the scope of the disclosure, given that the full amount of surplus note interest paid was/would be due regardless of whether a portion is offset pursuant to an administrative netting arrangement.

**Proposed Revisions**

Interested parties recommend revisions to the proposed disclosures which would provide regulators who are not involved in the approval and ongoing review of a surplus note transaction with information to assess the nature of the transaction and to determine whether more detailed review is needed. Specifically, our revisions would require disclosure of whether cash flows are offset but would differentiate between administrative offsetting and the contractual “linkage” that is of concern to regulators. These revisions would also remove information that we believe is confidential in nature and would not be appropriate for public disclosure. Finally, we have proposed several additions to the required disclosures, which we believe would provide useful information about transactions involving surplus notes.

Our suggested revisions to the disclosures are included in Exhibit A and summarized below. For ease of review, revisions proposed by NAIC staff have been accepted, and interested parties’ comments are presented as tracked changes.

**Summary of Proposed Revisions**

- Expand the disclosure requirement to the financial statements of the ceding company as well as the surplus note issuer.
- Retain the current disclosure of total interest paid (gross of any administrative or other netting)
- Replace quantitative disclosure of “interest remitted” and “cost of liquidity” with three Y/N disclosure columns which correspond to the criteria used in the data call scoping:
  1. Do surplus note / associated asset terms negate or reduce cash flow exchanges, and/or are amounts payable under surplus notes and amounts receivable under other agreements contractually linked? (For example, the asset provides interest payments only when the surplus note provides interest payments.)
  2. Are any amounts due under surplus notes and associated assets netted or offset (partially or in full) thus eliminating or reducing the exchange of cash or assets
that would normally occur throughout the duration, or at maturity, of the agreement. (This may be referred to as administrative offsetting.)?

3. Were the proceeds from the issuance of a surplus note used to purchase an asset directly or indirectly from the holder of the surplus note?

- Replace confidential information about 3rd party liquidity (e.g. maximum liquidity amount and cost of liquidity source) with a description of terms under which liquidity would be provided should a triggering event occur.
- Add requirement for narrative disclosure of any related guarantees or support agreements.

Ref #2019-38: Financing Derivatives

The Working Group moved this agenda item to the active listing and exposed revisions to SSAP No. 86—Derivatives, to clarify the reporting of derivatives with financing premiums. The reporting revisions propose allowing the present value of the derivative premium receivable (and payable) for financed derivatives to be factored into the counterparty risk assessment for life RBC. (If supported, RBC changes would be subsequently referred to the Capital Adequacy (E) Task Force for consideration.) Comments are also requested as to whether derivatives and related financing provisions that would generally not meet the SSAP No. 64—Offsetting and Netting of Assets and Liabilities right to offset criteria and if explicit guidance allowing offset should be considered.

Interested parties request the exposure be given an effective date of at least January 1, 2021. The exposure represents a significant change to how certain companies account for derivatives and must be implemented in our investment systems prior to adoption. Interested parties do not believe the assets and liabilities under this exposure meet the right to offset criteria in SSAP No. 64—Offsetting and Netting of Assets and Liabilities, because they originate within the same contract. Additionally, we believe the netting guidance outlined in paragraph 19c would be difficult to implement and recommend it be removed.

Ref #2019-39: Acceptable Collateral - Counterparty Exposure for Derivative Instruments

The Working Group moved this agenda item to the active listing and exposed revisions to SSAP No. 86—Derivatives, to clarify that the fair value of collateral received or held, for derivative disclosure purposes, shall be reported net of collateral paid/pledged, in the event a counterparty has the legal right to offset against, as defined in SSAP No. 64—Offsetting and Netting of Assets and Liabilities. Minor updates to the applicable annual statement instructions were also proposed to be concurrently exposed.

Interested parties fully support the appropriate depiction within the statutory financial statements and schedules of the availability of insurance company assets to fulfill policyholder obligations, including consideration of a reporting entity’s access to and control over the assets and any contingencies pertaining to the attendant rights & benefits of ownership. We appreciate the opportunity to dialogue further on this matter and ensure the regulatory objective is achieved.
regarding both financial statement presentation and the risk-based assessment of capital.
The ability to make efficient use of derivative instruments as part of hedging transactions, income generation transactions and replication (synthetic asset) transactions, in accordance with SSAP No. 86 – *Derivatives* (“SSAP No. 86”), is a crucial component of insurers’ ability to effectively manage risk and prudently maintain yields in support of our ability to deliver on promises to our policy and contract holders. With broader federal regulation now driving a migration for many of the interest rate and credit derivatives insurers use to these ends towards the central clearinghouse or “cleared” space, the significance of appropriately depicting the specific economic substance and attendant risks associated with each of the various forms of collateral posted to central clearinghouses has never been greater.

Given this backdrop, our concerns with exposure 2019-39 are as follows:

1) The language in the proposal does not provide clear, consistent definition of scope or objective(s);
2) The exchange of initial margin on cleared trades represents a contingency distinct from that associated with the exchange of variation margin; and
3) The existing statutory accounting, reporting and risk-based capital models already appropriately depict the economic substance and inherent risk associated with the exchange of initial margin, and the proposed changes would result in inappropriate duplication of risk-based capital charges.

In terms of intended scope, the narrative commentary and proposed updates to existing guidance make it unclear as to whether the proposal aims to refine accounting & reporting guidance for:

- initial margin, variation margin, or both;
- bilateral (over-the-counter, “OTC”) trades, trades executed with central clearinghouses, or both;
- exchanges of cash collateral, non-cash collateral (e.g. securities) or both.

The summary introduction to the proposal appears to target a perceived issue with the Schedule DB-D, Section 1 reporting of initial margin exchanged with central clearinghouses. The narrative commentary provided does not identify specific concerns pertaining to the reporting of collateral associated with bilateral OTC trades or variation margin. However, the attendant proposed edits to SSAP No. 86 and the Blank Instructions for Schedule DB-D, Section 1 encompass collateral exchanges with both bilateral OTC counterparties and central clearinghouses...inherently scoping in both OTC and cleared trades as well as all forms of collateral (variation margin, initial margin and traditional margin on legacy bilateral OTC trades). In addition, the proposal makes no clear distinction between proposed updates regarding exchanges of cash collateral vs exchanges of non-cash collateral, often using the terms collectively and interchangeably, whereas the guidance within the AP&P Manual makes clear distinctions regarding their respective accounting and reporting - as they have distinct implications for users of statutory financial statements. The guidance for cash collateral exchanges under SSAP No. 103R – *Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (“SSAP 103R”) paragraphs 19 & 20 is distinct from that of non-
cash collateral exchanges, which is also further detailed in INT 01-31 – *Assets Pledged as Collateral* (“INT 01-31”). Anecdotally, though the SSAP No. 86 Appendix C guidance for the initial carrying value on futures paraphrased in the 2019-39 exposure commentary applies to exchange traded derivatives (which do not appear to be within the scope of this current exposure), it maintains conceptual symmetry with the distinct cash collateral guidance from SSAP No. 103R; classifying only cash postings of initial margin as a form of basis deposit necessitating distinct accounting and financial statement presentation. Additional clarification regarding both the perceived issue(s) and the objective(s) underlying the proposed updates is requested in order to ensure industry can assist in fully and appropriately addressing each underlying concern in light of the applicable regulatory objective(s).

The exchange of initial margin with central clearinghouses is clearly distinct in function from the exchange of variation margin. As referenced in the proposal, initial margin is a minimum amount of equity that must be provided to a clearinghouse to initiate a position. It effectively represents the deposit of chips required to play at the table (“table stakes”), and is required from both respective parties entering into the derivative transaction as protection for the clearinghouse against the potential that either respective party will not make good on its respective commitments (i.e., initial and continuing participation in the transaction and the associated exchanges of variation margin driven by the derivative price movements until expiry or novation) – leaving the clearinghouse exposed, as intermediary, to the remaining party. Once such a trade expires or is novated, assuming the respective party has made good on all its variation margin payments during the course of the trade being open, the asset(s) posted to the clearinghouse as initial margin is returned to that exiting party. In the instance that a party exiting the derivative transaction has not stayed current with its respective variation margin obligations, the clearinghouse will return the remaining value of the initial margin after settling up the unpaid variation margin obligations. As such, the contingencies associated with maintenance of exclusive control over the rights and benefits of asset ownership for an entity posting initial margin are primarily a function of the entity’s continuing involvement in the trade with the clearinghouse, which is distinct from the derivative price movement contingencies directly associated with variation margin.

Reporting entities often utilize non-cash collateral (e.g., US Treasuries) for posting as initial margin to clearinghouses, as the required initial margin value can be comparatively high (driven by risk adjusted trailing price volatility of the underlying derivative and overcollateralization conventions) but the reporting entity maintains the full rights & benefits of ownership over an already held yield generating asset – in many instances preferable to locking up a chunk of otherwise investible cash. The ability to maintain full control over the rights and benefits of ownership on this yield generating non-cash collateral posted (e.g., avoiding forced sales of the non-cash collateral to satisfy unfulfilled variation margin obligations) also incentivizes a reporting entity to remain current on variation margin obligations while the trade remains open. Existing statutory accounting guidance (e.g., the previously referenced SSAP No. 103R and INT 01-31) already provides for appropriate classification, measurement and presentation of collateral posted as initial margin. In the much more likely instance that non-cash collateral has been posted to a clearinghouse as initial margin, the pledging insurer continues to record the pledged collateral as an admitted asset until they have committed a contract default that has not
been cured. In the unlikely instance that the non-cash collateral has to be liquidated in order to satisfy unmet variation margin payment obligations associated with a trade being exited, any associated realized loss would be recognized and the reclassification of the remaining initial margin value due back from the clearing house will be recorded – likely as either cash or a receivable - in accordance with applicable statutory guidance. The Blanks instructions require that any such non-cash or cash collateral posted as initial margin be marked as such on the attendant investment schedule, identified at the specific asset level on Schedule DB-D Section 2 (complete with an identifier indicating that the posting represents initial margin) and summarized within Note 5 (Restricted Assets). As such, the availability of the assets to fulfill policyholder obligations, as well as identification at the specific asset level of the unique and specific contingencies associated with initial margin posting are already presented appropriately for the consideration of financial statement users. Altering the presentation of initial margin postings on the summary Schedule DB-D Section 1 would not augment a financial statement user’s understanding of the reporting entity’s solvency or financial condition, as the “net realizable margin” associated with the open derivative contracts is already appropriately presented – initial margin posted is not directly or typically subject to the derivative price movement contingencies inherent in arriving at an appropriate “Exposure Net of Collateral” total on Schedule DB-D Section 1.

Equally as important, incorporation of initial margin posted into the “Exposure Net of Collateral” total on Schedule DB-D Section 1 would lead to inappropriate and misleading downstream consequences for a reporting entity’s Risk Based Capital calculation. Any collateral (whether non-cash or cash) posted as initial margin is already captured in the Life RBC formula on LR017 (Off Balance Sheet and Other Items), where all collateral postings are pulled directly from Schedule DB-D Section 2 and assessed RBC charges associated with the specific contingency of pledging of the assets to an external counterparty. Thus, netting initial margin postings into the “Exposure Net of Collateral” total on Schedule DB-D Section 1 would make the total derivative exposure (net of collateral) that flows through to LR012 in the Life RBC formula too high – inappropriately double counting the RBC charges associated with the posting of initial margin to a clearinghouse. In addition, the understatement of net realizable collateral (Fair Value of Acceptable Collateral) on Schedule DB-D Section 1 would also, in many instances, mechanically carry through to overstate the “Off Balance Sheet Exposure” reported on the same schedule – which would result in even further overstatement of RBC charges as this “Off Balance Sheet Exposure” flows through the Life RBC formula to be assessed charges on LR017. Doubling, and possibly tripling the RBC charges associated with the posting of initial margin to a central clearinghouse is not an appropriate depiction of true risk for such margin.

Given the ambiguities in the exposure language, the appropriate depiction of economic substance and inherent risk associated with exchanging initial margin within the existing statutory accounting, reporting and RBC frameworks, and the importance of maintaining insurers’ ability to utilize cleared derivatives to effectively manage risk and prudently support yields, we respectfully request that the Working Group withdraw the current proposal and direct NAIC Staff to collaborate with industry to specify and appropriately address any remaining concerns. We stand ready to work through any lingering misgivings the Working Group may have with regard to financial statement presentation but request that such endeavors be empirically
grounded in specific observed instances of incomplete or inappropriate reporting.

**Ref #2019-40: Reporting of Installment Fees and Expenses**

The Working Group proposed revisions to SSAP No. 53 – *Property and Casualty Contracts* (SSAP No. 53) to clarify that the installment fee reporting guidance should be narrowly applied. Comments are also requested on whether guidance should be developed to allow expenses associated with installment fees to be reported as a contra revenue in “aggregate write-ins for miscellaneous income” and whether diversity should be permitted in reporting installment fee expenses. Additionally, the Casualty Actuarial (C) Task Force and Property and Casualty Risk Based (E) Working Group will be notified of this exposure.

With regard to the proposed change to emphasize that current guidance in SSAP No. 53 should be interpreted narrowly, interested parties recommend the following revision to the last sentence of the proposed wording in the footnote to SSAP No. 53 paragraph 6:

*Clarification: Reporting of installment fees in the context of finance and service charges as other income should not be construed as having any bearing on whether such charges are subject to premium taxation, which remains an issue of state law and regulation.*

Although interested parties did not survey companies, we believe the assertion by NAIC staff that expenses associated with installment fees are often immaterial is reasonable. We also believe that current reporting of the related installment fee expenses in other underwriting expenses is appropriate. For practical purposes, we do not see the benefit of isolating the expense related to processing the relatively small fee component of a premium billing for separate expense reporting purposes. We believe the reporting of expenses should be consistent and would not support the reporting of the related expenses as an “aggregate write-ins for miscellaneous income” or as a contra revenue to “finance and service charges not included in premiums.”

**Ref #2019-41: Eliminating Financial Modeling Process**

The Working Group moved this agenda item to the active listing and exposed revisions to SSAP No. 43R—*Loan-backed and Structured Securities*, to eliminate the multi-step financial modeling designation guidance in determining final NAIC designations for residential mortgage-backed securities (RMBS) / commercial mortgage-backed securities (CMBS) securities. Exposure was contingent upon the Valuation of Securities (E) Task Force’s concurrent exposure, which occurred on December 8, 2019. The Working Group noted that final action on this would not be taken until the Valuation of Securities (E) Task Force takes action on their related item.

Interested parties have no comment on this item at this time.
Ref #2019-42: Inclusion of Cash / Liquidity Pools - Cash Equivalents as defined in SSAP No. 2R

The Working Group moved this agenda item to the active listing and exposed revisions to SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments to specify that cash pooling structures that meet specified criteria qualify as cash equivalents.

Interested parties appreciate that a separate Form A (Ref #2019-42) was written related to Cash/Liquidity Pools (“pools”) to clarify the accounting associated with them. We agree with the addition of a paragraph, similar to paragraph 8, to SSAP No. 2R to provide guidance related to pools; however, given that the characteristics of pools differ by company, we propose some modifications to paragraph 8 in order to address those varied characteristics.

Interested parties’ comments related to the proposed paragraph 8 are as follows:

1) Regarding the proposal to look through the ownership structure to report the assets held as cash equivalents, we agree that look through is appropriate. Some pools, as approved by regulators, consist of assets that meet the Statutory definition of cash equivalents and thus the interest held in the pools are reported as cash equivalents on Schedule E2. However, other pools, also approved by regulators, include assets that meet the definition of short-term investments in SSAP No. 2 and thus the interest held in the pools are reported as short-term investments on Schedule DA. Some pools may include both short-term investments and cash equivalents.

Given the varied characteristic discussed above, we recommend paragraph 8 be modified to state that, if the requirements of paragraph 8 are met, the reporting entity may look through the ownership structure and report the assets as either cash equivalents or short-term assets based on the predominant characteristic of the underlying assets. This would allow companies the flexibility to report their investments in the pools in the Statutory statement schedule that is more reflective of the type of underlying investments in their pool and prevent the need for companies to reclassify/change their existing reporting to Schedule E2 from DA if they currently report the pools in DA due to the underlying assets.

2) Regarding paragraph 8d (i.e., the requirement to produce annual U.S. GAAP audited report of the pools including schedules showing each affiliate’s prorata share of the investments), insurance companies already receive an independent audit under Statutory Accounting Principles (“SAP”), which would include the insurance company’s investment in a pool. Requiring cash pools to be separately audited under U.S. GAAP would come at a cost, in time and resources, to insurers with pools. In addition, some insurers have pools which are not in the form of legal entities.

An alternative to the U.S. GAAP audit requirement of paragraph 8d. is to require a footnote disclosure at the reporting date for each insurer that participates in a pool, which identifies that the insurer is invested in a cash pool, provides the reporting entity’s share
of the pool, and the insurers dollar share of cash equivalents and short-term investments in the pool. This disclosure would be subject to audit on an SAP basis of accounting. IPs believe the audit of the disclosure along with the audit of the insurance company would be adequate to meet the objectives of ensuring that the pool allocation process is accurate. Other alternatives include targeted financial examination procedures for pools, which could include procedures to confirm the balance of the pool and verify the individual legal entities’ balances for participating in the pool.

3) We note that the addition of the proposed pool language in SSAP No. 2 does not specifically address the reporting and accounting for the interests held in the pool. We recommend, if the pool is managed on a fair value basis (i.e., interest in the pool are bought and sold at fair value), that the book/adjusted carrying value for the interest held in the pool would be reported at fair value with changes in fair value reported in unrealized gains and losses. If the pool is not managed on a fair value basis, the interest held in the pool would be reported at amortized cost. It is important to note that pools managed on a fair value basis may use amortized cost as the best estimate of fair value, depending on the characteristics of the underlying assets.

Finally, in the issue paper, NAIC staff questioned whether changes to SSAP No. 48, Joint Ventures, Partnerships and Limited Liability Companies are needed, since many pools are held in a Limited Liability Company (“LLC”). Interested parties do not believe such changes are needed to SSAP No. 48; however, it would be helpful to users of the SSAPs to add a footnote to paragraph 8 of proposed SSAP No. 2R stating that pools may be held in LLCs, for example, and if so, SSAP No. 2 is to be applied and not SSAP No. 48.

Ref #2019-43: ASU 2017-11 - Financial Instruments with Down Round Features

The Working Group moved this agenda item to the active listing and exposed revisions to SSAP No. 86—Derivatives to reject ASU 2017-11, Earning Per Share, Distinguishing Liabilities from Equity, Derivatives & Hedging and incorporate guidance into SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets and SSAP No. 72—Surplus and Quasi-Reorganizations for when certain freestanding instruments shall be recognized as liabilities and not equity.

Interested parties have no comment on this item.

Ref #2019-45: ASU 2013-11, Presentation of an Unrecognized Tax Benefit

The Working Group moved this agenda item to the active listing and exposed revisions to SSAP No. 101—Income Taxes to reject ASU 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists for statutory accounting.

Interested parties support adoption of this item but note that the following statement should be removed from the document as it is incorrect (see IFRC 23, Uncertainty over Income Tax Treatments):
Convergence with International Financial Reporting Standards (IFRS):
IFRS does not include specific guidance on the presentation of unrecognized tax benefits.

Ref #2019-46: ASU 2016-14, Presentation of Financial Statements of Not-for-Profit Entities

The Working Group moved this agenda item to the active listing and exposed revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2016-14, Presentation of Financial Statements of Not-for-Profit Entities as not applicable to statutory accounting.

Interested parties have no comment on this item.

Ref #2019-47: Grade in of Variable Annuity Reserves

The Working Group moved this agenda item to the active listing and exposed revisions to SSAP No. 51R—Life Contracts and SSAP No. 3—Accounting Changes and Corrections of Errors. The revisions add reference, disclosures and accounting for Section 21 of the Valuation Manual, Requirements for Principle-Based Reserves for Variable Annuities, and grade-in requirements for reporting changes in the valuation basis for years beginning January 1, 2020.

This exposure consists of several parts, some of which we agree with and others we find both confusing and unnecessary. We agree that documentation of the choices made among the options for phase-in in VM-21 and the impact of those choices is important. The exposed edits focus on the adoption of the new reserve requirements for variable annuities (revised VM-21 and AG-43). Information on those choices and impacts will be provided to regulators through the PBR Actuarial Memorandum required by VM-31. This includes highlighting the elements of any Phase-in in the executive summary of the PBR Actuarial Memorandum. Given the current requirements of SSAP3 and SSAP51, documentation in the notes to the Annual Statement is also appropriate.

In Recommendation #2, the proposal would require the amounts from the Phase-in to be designated as “special surplus”. We disagree with this recommendation for the following reasons:

- This is a new requirement whose need has not been established. Disclosure of the amounts will provide information necessary for users of the financial statements to understand the basis of the reported financials.
- SSAP72 defines Special Surplus as amounts designated for specific contingencies. Recommendation #2 would be a change to the definition and purpose of special surplus that is inappropriate and would create an undesirable precedent.

Finally, the proposed language is unnecessary, and possibly confusing. VM-21 defines the minimum reserve requirement. Within that requirement, the company has the option to compute the reserves using the Phase-in provision of Section 2.B. Whichever option is elected, VM-21 defines the reserve. SSAP51 defines the amount of the “Change in Basis” as the difference
between the amount under the prior VM-21 and the amount required by the current VM-21 as of 1/1/2020. If the Phase-in has been elected, that difference will generally be zero. The change in basis amount as defined in SSAP51 paragraph 39 is not being graded in – it is what it is following the VM-21 reserve requirements as stated. As such, SSAP51 does not need to make provision for a grade in. We propose the attached language as being clearer in defining the amounts to be disclosed, to use language consistent with VM-21, and to recognize the role of VM-21 to define the reserve requirement.

Ref #2019-48: Disclosure Update for Reciprocal Jurisdiction Reinsurers

The Working Group moved this agenda item to the active listing and exposed revisions to SSAP No. 62R—Property and Casualty Reinsurance, to incorporate disclosure updates for reinsurers from Reciprocal Jurisdictions.

Interested parties have no comment on this item.

Ref #2019-49: Retroactive Reinsurance Exception

The Working Group moved this agenda item to the active listing with a request for comments on the preferred approaches to reporting and the advantages and disadvantages to each approach being used, including impacts on the Schedule P (and related loss analysis) and risk-based capital. Industry and state insurance regulator volunteers are requested to assist with developing guidance to clarify both the accounting and reporting for retroactive contracts which are accounted for prospectively. The Working Group directed NAIC staff to notify the Casualty Actuarial and Statistical (C) Task Force of the request for comments.

With regard to retroactive portfolio transfer deals within the same group that qualify for prospective treatment, interested parties identified the following issues related to reporting transactions in Schedule P.

Main Issues

- Should there be a requirement to have offsetting entries for the ceding and assuming entity within the group, such that the group Schedule P is not impacted (and industry Schedule P is not impacted)? (If so, then the ceding entity can’t record ceded amounts for prior AYs while the assuming company records assumed amounts all in the current CY/AY.)

- Should retroactive changes in previous premium amounts be allowed? (If no, and there is a desire to have both entities record the ceded/assumed in the affected older AYs, then the reinsurance premium would need to be treated as a paid loss – positive paid for the ceding entity and negative paid for the assuming entity.)

- Should the reporting prevent “cliffs” in the historic development reported in Schedule P. (If the cede transaction is reported as a premium and spreading to prior CYs, effectively changing prior values retroactively, then the prior incurred loss amounts in
Schedule P, Part 2 would need to be adjusted to avoid a “cliff”.) Note that cliffs in Schedule P, Part 2 can have a material RBC impact with regard to the company experience adjustment.

**Two Alternative Approaches**

Interested parties identified two alternative approaches to recording intercompany, retroactive reinsurance:

- Record the reinsurance premium as a paid loss (positive paid for the cedant, negative for the assuming company), spreading the “premium” to the same AYs as the ceded losses. This avoids cliffs and avoids restating past CY Earned Premium, although it produces unusual results for the assuming company’s Schedule P.

- Record the reinsurance premium as premium, restating prior CY Earned Premium. Spread losses to the impacted AYs. This would create cliffs in Schedule P unless prior AYs are restated for the impact by AY of the reinsurance contract at inception.

*   *   *

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
Disclosures
18. The notes to the financial statements of a reporting entity that issues surplus notes shall disclose the following as long as the surplus notes are outstanding:

a. Date issued;

b. Description and fair value of the assets received;

c. Holder of the note or if public, the names of the underwriter and trustee, with identification on whether the holder of the surplus note is a related party per SSAP No. 25;

d. Original issue amount of note;

e. Carrying value of note;

f. The rate at which interest accrues;

g. Maturity dates or repayment schedules, if stated;

h. Unapproved interest and/or principal;

i. Life-to-date and current year approved interest and/or principal recognized;

j. Disclosure of whether the surplus note was issued as "paid" part of a transaction with identification of the amount of approved following attributes:

i. Do surplus note / associated asset terms negate or reduce cash flow exchanges, and/or are amounts payable under surplus notes and amounts receivable under other agreements contractually linked (For example, the asset provides interest and/or principal remitted payments only when the surplus note provides interest payments)?

ii. Are any amounts due under surplus notes and associated assets netted or offset (partially or in full) thus eliminating or reducing the exchange of cash or assets that would normally occur throughout the duration, or at maturity, of the agreement. (This may be referred to as administrative offsetting)?

iii. Were the proceeds from the issuance of a surplus note used to purchase an asset directly or indirectly from the holder of the surplus note (actual transfer of cash / assets) and the amount of approved interest and/or principal not remitted to the holder of the surplus note (no transfer of cash / assets)? If so, was the asset issuer a related party per SSAP 25?

iv. Information regarding a 3rd party liquidity source including name, identification if a related party, cost of the liquidity guarantee, and maximum amount available should a triggering event occur.

k. Principal amount and fair value of assets received upon Surplus Note issuance, if applicable;

l. Subordination terms;

m. Liquidation preference to the reporting entity’s common and preferred shareholders;

n. The repayment conditions and restrictions;

---

1 Interest and principal reported pursuant to 18.i include amounts offset by amounts receivable under other agreements, unless the reporting entity has a legal right of offset. Such offsetting arrangements shall be disclosed pursuant to paragraph 18.i.i through 18.i.iii
o. Information about any guarantees, support agreements, or related party transactions associated with the surplus note issuance, and whether payments have been made under such agreements.

19. If a reporting entity has ceded business to a surplus note issuer that is not remitting actual cash or assets to a related party as part of a reinsurance transaction in which the surplus note meets any of the criteria in 18. j above, the ceding entity shall provide a description of the transaction, including whether the criteria in 18. j above were met with respect to the surplus note issuance, as long as the reinsurance agreement remains in force. The ceding entity should provide a description of the risks reinsured, the related party reinsurer, any guarantees or support agreements and the amount of notes outstanding.

19.20. If the proceeds from the issuance of a surplus note used to purchase an asset directly or indirectly from the holder of the surplus note for approved interest or principal (as reported under paragraph 18. h), because the reporting entity is offsetting the amount owed under the surplus note with an amount receivable from a reported asset, the following information shall be disclosed regarding the offsetting assets received:

a. Identification of asset, including the investment schedule where the asset is reported and reported NAIC designation;

b. Book/adjusted carrying value of asset and interest income recognized in as of the current year.

c. Amount of principle return and interest income from the asset not received by the reporting entity as the amounts were offset with approved amounts owed by the reporting entity’s issued surplus note. date.

c. A description of terms under which liquidity would be provided should a triggering event occur.

20.21. In addition to the above, a reporting entity shall identify all affiliates that hold any portion of a surplus debenture or similar obligation (including an offering registered under the Securities Act of 1933 or distributed pursuant to rule 144A under the Securities Act of 1933), and any holder of 10% or more of the outstanding amount of any surplus note registered under the Securities Act of 1933 or distributed pursuant to Rule 144A under the Securities Act of 1933.

Proposed Blanks Disclosures:

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<th>Date Issued</th>
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<th>Original Issue Amount of Note</th>
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<th>Carrying Value of Note Prior Year</th>
<th>Carrying Value of Note Current Year</th>
<th>Unapproved Interest And Or Principal</th>
<th>Approved Interest Recognized</th>
<th>Interest Paid Current Year</th>
<th>Life-To-Date Total Interest Remitted (Actual Transfer of Cash/Assets)</th>
<th>Principal Paid Current Year</th>
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<td>* Include amounts offset with amounts owed from the holder of the surplus note.</td>
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<table>
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<tr>
<th><strong>Name of 3rd Party</strong></th>
<th><strong>Is Liquidity Source a Related Party to the Surplus Note Issuer?</strong></th>
<th><strong>Current Year Total Cost of Liquidity Source</strong></th>
<th><strong>Current Year Cost of Liquidity Source Reported as Surplus Note Interest</strong></th>
<th><strong>Total Cost of Liquidity Source Since Acquisition</strong></th>
<th><strong>Total Cost of Liquidity Source Reported as Surplus Note Interest Since Acquisition</strong></th>
<th><strong>Maximum Amount Surplus Note Issuer Can Receive from Liquidity Source</strong></th>
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*Include amounts offset with amounts owed from the holder of the surplus note.*
Exhibit B: 2019-47 Marked changes

SSAP No. 51R:

Change In Valuation Basis

36. A change in valuation basis for reserves determined under paragraphs 18-21, except for reserves defined under Actuarial Guideline XLIII—CARVM: For Variable Annuities (AG 43), as detailed in Appendix C of this Manual, shall be defined as a change in the interest rate, mortality assumption, or reserving method (e.g., net level, preliminary term, etc.) or other factors affecting the reserve computation of policies in force and meets the definition of an accounting change as defined in SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3).

37. Changes in reserves developed under paragraph 22 or AG 43 shall be reviewed to determine whether the change represents a change in valuation basis and if it meets the definition of a change in accounting as defined in SSAP No. 3.

   a. Changes in principle-based reserving assumptions are often the result of updating assumptions and other factors required by the existing reserving methodology. Reserve changes resulting from the application of principle-based reserving methodology including, but not limited to, updating assumptions based on reporting entity, industry or other experience, and having the reported reserve transition between net premium reserve, deterministic reserve or stochastic reserve, as required under existing guidance, shall not be considered a change in valuation basis. These types of changes also include, but are not limited to, periodic updates in Valuation Manual tables, such as industry valuation basic tables, asset spread tables and default cost tables.

   b. A change in valuation basis for principle-based reserves shall include cases where the required reserve methodology has changed, or the insurer makes a voluntary decision to choose one allowable reserving method over another. These types of changes include, but are not limited to, new standardized mortality tables such as Commissioners Standard Ordinary tables and regulatory changes in methodology.

38. Consistent with SSAP No. 3, any increase (strengthening) or decrease (destrengthening) in actuarial reserves resulting from such a change in valuation basis shall be recorded directly to surplus (under changes to surplus in the change in valuation basis annual statement line) rather than as a part of the reserve change recognized in the summary of operations.

39. The impact of a change in valuation basis on surplus is based on the difference between the reported reserve under the old and new methods as of the beginning of the year. This difference shall not be graded in over time unless this statement or the Valuation Manual in section VM-21 Requirements for Principle-Based Reserves for Variable Annuities (VM-21) prescribes a new method and a specific transition that allows for
Exhibit B: 2019-47 Marked changes

Grading. If the grading permitted by this statement or Valuation Manual section VM-21 represents an increase in the reserve liabilities, the unrecognized change in valuation basis reserve increase shall initially be reflected as an allocation from unassigned funds to special surplus until fully recognized in reserving and unassigned funds. The reclassification from unassigned funds to special surplus does not reduce total surplus, but highlights the ungraded in amount for transparency as it represents an unrecognized adjustment (decrease) to total surplus. The allocation to special surplus is reversed to unassigned funds as the grading of the increase in reserving is recognized as a decrease to total surplus. Some changes will meet the definition of a change in accounting as defined in SSAP No. 3 and a change in valuation basis as described in paragraphs 36-38 of this statement, but the adjustment to surplus will be zero. This can happen when the change in valuation basis is prospective and only applies to new policies and reserves meaning that policies in force for the prior year-end are not affected, or situations in which the change in reserving methodology did not change the reserves reported in the financial statements. Some changes will meet the definition of a change in accounting as defined in SSAP No. 3 and a change in valuation basis as described in paragraphs 36-38 of this statement, but the adjustment to surplus will be zero. This can happen when the change in valuation basis is prospective and only applies to new policies and reserves meaning that policies in force for the prior year-end are not affected, or situations in which the change in reserving methodology did not change the reserves reported in the financial statements.

40. Some changes will meet the definition of a change in accounting as defined in SSAP No. 3 and a change in valuation basis as described in paragraphs 36-38 of this statement, but the adjustment to surplus will be zero. This can happen when the change in valuation basis is prospective and only applies to new policies and reserves meaning that policies in force for the prior year-end are not affected, or situations in which the change in reserving methodology did not change the reserves reported in the financial statements. Some changes will meet the definition of a change in accounting as defined in SSAP No. 3 and a change in valuation basis as described in paragraphs 36-38 of this statement, but the adjustment to surplus will be zero. This can happen when the change in valuation basis is prospective and only applies to new policies and reserves meaning that policies in force for the prior year-end are not affected, or situations in which the change in reserving methodology did not change the reserves reported in the financial statements. Some changes will meet the definition of a change in accounting as defined in SSAP No. 3 and a change in valuation basis as described in paragraphs 36-38 of this statement, but the adjustment to surplus will be zero. This can happen when the change in valuation basis is prospective and only applies to new policies and reserves meaning that policies in force for the prior year-end are not affected, or situations in which the change in reserving methodology did not change the reserves reported in the financial statements.

The changes remain subject to the disclosures prescribed in SSAP No. 3. Effective January 1, 2020, if the phase-in provision of the Valuation Manual section VM-21 (on variable annuities) is elected by this statement prescribes or permits a grading in period or provides the option of multiple grading periods, reporting entities shall also include in the change in accounting disclosures required by SSAP No. 3 disclosure of the following:

a. the grade-phase-in period being applied, and the remaining time period of the grade-phase-in

b. any adjustments to the grade-phase-in period.

c. The phase-in amount as defined in VM-21 of change in valuation basis grade in, which has been recognized in unassigned funds and

d. the remaining amount to be graded phase-in amount (reflected in special surplus if the ungraded in amount represents an increase in reserving).
Exhibit B: 2019-47 Marked changes

to the related AG-43, which may result in retroactive application to the reserving for existing contracts. Therefore, upon the initial prospective adoption of principle-based reserving, the change in valuation basis reflected as an adjustment to surplus will be zero. After initial adoption of the Valuation Manual, changes in valuation basis will need to be evaluated to determine the amount of any surplus adjustments.

SSAP No. 3—Accounting Changes and Corrections of Errors

Disclosures

Disclosure of material changes in accounting and correction of errors shall include:

a. A brief description of the change, encompassing a general disclosure of the reason and justification for change or correction;

b. The impact of the change or correction on net income, surplus, total assets, and total liabilities for the two years presented in the financial statements (i.e., the balance sheet and statement of income and operations); and

c. The effect on net income of the current period for a change in estimate that affects several future periods, such as a change in the service lives of depreciable assets or actuarial assumptions affecting pension costs. Disclosure of the effect on those income statement amounts is not necessary for estimates made each period in the ordinary course of accounting for items such as uncollectible accounts; however, disclosure is recommended if the effect of a change in the estimate is material;

d. Changes in accounting that are changes in reserve valuation basis as described in SSAP No. 51R—Life Contracts which have elected grade phase-in or other optional application features defined in the Valuation Manual, shall also include in the change in accounting disclosures information regarding the application of any grade-phase-in as provided for in SSAP No. 51R, and

e. When subsequent financial statements are issued containing comparative restated results as a result of the filing of an amended financial statement, the reporting entity shall disclose that the prior period has been restated and the nature and amount of such restatement.
February 18, 2020

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 During the NAIC Winter National Meeting with Comments due January 31 Regarding Goodwill

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the exposure drafts regarding the recognition of goodwill for statutory accounting that was released for comment by the Statutory Accounting Principles (E) Working Group (the “Working Group”), during the NAIC Fall National Meeting in Austin.

Interested parties note that in October 2018, the FASB decided to add to its technical agenda a broad project to revisit the subsequent accounting for goodwill. In 2019, the FASB issued an Invitation to Comment, *Identifiable Intangible Assets and Subsequent Accounting for Goodwill*, and held public roundtable meetings to discuss the topics included in the Invitation to Comment. The FASB is still in the initial deliberations phase of this project. Given the broad scope of the FASB project and the potential for changes to the current GAAP goodwill accounting model, interested parties recommend that any changes to statutory accounting that impact the accounting for goodwill be limited in their nature in recognition that the Working Group will need to consider the applicability of the changes to GAAP accounting for goodwill once the FASB completes the project.

We offer the following comments to the exposure drafts released for comment by the Working Group:

**Ref #2019-12: ASU 2014-17, Business Combinations – Pushdown Accounting, a Consensus of the FASB Emerging Issues Task Force**
The Working Group adopted, as final, a clarification edit to SSAP No. 68—Business Combinations and Goodwill to clarify that all goodwill from an insurance entity’s acquisition of SCAs, regardless of whether pushdown accounting is applied, is subject to the existing 10% admittance limitation. (With adoption of this edit, paragraph 9 was split into two separate paragraphs.) The remainder of this agenda item was re-exposed to allow additional time for specific examples of pushdown accounting to be provided by interested parties, as well as consider comments received on pushdown accounting.

Interested parties recommend that paragraph 5 of SSAP No. 68 be revised further as marked below to clarify the appropriate valuation that should be used for an acquired entity:

5. A business combination accounted for under the statutory purchase method and in which the acquired entity is valued in accordance with paragraphs 8.b.ii., 8.b.iii. or, 8.b.iv. of SSAP No. 97 shall determine the amount of positive goodwill or negative goodwill created by the combination using the reporting entity’s share of the GAAP net book value of the acquired entity, adjusted to a statutory basis of accounting in accordance with paragraph 9 of SSAP No. 97 in the case of acquired entities valued in accordance paragraphs 8.b.ii. or 8.b.iv. of SSAP No. 97. The GAAP net book value of the acquired entity used in this determination shall reflect the acquisition-date fair values of identifiable assets acquired and liabilities assumed, and goodwill, as recognized in the post-pushdown GAAP financial statements of the acquired entity, if applicable. Business combinations accounted for under the statutory purchase method and in which the acquired entity is valued in accordance with, paragraph 8.b.i. of SSAP No. 97 shall determine the amount of positive or negative goodwill created by the business combination using the insurer’s share of the statutory book value of the acquired entity.

**Pushdown Accounting**

Interested parties note that the GAAP guidance in ASU 2014-17, which was adopted by the SEC in Staff Accounting Bulletin (SAB) 115, provides clear guidance that an acquired entity has the option to apply pushdown accounting in its separate financial statements upon the occurrence of an event in which an acquirer obtains control of the acquired entity. Under applicable GAAP guidance, control generally results when one entity obtains, either directly or indirectly, more than 50 percent of the outstanding voting shares of another entity. This differs from the definition of control under statutory guidance which uses a threshold of 10 percent or more of voting control. As such, under GAAP, there would not be a scenario where an entity would be controlled by multiple owners with 10% or more ownership of outstanding shares.

Whether a company chooses to apply pushdown accounting depends on the facts and circumstances of a particular transaction. In certain situations, pushdown is preferable to eliminate the basis difference between an acquirer and the acquired entity. In other situations, a company may prefer pushdown accounting to better reflect the actual values of the acquired assets and assumed liabilities based on the purchase price of the entity.

When the SEC required pushdown for SEC registrants, there was limited guidance for non-
registrants under GAAP which resulted in some non-registrants also applying the SEC pushdown guidance. We believe retaining the *optionality* for statutory reporting allows for consistency and comparability across both SEC registrants and non-registrants and provides operational efficiency.

The option of not allowing subsequent elections for pushdown accounting is not practicable for SEC registrants that previously elected to use pushdown accounting. In order for such companies to discontinue use of pushdown accounting, a preferability letter would be required for a change in accounting policy to discontinue the use of pushdown accounting. Given that an election to discontinue use of pushdown accounting is not likely preferable, the insurer would be in the position of having to continue using pushdown accounting in order to receive a clean audit opinion on the GAAP financial statements of the SCA. Additionally, while ASC 805, *Business Combinations*, allows the election to be made for each change in control event, acquirers that report consolidated results may as a practical matter choose pushdown accounting at the subsidiary level to avoid separately tracking assets, and liabilities at two different values in two different ledgers.

As noted in the examples below, and in accordance with the guidance adopted during the December 7, 2019 Working Group meeting, interested parties understand the guidance clarified that all goodwill from an insurance entity’s acquisition of SCAs, regardless of whether pushdown accounting is applied, is subject to the existing 10% admittance limitation. Interested parties have summarized the interpretation of this clarification for an insurance entity’s acquisition of an 8.b.i (example 1), 8.b.ii (example 2a and 2b), 8.b.iii (example 3a and 3b) or 8.b.vi (example 2a and 2b) entity as follows:

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<thead>
<tr>
<th>Example</th>
<th>Type of acquired SCA</th>
<th>Is Pushdown elected?</th>
<th>Where does Goodwill resides?</th>
<th>Admissibility of goodwill limited to 10% of</th>
<th>Is Goodwill required to be amortized?</th>
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<td>8.b.i</td>
<td>Not permitted per SSAP No. 68 para 6</td>
<td>Insurance entity (Statutory goodwill)</td>
<td>Insurance Entity's Surplus per SSAP No. 68 para 7</td>
<td>Yes per SSAP No. 68para 8</td>
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<td>2a</td>
<td>8.b.ii or 8.b.iv</td>
<td>No</td>
<td>Insurance entity (Statutory goodwill)</td>
<td>Insurance Entity's Surplus per SSAP No. 68 para 7</td>
<td>Yes per SSAP No. 68para 8</td>
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<tr>
<td>2b</td>
<td>8.b.ii or 8.b.iv</td>
<td>Yes</td>
<td>SCA (GAAP goodwill)</td>
<td>SCA's GAAP equity per SSAP No. 97 para 9.d</td>
<td>Yes per SSAP No. 97 para 9.c.iii</td>
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<td>3a</td>
<td>8.b.iii</td>
<td>No</td>
<td>Insurance entity (Statutory goodwill)</td>
<td>Insurance Entity's Surplus per SSAP No. 68 para 7</td>
<td>Yes per SSAP No. 68para 8</td>
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<tr>
<td>3b</td>
<td>8.b.iii</td>
<td>Yes</td>
<td>SCA (GAAP goodwill)</td>
<td>Insurance Entity's Surplus per SSAP No. 68 para 7</td>
<td>No *</td>
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* See further discussion below related to amortization
After evaluating the accounting for goodwill from the various entities described in paragraph 8.b, we concluded that the NAIC should continue to allow insurers to elect pushdown accounting for acquisitions of non-insurance entities (Option 2) for the following reasons:

1. Statutory goodwill, created when the insurer is the acquirer, is subject to an existing 10% admittance limitation as clarified in the changes adopted by the Working Group during the Fall National Meeting and demonstrated above; therefore, the resulting goodwill from pushdown accounting is subject to the statutory thresholds.

2. Pushdown accounting is consistent with GAAP, prior to ASU 2014-17, for SEC registrants and non-registrants that used pushdown accounting. As noted above, it is not practical to discontinue use of pushdown accounting as an insurer would need to continue the use of pushdown accounting in order to obtain a clean audit opinion on the GAAP financial statements of the SCA.

3. It is important to maintain consistency with current GAAP. Under ASU 2014-17, pushdown accounting may be elected in a later reporting period, after the initial acquisition date. We understand that there may be concerns with electing pushdown at a later reporting period after goodwill was originally determined and reported at initial acquisition date. However, rather than disallowing a later election to apply pushdown accounting, which creates a variance to GAAP, we suggest this could be addressed through changes to SSAP No. 97 to ensure that goodwill is not subsequently increased for statutory reporting, in the event pushdown accounting is elected after the initial acquisition date.

4. The recommendations above would allow the continued use of audited GAAP equity as the statutory carrying value for all non-insurance entities for insurers that previously elected pushdown accounting (both SEC registrants and non-registrants). Additionally, the ability to elect pushdown accounting for future acquisitions retains GAAP equity as the statutory valuation basis for SCAs and avoids restrictions that can impact insurers’ ability to obtain an unqualified opinion on the stand-alone financial statements of SCAs.

If a restriction were placed on the use of pushdown accounting at a future date, those entities that have previously elected pushdown will be forced to separately track assets, and liabilities at two different values in two different ledgers as well as address the issue of making a change in accounting policy that may not have preferability.

As a separate point, we suggest changing the heading for Option 2 from “Permission to use pushdown for all non-insurance entities” to “Use of pushdown for all non-insurance entities”, as the term “permission” implies that use of pushdown accounting is a permitted practice under the statutory accounting framework.
Amortization

Interested parties reiterate the concern that the revisions from the adopted language (new SSAP No. 68 paragraph 10) would inadvertently require amortization of pushdown goodwill. While staff has noted that amortization may be the proper approach, interested parties believes as it relates to paragraph 8.b.iii entities acquired by an insurance entity where pushdown is applied, there has been diversity in practice.

Interested parties concur with the NAIC’s staff’s position described in the December 2019 Public Hearing Agenda materials:

“(As detailed in the earlier discussion, the minor edit being discussed only focuses on nonadmittance for insurer entity acquired SCAs that have been pushdown. The edit would not mandate amortization for those pushdown situations. The discussion on whether amortization should be required for those situations is proposed to occur after the next exposure.)”

Ref #2019-14: Attribution of Goodwill

The Working Group re-exposed this agenda item to clarify that the “assignment” of goodwill is a disclosure element. The Working Group directed NAIC staff to prepare revisions to the Sub 1 Acquisition Overview template to capture this information for new SCA acquisitions.

Recommended Action:

NAIC staff identifies that the comments received on the proposed disclosure enhancement under this agenda item are limited, but generally request additional time before adoption. NAIC staff believes the disclosure information requested under this agenda item will be necessary regardless of the decision involving pushdown accounting. As a reminder, the proposed disclosure only details the amount of goodwill recognized from the acquisition of a downstream holding company and the assignment of the goodwill to the entities owned by the holding company. This information is necessary in determining the amount of goodwill that would need to be nonadmitted, or derecognized, if an underlying company in the downstream holding company was nonadmitted or sold.

Interested parties note that the December 2019 Public Hearing Agenda materials state:

“It is important to highlight that the clarification edit proposed for adoption consideration is specific to insurance entity acquisitions of SCAs. As such, if an acquisition occurred downstream from the insurance company (by a non-insurance holding company), and the holding company applied pushdown accounting, so that the goodwill was reported at the holding company’s acquired SCA, the proposed edit would not require that push down goodwill to be brought up to the insurance entity’s level and included in the 10% limit.”

Requiring attribution would be onerous and misleading to the users of the financial statements, particularly if the disclosure included detailing GAAP goodwill that is not subject to the 10%
Interested parties do not believe it is necessary to “attribute” goodwill to downstream SCAs of downstream holding companies. We believe that any concerns about the carrying value of the downstream holding company being overstated because it did not push down GAAP goodwill to a downstream SCA that was subsequently sold is mitigated by the fact that GAAP already requires the attribution and derecognition of goodwill associated with the business or SCA that is sold.\(^1\) To layer in a statutory attribution of goodwill is not necessary, overly complex, and may distort the accounting impact of a sale of a downstream SCA.

Therefore, we recommend that the disclosure of GAAP goodwill attributed to downstream SCAs of downstream holding companies focus on actual GAAP goodwill that was pushed down to the downstream SCAs and any statutory goodwill that occurred when the insurer is the acquirer, subject to the existing 10% admittance limitation as illustrated and discussed in the examples above.

* * *

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

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\(^1\) ASC 350-20-40, *Intangibles – Goodwill and Other - Goodwill – Derecognition*, paragraphs 1 and 2:

40-1: When a reporting unit is to be disposed of in its entirety, goodwill of that reporting unit shall be included in the carrying amount of the reporting unit in determining the gain or loss on disposal.

40-2: When a portion of a reporting unit that constitutes a business (see Section 805-10-55) or nonprofit activity is to be disposed of, goodwill associated with that business or nonprofit activity shall be included in the carrying amount of the business or nonprofit activity in determining the gain or loss on disposal.
January 31, 2020

Dale Bruggeman, Chair  
Statutory Accounting Principles (E) Working Group  
National Association of Insurance Commissioners

Re: Ref #2019-20, Rolling Short-Term Investments

Dear Mr. Bruggeman:

The American Property Casualty Insurance Association (APCIA) appreciates the opportunity to comment on the Statutory Accounting Principles (E) Working Group’s exposed revisions to SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments and SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities relating to rolling short-term investments. APCIA is the primary national trade association for home, auto, and business insurers. APCIA promotes and protects the viability of private competition for the benefit of consumers and insurers, with a legacy dating back 150 years. APCIA members represent all sizes, structures, and regions—protecting families, communities, and businesses in the U.S. and across the globe.

APCIA writes to highlight our support for the recommendations on this proposal provided in the comment letter of the “Interested Parties” coalition. APCIA and our members regularly participate in the Interested Parties’ discussions and drafting process.

SSAP No. 2R generally requires debt obligations with a maturity date of less than one year to be reported on Schedule DA. However, the proposed revisions to SSAP No. 2R would specify that any investment reported as a short-term obligation which was renewed or extended past its original maturity date would need to be reported as a long-term obligation, and a reporting entity would not be permitted to acquire the same or a substantially similar security within a 1-year time frame unless such security is reported as a long-term obligation. APCIA believes appropriate safeguards already exist, or could be put in place, to address the concerns underlying this proposal. We support the recommendations of the Interested Parties in the context of both unaffiliated and affiliated short-term loans.

Unaffiliated short-term loans provide important flexibility and efficiencies for insurers. So long as the lender has a reasonable expectation that the investment can terminate and be repaid on the maturity date, and both the borrower and lender have the ability to reevaluate and renew the loan at maturity, we believe unaffiliated short-term loans are properly reported on Schedule DA as a short-term risk asset. As such, APCIA supports the objective criteria proposed by the Interested Parties for determining when an unaffiliated loan qualifies as short term:

1) The loan includes a maturity date less than one year from closing at which the borrower has an unconditional repayment obligation and on which the lender has a reasonable expectation that the investment can be terminated and repaid if so desired by the insurer; and

2) Any subsequent renewal is only completed in the sole discretion of both the borrower and the lender.

In the context of short-term loans between affiliates, the Model Holding Company Act already requires regulatory filing and approval of loans exceeding a materiality threshold. Further, as the Interested Parties’ letter also points out, loans between affiliates are an important mechanism for meeting short-term liquidity needs for an entity within a broader group. Given the importance of insurers being able to utilize loans from affiliates to meet short-term needs and the regulatory oversight of these transactions that already exists, APCIA agrees with Interested Parties that short-term loans between affiliates should continue to be classified as short term.
Thank you for considering our comments. If you have any questions or would like to discuss this further, please contact Steve Broadie at steve.broadie@apci.org or 847.553.3606.

Sincerely,

[Signature]

Stephen W. Broadie
Vice President, Financial & Counsel
Dale Bruggeman  
Chair of Statutory Accounting Principles (E) Working Group

We have reviewed the proposed changes to SSAP No. 71 – Policy Acquisition Costs and Commissions as outlined in Ref. #2019-24 as revised on December 7, 2019.

The most effective way to appreciate the unintended consequences of the proposal is to start with a basic understanding of a typical distribution structure. Reporting entities execute distribution agreements, including compensation structure, with distribution partners (IMO, BGA, TPM, MGA, BD, for example). These distribution partners recruit, contract, train, supervise, and compensate smaller organizations (agencies, selling groups, brokerages, etc.) and individual producers (agents, brokers, etc.).

SSAP No. 71 prescribes statutory accounting treatment for reporting entity compensation agreements entered for the sale, distribution, and servicing of policies. The revisions proposed in Exposure Draft 2019-24 (as revised December 7, 2019) focus on two areas: (1) levelized commissions or “trail” payments paid directly to distribution partners or individual producers by a reporting entity and (2) levelized commissions or other installment payments paid to “third parties” by the reporting entity solely in exchange for the third party making non-levelized payments to the distribution partners or individual producers in place of the reporting entity (sometimes called “funding agreements”).

The proposed Exposure Draft relating to the first are in Paragraph 2 and call for “…commission shall be accrued based on experience to date for the policy period that the commission relates.” This specifically relates to the required timing or obligating event of a reporting entity’s liability for the cost of a commission payment specifically linked to persistency or policy renewal upon the anniversary of a policy issue date or some other future date or event.

The proposed Exposure Draft revisions relating to the second are (a) in paragraph 4, “…regardless of how the payment to the third party is characterized.”, (b) in paragraph 5, “…paid by a third party to the agents...by the reporting entity.”, and (c) in a footnote to paragraph 5, “The guidance in this paragraph notes that levelized commissions which use a third party to pay agents that are linked to traditional elements require establishment of a liability for the amounts that have been paid to the agents and any interest accumulated to date.”

The proposed revisions have different implications for different constituencies. We have endeavored to capture the essence of the concern from each party below. The proposed revisions have substantive implications for each of the noted constituencies, contrary to the non-substantive assertion in the revised exposure draft 2019-24. As a direct result of the inequity of the proposed changes upon various constituencies and the potential for substantial...
financial and economic harm incurred by the adoption of these changes to a variety of constituencies, we strongly recommend and request that the proposal not go forward.

Reporting Entity/ Carrier perspective:
1. Levelized commission programs are economic equivalents to “normal (non-level) commissions.” Levelized commission programs are preferable as they create a virtuous cycle linking the interests of consumers, agents, distribution partners and carriers to maintain ongoing servicing relationships, improving consumer support and policy persistency. Distribution relationships are multi-faceted, including agent recruitment and oversight, sales, sales support, underwriting support, premium collection, policy delivery and agent payment. Characterizing distribution partners as a ‘third party’ under the proposed footnote to paragraph 5 of SSAP No. 71 discounts the complexity of these relationships and the value of these vital roles dramatically altering carrier dynamics with distribution partners.
2. Reporting entities or carriers will be unduly penalized for economic transactions negotiated under existing accounting principles as a direct result of this proposal. The value of those transactions is retroactively altered by the introduction of a modified accounting principle which neither party initially anticipated, negotiated or priced.
3. Higher required capital and lower returns resulting from an arbitrary modification to an existing accounting practice will drive product design reviews and likely product redesigns modifying or eliminating levelized commission options or reducing value to the consumer through higher premiums and/or lower benefits.
4. The proposal to require reserves for future persistency based levelized commissions creates a disconnect with GAAP accounting where there is no reserve requirement. Moreover, the proposal creates new uncertainty around which other, long standing accounting treatment will be changed next

Distributor/ Agent perspective
1. The trail compensation approach incentivizes all parties to maintain a long-term relationship based upon ongoing agent support of consumer needs. Reducing or removing recurring compensation in the form of persistency based levelized commissions, shifts distributor economic motivation to new product sales, further degrading product level returns for the carrier. Reducing benefit levels or increasing premiums for the same benefit levels will lower the value proposition for effected products very likely reducing sales and consumer protection delivered by the products.

Consumer perspective:
1. The fallout from the changes will diminish value of insurance products through higher premiums and/or lower benefits enacted by carriers seeking to make up lost economic value and from lower service levels provided by brokers or agents as their incentives shift from ongoing consumer service relating to in-force policies to selling new policies (whether to the individual policyholder or other prospective clients).
January 30, 2020

Dale Bruggeman, Chair
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street
Kansas City, MO 64106

Re: SSAP No. 71—Policy Acquisition Costs and Commissions

Dear Mr. Bruggeman:

Thank you for the opportunity to provide comments on Proposal 2019-24 from the Statutory Accounting Principles Working Group regarding Policy Acquisition Costs and Commissions. The Working Group voted to re-expose revisions to SSAP 71 – Policy Acquisition Costs and Commissions - for comment at the NAIC Fall Meeting on December 7, 2019, continued to categorize the revisions as non-substantive, and further clarified levelized commission guidance and direction regarding certain commission obligations. I offer comments on behalf of our client, DRB Insurance Solutions, LLC, a licensed insurance producer (“DRB”).

SSAP No. 71 provides that levelized commissions occur in situations in which a third party, such as a funding agent, pays agents non-levelized commissions and the reporting entity pays the third party by levelized payments. The Working Group notes that it is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third-party would ultimately be repaid to the third-party from the reporting entity. SSAP No. 71 identifies such arrangements as “funding agreements” between the reporting entity and the third-party. SSAP No. 71 further provides that the use of a commission arrangement where commission payments are not linked to traditional elements (such as premium payments and policy persistency) requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which is payable to a third-party related to levelized commissions.

While revisions were made to several paragraphs and footnote 1 in the initial proposal at the Working Group’s meeting in December, the current exposure language remains overly broad to address the issue identified and intended to be clarified by the Working Group. Regulators have identified levelized commissions as funding arrangements to bypass recognition of acquisition costs by insurers and believe recognizing the full acquisition expense at the time of policy issuance is appropriate accounting treatment pursuant to SSAP No. 5R and the Statement of Concepts.
focusing on Recognition. Notably, the Working Group intended to restrict intercompany and affiliated transfers of trailing commission structures as pure accounting transactions solely for the purpose of deferring expense recognition of commission obligations, which is a laudable goal.

However, the language exposed to classify trailing commission transactions as funding arrangements is so broad, it encompasses practically every broker contract with an insurer that allows for any alternative payment arrangement between the broker and the issuing agent. DRB Insurance Solutions is an independent third-party master producer which uses various contracts between DRBIS and its sub-agents for commission payment, including trailing, heaped, partially heaped and trailing commissions, etc. The agreements between DRBIS and reporting entities are arms-length transactions, include the transfer of lapse risk, mortality risk and the commission expense obligation. The proposal requiring all insurers to accrue the full commission expense under these circumstances is illogical when the insurer no longer has the legal obligation to pay the expense and therefore, no longer has legally incurred the expense.

While regulators have opined that affiliated transactions shrouded as commission arrangements appear to circumvent accrual of commission expense at policy issuance, the goal to affect those transactions may continue to be addressed while narrowing the language to clarify that non-affiliated third-party contracts are not included. Accordingly, DRBIS offers the following amendment to the exposure draft to narrow the applicability to those affiliated transactions. Suggested language for Paragraph 4 and the footnote to Paragraph 5 is shown as shaded text as follows:

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party under the control of the reporting entity, its parent, and/or any subsidiary or affiliate of the reporting entity or its parent. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party under the control of the reporting entity, its parent, and/or any subsidiary or affiliate of the reporting entity or its parent to the agents requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party under the control of the reporting entity, its parent, and/or any subsidiary or affiliate of the reporting entity or its parent related to levelized commissions.

New Footnote – The guidance in this paragraph notes that that levelized commissions which use a third party to pay agents does not imply that levelized commissions that are linked to traditional
Dale Bruggeman, Chair  
National Association of Insurance Commissioners  
January 30, 2020  
Page 3

elements do not require establishment of a liability for the amounts that have been paid to the agents and any interest accumulated to date. Rather, such levelized commission obligations should be accrued for as set forth in paragraph 3.

The proposed language requires recognition of commission expense in situations where affiliated companies trade lapse and mortality risk amongst and between affiliated reporting entities using a commonly owned master producer while excepting unaffiliated third-party transactions from similar treatment. In these unaffiliated contractual arrangements, where risk and liability is transferred, the reporting entity may not even be aware of the payment schedule between the master producer and its sub-agents and certainly should not be required to accrue the full amount of the commission expense at policy issuance when the insurer is no longer legally required to pay that expense.

Non-Substantive Change
Finally, DRBIS would like to restate its opposition to consideration of the exposure draft as a non-substantive change. As previously stated, levelized commission programs began over thirty years ago, before the 1998 publication of Statutory Issue Paper No. 71 and the January 1, 2001 codification of Statutory Accounting Principles. The primary objectives of a levelized commission structure include aligning the interests of the customer, the agent, and the company and improved persistency from providing ongoing customer service. There is a duty to act in the best interests of the policyholder, as well as a compensation incentive, to make sure policies are well serviced so they stay in-force.

The proposed revisions to SSAP No. 71 are designated as non-substantive and deemed to be a clarification of intent of the codified statutory guidance. However, levelized commission programs were implemented more than a decade before the codification in 2001. Therefore, this is a material change to historical accounting practices and not a clarification of original intent. Even after codification, levelized commission programs continued for years and were not identified as applying statutory accounting incorrectly.

In conclusion, the current exposure draft of SSAP 71 is clearly not “non-substantive” and would have substantial unintended consequences without the amendments proposed above. Additionally, the expansive effect of this policy decision should be subject to open deliberation and public comment as the Working Group considers adoption. Thank you for the opportunity to comment.

Very truly yours

GREENBERG TRAURIG, P.A.

Julie Mix McPeak

Julie Mix McPeak
January 14, 2020

Mr. Dale Bruggeman, Chair
NAIC Statutory Accounting Principles (E) Working Group
1100 Walnut Street, Suite #1500
Kansas City, MO 64106-2197

RE: REPORTING OF INSTALLMENT FEES AND EXPENSES – REQUESTS FOR COMMENTS

Dear Mr. Dale Bruggeman,

At the December 2019 meeting, the NAIC exposed and requested comments on the “Reporting of Installment Fees and Expenses” in the financial statements. This guidance allows for installment fees that meet specified criteria to be excluded from premium income, if it is an avoidance amount by the policyholder and the policy would not be cancelled for nonpayment of the installment fees. The guidance is consistent with the footnote in SSAP No.53 (“Property Casualty Contracts – Premiums”) and in line with our current industrywide reporting of this item in the financial statements.

With respect to the reporting of the corresponding “Installment fees related Expenses”, we believe that these associated Expenses should be reported as part of the Other Underwriting Expenses Incurred (“OUE”) on Line 4 of the Statement of Income and as an ancillary to the normal underwriting activities primarily due to immateriality. Such a presentation will allow insurers to report and reconcile the gross Installment fees amount to the corresponding balance reflected in Schedule T, Column 8 as well as in the Write-ins amount on the Statutory Page 14, along with premium tax payments. Currently, there is inconsistency in reporting in the industry, with some companies reflecting these associated Expenses as part of the Other Underwriting Expenses Incurred on Line 4 of the Statement of Income while others reflect such Expenses as part of the Aggregate write-ins for miscellaneous income on Line 14 of the Statement of Income.

However, as we believe others have also pointed out, this guidance specifically addresses fees charged on Installment premiums, but there are other equally nonrefundable “Other fees” charged by many companies, as part of the billing and collection process, but that are not specifically mentioned in this guidance. That is to say, there are “Other Fees” charged by insurers as part of the collection process, all of which, like Installment fees, are not only non-refundable, but are also avoidance amount by the policyholder and would not be cancelled for non-payment of the installment fees, similar to Installment fees.

These nonrefundable “Other fees”, include, but are not limited to:

1. Late fees - fees and expenses charged on flexible/installment plans that are received after a specified cut-off period e.g. 30 days
2. Non-sufficient funds (“NSF”) fees - fees and expenses collected on returned payments due to non-sufficient funds

3. Reinstatement fees - fees and expenses received on policies that expired and are subsequently reinstated, among others etc.

Currently, there is divergence in reporting in this area of this relatively immaterial amounts for nonstandard and standard writers and therefore need for clarification for consistency in reporting going in.

The reporting issue here then is, where and how to report all of these “Other fees”, excluding Installment fees. Should all these “Other fees” be reported as part of:

   a) Other underwriting expense incurred on Line 4 of the Statement of Income
   b) Finance and service charges on Line 13 of the Statement of income, akin to installment fees
   c) Aggregate write-ins for miscellaneous income on Line 14 of the Statement of income

Typically, most companies report these nonrefundable “Other fees” as “Other income” on Line 14 of the Statement of Income.

Consistent with current practice, we also believe all these “Other fees”, net of applicable expenses, if any, should be reported as part of the Aggregate-write-ins for miscellaneous income on Line 14 of the Statement of Income. However, if for some reason this first preference is determined to be untenable, then we believe the next viable alternative could be the “Other underwriting expenses incurred” on Line 4 of the Statement of Income, under the assumption that all these other fees are ancillary to the normal underwriting activities, but defer ultimately decision to the NAIC staff for review and consideration.

We appreciate the opportunity to comment on this and related issues. Thank you.

Sincerely,

Joseph Hammond, CPA, FLMI
Director of P&C Accounting
Farmers Insurance Group
(818) 876-7924

“Internal Use Only”

cc: Robin Marcotte File
February 27, 2020

Dale Bruggeman, Chair
Statutory Accounting Principles (E) Working Group
National Association of Insurance Commissioners

Via email

Dear Mr. Bruggeman:

I am writing on behalf of the American Academy of Actuaries\(^1\) Committee on Property and Liability Financial Reporting (COPLFR). We are following up on previous correspondence regarding Schedule P Instructions for Retroactive Reinsurance between Affiliates and Non-Affiliates.

COPLFR appreciates that the Statutory Accounting Principles Working Group (SAPWG) is looking into certain inconsistencies that were identified in our May 21, 2019, letter to you. In July, Julie Lederer, acting in her capacity as a member of the Casualty Actuarial and Statistical (C) Task Force, posed several questions about specific details in our initial comment letter. Her comments and COPLFR’s replies are presented here.

**Julie Lederer’s Comment**

1. I’m not sure what Allianz/Allianz Re agreement the letter is referring to. The letter suggests that this agreement was enacted in 2015 and that the accounting changed between year-ends 2015 and 2016, but Allianz Re’s 2018 MD&A (which is said to be included as an attachment to COPLFR’s letter but is not) suggests that the agreements between Allianz and Allianz Re weren’t enacted until 2016. Allianz Re did assume retroactive business from a different entity, Fireman’s Fund, in 2015:

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\(^1\) The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.
a. There’s hardly any workers comp data in Allianz’s 2015 Schedule P. There’s a lot of WC data at year-end 2016, which appears to be due to the addition of Firemen’s Fund to the pooling agreement.

b. When I compare Allianz Re’s 2015 and 2016 Schedule Ps, I don’t see major changes. There is significant assumed premium reported in CY 2015 in both statements, and both statements show assumed reserves only for AYs 2012 and prior. I think this is related to Allianz Re’s transaction with FFIC (as mentioned in the MD&A above), not with Allianz.

**COPLFR’s Response**

The May 21, 2019, COPLFR letter is referring to the July 1, 2015, reinsurance agreement between FFIC and Allianz Reinsurance America (“Allianz Re”), where Allianz Re agreed to reinsure certain workers’ compensation (WC) and construction defect liabilities. The 2015 Schedule P, Part 1 of Allianz Re (page 4 of the May 21 letter PDF) shows $1.1 billion of 2015 accident year direct and assumed WC earned premium, presumably this Loss Portfolio Transfer. The 2016 Schedule P of Allianz Global Risk US Ins Co. (“Allianz or FFIC”) (page 7 of the May 21 letter PDF) shows $1.1 billion of 2015 accident year WC ceded earned premium, about equal to the assumptions of the Allianz Re premium discussed in the prior sentence. Allianz Global Risk US is synonymous with FFIC, as we understand it.

In our May 21, 2019, letter, we did state that “Initially, as of December 31, 2015, Allianz included all of the ceded losses in accident year (‘AY’) 2015.” We did only include the 2016 Allianz Schedule P; it would have been clearer to include the 2015 Allianz Schedule P as well, which we have attached as page 15 of the May 21 letter PDF (Attachment A). We agree with the comment in a. above that the additional data is due to the addition of Fireman’s Fund in the pooling agreement. Similarly, for b., we only show Allianz Re’s 2015 Schedule P.; we should additionally obtain Allianz Re’s 2016 Schedule P. We would not expect much change from the 2015 to 2016 Schedule P. Finally, our comments were not intended to suggest that the agreement between Allianz and Allianz Re was not enacted until 2016. We did, however, want to point out that as of Dec. 31, 2015, Allianz included all of the ceded losses in AY 2015, and in the following year, as of Dec. 31, 2016, Allianz recorded the ceded losses across the subject AYs 2012 and prior, as shown in Schedule P, Part 2 of Allianz (see page 8 of the PDF).

**Julie Lederer’s Comment**

2. I believe some of the attachments noted in the letter are missing:
   a. The letter includes Allianz Re’s 2015 Schedule P and Allianz’s 2016 Schedule P, but the text of the letter suggests that Allianz’s 2015 and 2016 Schedule Ps are included.
i. Regardless, it’s pretty hard to compare Allianz’s 2015 and 2016 Schedule Ps anyway, since Fireman’s Fund was added to the intercompany pool in 2016 and the historical AYs in Allianz’s 2016 Schedule P were adjusted accordingly.

ii. When I compare Allianz Re’s 2015 and 2016 Schedule Ps, I don’t see major changes. The assumed premium is reported in CY 2015 in both statements, and both statements show assumed reserves only for AYs 2012 and prior.

b. Attachment A1SAO (Allianz Re’s 2018 SAO) is missing. I looked up the SAO myself and found this passage, which is rather vague, doesn’t name the counterparties, and doesn’t discuss the accounting for the agreements:

The Company entered into several significant reinsurance arrangements during calendar years 2015 – 2018, some of which serve to mitigate the risk factors discussed above.

1. Effective January 1, 2015, the Company entered into a reinsurance agreement whereby the Company assumed and agreed to reinsure certain A&E reserves. Effective July 1, 2015, the Company further assumed and agreed to reinsure certain WC and CD reserves.

2. Effective January 1, 2016, the Company entered into a reinsurance agreement by which the Company ceded 50% of the Company’s carried A&E, WC, and CD liabilities acquired in 2015.

Additionally, effective January 1, 2016, the Company entered into reinsurance agreements whereby the Company assumed and agreed to reinsure certain Professional Healthcare liabilities and certain A&E, GL/Excess and WC liabilities. Effective July 1, 2016, the Company entered into another reinsurance agreement by which the Company assumed and agreed to reinsure certain GL/Excess exposure.

c. Attachment A2MDA (Allianz Re’s 2018 MD&A) is missing. I looked this up myself and included a relevant passage above in item #1.

COPLFR’s Response
The attachments were in the Academy’s submission to the CASTF and were in the CASTF materials for a call in June, but apparently were omitted by NAIC staff in materials provided for subsequent calls and referrals.

We too consider the excerpt you provided to be vague. To help clarify the issue, we are attaching MD&As from 2015 and 2016 that include Fireman’s Fund Insurance Company in their scope (attachments B and C). One of the difficulties in tracking this issue is the series of actions taken by Allianz since 2015.

Julie Lederer’s Comment

3. GEICO’s Note 21, included as an attachment, is useful, but it’s not clear what we should take away from GEICO’s 2014 Schedule P alone. It might have been useful to attach the 2013 Schedule P as well. By comparing the 2013 and 2014 Schedule Ps, it’s clear that GEICO made significant cessions in 2014 and that these were spread among older AYs.

COPLFR’s Response

Our takeaway from GEICO’s 2014 Schedule P alone is that Schedule P, Part 2 (page 13 of the PDF) shows $3.3 billion of decreased development. This is a distortion as we understand it and is supported by the 2013 and 2014 comparison noted above. That distortion would carry over to the RBC filings of the respective entities (based on our understanding of the RBC formula and
related instructions). Industry Schedule P data can also be distorted based on what is and is not included in industry totals based on the data scrubbing performed.

We believe that this additional information clarifies our original comments and will help SAPWG to move forward with its own analysis. If you have additional questions, contact Marc Rosenberg, the Academy’s senior casualty policy analyst, at 202-785-7865 or rosenberg@actuary.org.

Sincerely,

Kathy Odomirok, MAAA, FCAS
Chairperson, COPLFR
American Academy of Actuaries

3 attachments