**Statutory Accounting Principles (E) Working Group**

**Meeting Agenda**

**July 30, 2020**

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

**A. Consideration of Maintenance Agenda – Pending List**

1. Ref #2020-17: Updating the SCA Review Process
2. Ref #2020-18: SSAP No. 97 Update
3. Ref #2020-19: Clarifying Edits – Participating in Mortgages
4. Ref #2020-20: Cash Equivalent Disclosures
5. Ref #2020-21: SSAP No. 43R – Designation Categories for RMBS/CMBS Investments
6. Ref #2020-22: Accounting for Perpetual Bonds
7. Ref #2020-23: Leasehold Improvements
8. Ref #2020-24: Accounting and Reporting of Credit Tenant Loans
10. Ref #2020-26: ASU 2015-10, Technical Corrections and Improvements
11. Ref #2020-27: ASU 2019-09, Financial Services – Insurance, Effective Date
12. Ref #2020-28: ASU 2020-01, Investments ASU 2020-01, Investments—Equity Securities, Investments—Equity Method and Joint Ventures, and Derivatives and Hedging
13. Ref #2020-29: ASU 2020-05, Revenue from Contracts with Customers and Leases, Effective Dates for Certain Entities
14. Ref #2020-30: Premium Refunds and Other Adjustments

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<td>2020-17</td>
<td>Updating the SCA Review Process</td>
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<td>SSAP No. 97 (Fatima)</td>
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**Summary:**

This agenda item proposes updating the current SCA filing review process as is required by SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities. Proposed edits will eliminate many of the manual steps required to annually review each submitted SCA. During calendar year 2019, NAIC staff reviewed over 825 filings, adoption of the proposed process changes will generate a significant savings of administrative processing.

Financial statement filers would be responsible for retrieving their finalized SCA review information from VISION, which will eliminate the need for NAIC staff to manually insert this information into a template to be emailed to the filer. NAIC staff will still export this information for regulators and will send them the review information in an email on a monthly basis. Regulators will benefit by receiving only one monthly correspondence of all applicable SCA reviews – as opposed to a communication for every review. Regulator access to VISION will be unaffected by this proposal. Regulator feedback is requested on whether this process change will adversely impact operations.

Additionally, various minor updates are proposed to improve readability of various paragraphs.

**Recommendation:**

NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, which update 1) various paragraphs with improved descriptive language and 2) the availability/delivery of completed SCA reviews for both domestic regulators and financial statement filers.
Summary:
In March 2020, the Working Group adopted agenda item 2018-26: SCA Loss Tracking – Accounting Guidance, for SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, which clarified guidance stating that reported equity method losses of an investment in a subsidiary controlled or affiliated entity (SCA) would not create a negative value in the SCA investment, thus stopping the reporting of the equity method losses at zero. However, to the extent there was a financial guarantee or commitment, it would require appropriate recognition under SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets.

This agenda item is to provide a minor revision to the end of paragraph 9 to corroborate the revisions adopted in agenda item 2018-26 and remove a lingering reference that guarantees or commitments can result in a negative equity value for the SCA.

Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, to update language to remove the statement that guarantees or commitments from the insurance reporting entity to the SCA can result in a negative equity valuation of the SCA.

Summary:
This agenda item has been drafted to propose clarification edits to the statutory accounting guidance for a participation in mortgage loans. In summary, questions have been raised regarding the scope of “financial rights and obligations” that a reporting entity lender should possess via a participation agreement and if these extend beyond the right to receive contractual cash flows. Specifically, whether these rights should include items beyond the attachment to cash flows, such as the ability to independently take legal action against the borrower, participate with other lenders in determining whether legal action should be taken, or under normal circumstances, communicate directly with borrower.

Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to clarify the requirements for participation loans in SSAP No. 37—Mortgage Loans. Revisions clarify that a participant’s financial rights may include the right to take legal action against the borrower (or participate in the determination of legal action), but do not require that the participant have the right to solely initiate legal action, foreclosure, or under normal circumstances, require the ability to communicate directly with the borrower.
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<td>Ref #2020-21 \n SSAP No. 43R (Jim)</td>
<td>SSAP No. 43R –Designation Categories for RMBS/CMBS Investments</td>
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**Summary:**

On May 20, the Working Group adopted agenda item 2019-20: *Rolling Short-Term Investments*, incorporating additional principle concepts **restricting the classification of certain related party or affiliated investments as a cash equivalent or short-term investments**. These restrictions would apply for items in scope of SSAP No. 26R—Bonds, SSAP No. 43R—Loan-Backed and Structured Securities, or that would be reported as “Other Invested Assets.” With adoption, an additional disclosure element was required stating that short-term investments (or substantially similar investments) which remain on the short-term schedule for more than one consecutive year (i.e. a re-underwritten investment that is renewed) shall be disclosed in the financial statements.

The scope of agenda item 2019-20 covered both cash equivalent and short-term investments and although cash equivalent investments were referenced throughout the agenda item, the adopted disclosure only specifically stated that disclosure was required for short-term investments or substantially similar investments in which remain on the short-term schedule for more than one year. Due to the importance of identifying certain rolled or renewed cash equivalent investments, this agenda item proposes identification of cash equivalents and short-term investments (or substantially similar investments) which remain on the same reporting schedule for more than one consecutive reporting period shall be disclosed. Additionally, at the request of industry, additional clarification was added stating that the disclosure of such investments is satisfied by use of a designated code in the appropriate investment schedules of the statutory financial statements.

**Recommendation:**

NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 2R—*Cash, Cash Equivalents, Drafts and Short-Term Investments* to require the identification/disclosure of cash equivalents and short-term investments, or substantially similar investments, which remain on the same reporting schedule for more than one consecutive reporting period. (This revision expands current disclosure requirements to include cash equivalent investments.) Furthermore, the revisions clarify that the disclosure is satisfied through the use of the code on the investment schedules.

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**Summary:**

On May 14, the Valuation of Securities (E) Task Force adopted revisions to the *Purpose and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual), for residential mortgage-backed securities (RMBS) / commercial mortgage-backed securities (CMBS). The current financial modeling process remains unaffected, however the NAIC designations, as produced by the financial model (and as previously used for reporting), will now be mapped to a final NAIC designation category. Reporting entities will then utilize the new NAIC designation category for accounting and reporting purposes. The edits proposed in this agenda item update the NAIC designation category mapping instructions in SSAP No. 43R—Loan-Backed and Structured Securities for RMBS/CMBS investments.

**Recommendation:**

NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 43R—*Loan-backed and Structured Securities* to reflect the
updated final designation guidance for RMBS/CMBS securities. This update will reflect the guidance recently adopted for the *Purpose and Procedures Manual of the NAIC Investment Analysis Office*.

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<td>Accounting for Perpetual Bonds</td>
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**Summary:**
This agenda item addresses the accounting treatment for perpetual bonds held as investments within scope of *SSAP No. 26R—Bonds*. A perpetual bond is a fixed income security, representing a creditor relationship, with a fixed schedule of future payments, however it does not contain a maturity date - thus yielding the definitional term “perpetual.” These bonds are typically not redeemable at the option of the holder but likely possess call options for the benefit of the issuer.

Due to the numerous payment similarities between perpetual bonds and perpetual preferred stock, this agenda item proposes that similar accounting and reporting treatment be applied for these two instruments. Additionally, the accounting guidance proposed in this agenda item reflects the accounting and reporting guidance that is anticipated to be adopted for perpetual preferred stock in conjunction with agenda item 2019-04: SSAP No. 32 – Investment Classification Project. This agenda item substantially revises *SSAP No. 32—Preferred Stock* and is expected to be adopted during the Summer National Meeting.

**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 perpetual bonds shall be reported at fair value, not to exceed any current effective call price. Although this is considered a nonsubstantive change, if a stated effective date is preferred (instead of immediately upon adoption), NAIC staff recommends an effective date of Jan. 1, 2021, with early application permitted. (This date would correspond with the expected effective date of the substantially revised SSAP No. 32, which would require that perpetual preferred stock to also be reported at fair value, not to exceed any current effective call price.)

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**Summary:**
In 2019, the Working Group adopted substantive revisions to *SSAP No. 22R—Leases*, which rejected the financing lease concept that has been adopted in U.S. GAAP, but brought in language from ASC Topic 842 to keep SSAP No. 22R as consistent as possible with U.S. GAAP, all while maintaining the operating lease concept for statutory accounting. This agenda item is to update the guidance for the depreciable lives of leasehold improvements in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities* to reflect adopted guidance regarding the definition of lease terms in SSAP No. 22R.

**Recommendation:**
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and incorporate revisions to *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities* to update the amortization guidance for leasehold improvements. The updated language will
allow leasehold improvements to have lives that match the associated lease term, which agrees with U.S. GAAP in ASC Topic 842.

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<td>Ref #2020-24 SSAP No. 43R (Julie)</td>
<td>Accounting and Reporting of Credit Tenant Loans</td>
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Summary:
This agenda item intends to clarify the reporting of credit tenant loans (CTL) for statutory accounting. Although this is an investment (that if meeting certain criteria) may have been historically captured in SSAP No. 43R—Loan-Backed and Structured Securities, due to recent discussions at the Valuation of Securities (E) Task Force, in order to provide timely guidance, it was identified that this issue needs to considered separately outside of the substantive SSAP No. 43R project. As the SSAP No. 43R project is a substantive assessment, with various aspects being considered, it is noted that the conclusion of that project may extend beyond the timeframe for which clarity on CTLs is needed. This agenda item focuses on credit tenant loans. There are other variations of similar investments that should also be specifically named / addressed in the AP&P Manual. These include ground lease financings as well as other lease-backed (non-ABS) securities. NAIC staff recommends that the Working Group consider first CTLs, with separate subsequent consideration of other structures.

The focus of this agenda item is to inquire whether conforming CTLs should be captured in scope of SSAP No. 43R or whether these investments should be captured in SSAP No. 21R—Other Admitted Assets. This agenda item is not proposing that structures that do not conform to current requirements be considered in scope of SSAP No. 43R. This agenda item also inquires whether structures that are not conforming CTLs should be reported as mortgage loans or whether these structures should be captured in SSAP No. 21R. This agenda item is not proposing to reconsider the existing SVO guidelines in determining whether a CTL is “conforming” and in determining what is considered to be a suitable amount of “residual risk.” If there is a desire to reassess these provisions, NAIC staff would recommend a separate project with the Task Force, after concluding on desired reporting location and governing SSAP, to review these parameters.

Although it is understood that historical practice has permitted certain SVO verified CTLs that meet legal and structural analyses to be reported on Schedule D, there is a question whether these investments reflect bonds or securitized assets that should be included on the bond schedule. If preferred by the Working Group, revisions can be considered to remove these items from potential Schedule D reporting and instead capture these investments in scope of SSAP No. 21R. Some elements to consider in determining whether SSAP No. 21R would be more appropriate:

- If captured in scope of SSAP No. 21R, all CTLs will be reported in the same schedule, regardless of whether they are considered “conforming” or “non-conforming” CTLs. (In other words, the same reporting schedule would occur regardless of the NAIC SVO assessment.) This reporting process would likely result with improved identification and assessment of CTL investments in the financial statements. Under the current process, since CTLs are bifurcated across reporting schedules, it is not possible to identify the full extent an insurer is invested in CTLs (regardless if confirming or non-conforming).

- If captured in scope of SSAP No. 21R, CTLs could still be filed with the NAIC SVO for the legal and structural analysis and, if qualifying, to obtain an NAIC designation. For these “conforming” CTLs, revisions could be incorporated to permit the NAIC designation to be reported on Schedule BA. This NAIC designation could be used by life insurers to obtain an improved RBC designation. (Although the improved RBC is not an option under the current RBC formula for non-life entities, from information gathered, most CTL holders are life insurers.)
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- Reporting CTLs in scope of SSAP No. 21R would be consistent with previous decisions of the SAPWG to not report non-bond items as bonds simply for RBC purposes. It would also be consistent with the policy statement that obtaining an NAIC designation does not direct statutory accounting or reporting. Pursuant to this policy statement, obtaining an NAIC designation does not change an investment’s applicable SSAP, annual or quarterly reporting schedule or override other SSAP guidance required for the investment to be an admitted asset. This policy statement does identify that there are limited situations in which an SVO-listing could be used for classification purposes that focuses on the underlying structure of the investment. If conforming CTL investments are retained in SSAP No. 43R (and not moved to SSAP No. 21R), it would be recommended that CTLs that meet the SVO structural analysis be captured on a listing that could be referred to in the scope section of SSAP No. 43R. It is noted that the recent issues involving non-conforming CTLs seem to originate from an interpretation that obtaining a CRP rating would allow entities to report these structures as bonds on Schedule D through the filing exemption process. This assessment is incorrect under existing statutory accounting guidance and the existing policy statement.

- Reporting CTLs in scope of SSAP No. 21R would seemingly be consistent with the decision made for structured settlements in 2018. Although structured settlements and CTLs are vastly different investments, they both represent an investment, that is not a bond, but reflects an investment in a cash flow stream that is subject to the underlying credit quality of the payer.

On May 29, 2020, the Valuation of Securities (E) Task Force submitted a referral to the Working Group to permit non-conforming CTLs that receive an NAIC designation from the SVO to be considered in scope of SSAP No. 43R. This referral is included as Attachment O (with the summary of referrals received). Excerpts of this referral have been provided below:

The Task Force is referring this memo and proposed amendment to the Statutory Accounting Principles (E) Working Group and requesting the Working Group affirm that they would consider these Non-conforming CTLs to have the characteristics of a bond if assigned an NAIC Designation by the SVO staff. Like the referral from earlier this year on GLFs, these Non-conforming Credit Tennant Loan (CTL) Transactions have historically been reported under the Accounting Practices & Procedures Manual’s SSAP No. 43R – Loan-Backed and Structured Securities under Paragraph 27, b as a type of CTL. The SVO staff recommends affirming that treatment only if the SVO staff can assign an NAIC Designation.

The edits noted in the Task Force referral are revisions to the Purposes and Procedures Manual (P&P) to affirm the Task Force’s role in making all decisions on the use of CRP ratings and provides guidance to insurance company filers on what to do if they are uncertain about the filing procedure for a particular security or class of securities.

NAIC staff highlights that it would be inconsistent with the Policy Statement on Coordination of the AP&P Manual and the P&P Manual of the NAIC IAO to permit CTLs to be classified as a bond simply in accordance with an NAIC designation / CRP rating. However, the provisions in the Policy Statement does identify that such classifications can occur based on an SVO structural assessment of an investment. NAIC SAPWG staff has confirmed with the SVO staff that the review and assignment of an NAIC designation for CTLs requires a structural assessment, and they only receive an NAIC designation if the CTL possess bond characteristics.

Recommendation:

NAIC Staff recommends that the Working Group move this item to the active listing, initially categorized as nonsubstantive and expose the agenda item to solicit comment before directing NAIC staff on the desired guidance for CTLs. There are two general options:

- Option 1: SSAP No. 43R for Conforming CTLs (this includes CTLs With SVO-Identified Bond Characteristics Acquired Prior to Jan. 1, 2020 as detailed in the P&P Manual) – With this option, statutory accounting will continue with historical application and keep CTLs that are identified to have
bond characteristics, after review by the SVO, in scope of SSAP No. 43R and reported on Schedule D as bonds. If selecting this option, the Working Group should also advise if they would prefer for the nonqualifying CTLs to be in scope of SSAP No. 37—Mortgage Loans and reported on Schedule B, or if they want these investments to be considered an “other invested asset” under SSAP No. 21 and reported on Schedule BA. (Note: The SVO only will review non-conforming CTLs held prior to Jan. 1, 2020 for bond characteristics. As such all non-conforming CTLs acquired after Jan. 1, 2020 will not be in scope of SSAP No. 43R.)

If selecting this option, NAIC staff will propose edits to SSAP No. 43R to explicitly include in scope CTLs that are included on an SVO-Identified listing based on a structural analysis. Furthermore, revisions will be proposed to either SSAP No. 37 or SSAP No. 21R—Other Invested Assets to capture CTL type structures that are not on the SVO identified listing.

**Option 2: SSAP No. 21 for All CTLs** – With this option, statutory accounting revisions will be proposed to capture all CTLs in scope of SSAP No. 21—Other Invested Assets and reported on Schedule BA. With this approach, all CTLs will be reported on the same schedule, and revisions will be proposed to allow CTLs that are reviewed and approved by the NAIC SVO to be reported with an NAIC designation. This process will be similar to the existing approach for other non-bond items reported on Schedule BA that have underlying characteristics of fixed income instruments. With this approach, there will be no need to reference an SVO-Identified listing of qualifying CTLs in SSAP No. 21R. Pursuant to the Purposes and Procedures Manual, CTLs will not qualify as filing exempt, and a CTL would need an NAIC-provided NAIC designation if there was a desire to obtain a more favorable RBC. (Only CTLs the SVO determines qualify to receive an NAIC designation will be assigned one and will be identified on a separate listing maintained and published by the SVO.) (Under existing RBC parameters, the ability for a more favorable RBC on Schedule BA based on NAIC designation is only permitted for life entities.)

In addition to exposing a direction, NAIC staff recommends notifying the Valuation of Securities (E) Task Force of this agenda item in response to their referral. With this notification, NAIC staff will request further confirmation that an SVO-Listing could be developed to capture the CTLs that meet the SVO’s structural and legal analysis and possess bond characteristics.

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<td>SSAP No. 62R</td>
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**Summary:**
Maintenance updates provide revisions to the NAIC Accounting Practices and Procedures Manual, such as editorial corrections, reference changes and formatting as summarized below:

- **SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets:** Remove redundant paragraph references.

- **SSAP No. 62R—Property and Casualty Reinsurance:** Adding a table that lists the questions addressed in Exhibit A - Implementation Questions and Answers.

**Recommendation:**
NAIC staff recommends that the Working Group move this agenda item to the active listing, categorized as nonsubstantive, and expose the editorial revisions to SSAP No. 5R and SSAP No. 62R.
## Summary:
FASB issued ASU 2015-10, *Technical Corrections & Improvements* to update various FASB Accounting Standards Codification for minor corrections or clarifications. This is a standing project to address feedback received from stakeholders on Codification and to make other incremental improvements to U.S. GAAP. Each update/modification was reviewed for a possible statutory accounting impact with rational detailing the recommendation for rejection.

### Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject ASU 2015-10, *Technical Corrections & Improvements* as not applicable for statutory accounting.

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<td>ASU 2015-10, <em>Technical Corrections &amp; Improvements</em></td>
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## Summary:
FASB issued ASU 2019-09, *Financial Services – Insurance; Effective Date* to defer the effective date of the amendments in ASU 2018-12, *Targeted Improvements to the Accounting for Long-Duration Contracts*. While minor edits were adopted to the Preamble, ASU 2018-12 was rejected for statutory accounting. The sole function of ASU 2019-09 is to extend the effective date for ASU 2018-12.

### Recommendation:
NAIC Staff recommends the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject ASU 2019-09—*Financial Services – Insurance* as not applicable for statutory accounting. This ASU solely addresses the effective date of ASU 2018-12, which was rejected by the Working Group on Aug. 3, 2019.

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## Summary:
In Jan. 2016, FASB issued ASU 2016-01, *Financial Instruments, Recognition and Measurement of Financial Assets and Financial Liabilities*, which allows an entity to measure certain equity securities (without a readily determinable fair value) at cost, less any impairments. This alternative measurement method and ASU 2016-01 was rejected in its entirety for statutory accounting.

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<td>ASU 2020-01, <em>Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815</em></td>
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Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to reject ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815 for statutory accounting. These revisions noting rejection are proposed to SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies, SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities and SSAP No. 86—Derivatives, as illustrated in the agenda item.

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Summary:
This agenda item propose rejection of ASU 2020-05, Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842), Effective Dates for Certain Entities, as it updates the effective dates for ASU 2014-19, Revenue from Contracts with Customers (Topic 606) and ASU 2016-02, Leases (Topic 842), both of which were previously rejected for statutory accounting. The guidance in ASU 2020-05 defers the effective date for the aforementioned ASUs by one year for certain companies.

Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2020-05, Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842), Effective Dates for Certain Entities as not applicable to statutory accounting. This item is proposed to be rejected as not applicable as ASU 2020-05 only impacts the effective date for U.S. GAAP guidance that has previously been rejected for statutory accounting.

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Summary:
This agenda item is to provide more explicit guidance on return of premium and other premium adjustments. The discussion during the exposures of INT 20-08: COVID-19 Premium Refunds, Rate Reductions and Policyholder Dividends, highlighted the need for more explicit guidance regarding policyholder refunds and other premium adjustments for accident and health and property and casualty lines of business. The premium adjustments addressed will also address newer policy form types.

SSAP No. 53—Property and Casualty Contracts – Premiums provides guidance for premium adjustments due to changes to the level of exposure based on insurance risk. SSAP No. 66—Retrospectively Rated Contracts provides guidance for loss sensitive products. Some property and casualty products, which are commonly referred to as data telematics policies, provide premium adjustments for other reasons than what is articulated in the current guidance. One example of a data telematics policy would be the use of an automobile plug-in to determine driving habits of the insured for purposes of policy pricing. As such there is a need to provide principles-based guidance for these types of policies.
Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, initially categorized as nonsubstantive and expose with request for comments / input on the issues described below. In addition, NAIC staff should be directed to draft to guidance to address premium refunds and other policy adjustments for both property and casualty and accident and health lines of business. NAIC staff anticipates coordinating with industry representatives in gathering input for developing principles-based guidance, particularly for the varieties of data telematics policies.

Comments are requested on the following:

1. NAIC Staff’s preliminary recommendation is that the proposed guidance should follow the existing principles of adjustable premium and shall be recognized as adjustments to premium based on experience to date.

2. Examples of existing products that have premium adjustments for reasons other than the existing guidance or how the existing guidance can be expanded.

3. If accounting treatment that is being applied is different from premium adjustments, please provide overview of key attributes.

ANY OTHER MATTERS

a. Ref #2019-21: SSAP No. 43R – (Julie)
   An issue paper was exposed on March 18, 2020 to review and consider substantive revisions to SSAP No. 43R. Since the exposure, NAIC staff has had many conversations with industry representatives as well as investment providers to discuss differing structures that may have been captured in scope of SSAP No. 43R. While work has continued this topic, the comment deadline regarding the initial issue paper is July 31. Accordingly, a subsequent conference call will be scheduled to consider comments and continue discussion.

b. Deferred Agenda Items – (Dale)
   For the purposes of this meeting, the SAPWG has currently deferred the following topics. The Working Group will continue discussions on a subsequent conference call or national meeting:  
   o Ref #2018-07: Surplus Note Accounting – Referral from the Reinsurance (E) Task Force  
   o Ref #2019-12: ASU 2014-17, Business Combinations, Pushdown Accounting  
   o Ref #2019-49: Retroactive Reinsurance Exception

c. Referrals – (Dale)
   1. The Working Group received a referral from the Valuation of Securities (E) Task Force regarding the accounting and reporting of Credit Tenant Loans (CTLs). While the referral is attached, the resulting action is indicated below.

   Referral – Non-conforming CTL Transactions (Attachment O)  
Proposed SAPWG Response – New agenda item (Ref. 2020-24)
2. The Working Group received referral from the Financial Condition (E) Committee regarding an ACLI request relative to the accounting treatment of certain “basis swaps,” permitted under state law, as a result of the transition away from the London Interbank Offered Rate (LIBOR).

**Referral – Regarding Reporting of “Basis” Swaps (Attachment P)**

**Proposed SAPWG Response** – Consideration of Interpretation 20-09T (Attachment Q), proposing that the reporting of “basis swaps” shall reflect a “hedging other” transaction and shall be valued as a noneffective hedge (at fair value), unless the reporting entity can demonstrate and maintain appropriate documentation evidencing that the basis swap derivative qualifies for effective hedge accounting per SSAP No. 86.

d. **Review of GAAP Exposures – Attachment R - (Jim)**

The attachment details the items currently exposed by FASB. NAIC staff recommends reviewing the issued ASUs under the standard SAP Maintenance process.

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

**The comment deadline for all exposed items is Friday, September 18, 2020.**
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Updating the SCA Review Process

Check (applicable entity):

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<tr>
<th>Modification of Existing SSAP</th>
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Description of Issue:
This agenda item has been drafted to update part of the SCA filing review process in SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities. In addition to these revisions, minor clarification revisions have also been proposed. In summary, the SCA filing review process begins when a filer submits an SCA filing in VISION and concludes when NAIC staff emails the filer and domiciliary state a review letter with its final approved value.

Current SCA Review Process
The SCA filing review process begins when a filer submits an SCA filing in VISION. NAIC staff will review the filing and verify the information claimed in the filing is validated with appropriate supporting documentation. After the filing has been reviewed and has been issued a completion code to initiate billing, the review has been finalized. Upon completion of the review, a file with the final validated information is available under the “Export State Information” in VISION. NAIC staff will open this and copy the final review information into a NAIC letter template for the relevant type of filing (i.e. Sub 1 filing, Sub 2 filing, Sub 2 Appeal filing, etc.). This letter is then saved, and the review process concludes when NAIC staff emails both the filer and domiciliary state regulator duplicate copies of the review letter. During calendar year 2019, NAIC staff reviewed over 825 filings, the creation of these review letters and correspondence to the both filers and regulators amounts to weeks’ worth of administrative work.

Proposed Updates
NAIC staff propose updating the SCA filing process by eliminating some of the manual steps in the process. VISION was designed to allow filers to have more control and access to their filing information, including the final review results. As such, filers should be responsible for pulling their own finalized review information from VISION, which will eliminate the need for NAIC staff to manually insert this information into a template and email it to them. NAIC staff will continue to export this information for regulators and will send them the review information in an email on a monthly basis. Regulators will benefit by receiving only one, monthly correspondence of all applicable SCA reviews – as opposed to a communication for every review.

Existing Authoritative Literature:

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

EXHIBIT A – SCA REPORTING PROCESS

50. SCA entities, except for domestic SCA insurance company investments accounted for under paragraph 8.b.i, in which the reporting entity has an equity interest (common or preferred stock), are required to be filed with the NAIC. Nonadmitted assets are not required to be filed in a Sub 2 as long as they were nonadmitted, or had a zero value, for the full reporting period (all interim and annual reporting). Immaterial asset SCAs do not have an automatic exclusion from filing, as immateriality of an SCA will be ascertained by the state of domicile of the insurance reporting entity, but companies are allowed to request an exemption from the domiciliary state to not file an SCA on the basis that it is immaterial. The filing process does not include investments within the scope of SSAP No. 48.
51. Except for domestic SCA insurance company investments accounted for under paragraph 8.b.i, all SCA investments within the scope of this statement, purchased during any one calendar year, shall be reported to the NAIC on a Sub 1 form within 90 days of the acquisition or formation of the investment; this includes nonadmitted, zero-valued and immaterial SCAs. The NAIC will process that filing in the same year but will not at that time approve or disapprove a value for the SCA investment. By August 31 of the following year, the insurance company shall submit a Sub 2 filing for the previously purchased SCA investment reported on a Sub 1 form and later that year, the NAIC will approve a value for the transaction. For SCAs that routinely receive their audit reports after the August 31 deadline, a filing deadline of one month after the audit date shall be applied. The value approved by the NAIC at the conclusion of the Sub 2 form filing is reported by the insurance company on its financial statement blank. If the insurance company has reported a value for the SCA investment on its financial statement blank that differs from the value approved by the NAIC, the insurer is required to adjust the reported value in its next quarterly financial statement blank unless otherwise directed by the insurer's state of domicile.

52. Insurance companies shall use one of the valuation methods described in paragraph 8 to calculate the value of their investments in insurance and non-insurance SCA companies. An insurance company shall calculate the value of its investments in foreign insurance and all non-insurance company SCA entities and report the value to the NAIC no later than August 31, or one month after the audit report date for SCAs that routinely receive their audits after August 31 for existing SCA investments, and within 90 days of the acquisition or formation of a new SCA investment.

Initial Reporting of SCA Investments

53. Reporting the acquisition or formation of a new investment is accomplished by submitting a completed Sub 1 form for each investment, disclosing (i) the valuation reported or to be reported by the insurance company on its latest or next quarterly financial statement blank, (ii) which method of those described in paragraph 8 was used to arrive at the valuation, (iii) the factual context of the transaction and (iv) economic and business motivations for the transaction. The submission will be processed by the NAIC only if the NAIC determines it has been provided with all material information with respect to all SCA companies of the reporting insurance company that require valuation.

54. The purpose of a Sub 1 filing is to determine whether the value claimed is reasonable. If the NAIC determines that the reported transaction meets the tests specified, it will complete the filing in the VISION database. If the NAIC determines that the transaction does not meet the tests specified, it shall not complete the filing in the VISION database and instead notify the reporting insurance company and the state of domicile in writing of its determination.

Subsequent Reporting of SCA Investments

55. By August 31 or one month after the audit report date of the year following the acquisition or formation, and reporting of an SCA investment on the Sub 1 form, the insurance company shall submit a Sub 2 form filing, with all supporting documentation for foreign SCAs provided in English, for the same SCA investment. Additionally, by August 31 or one month after the audit report date of each year, any insurance company that has made a Sub 2 form filing in a previous year must update the information by filing an updated Sub 2 form filing.

56. Each year the NAIC shall compile a list of all SCA investments (excluding insurance company SCAs (paragraph 8.b.i.) nonadmitted and zero-value SCAs) reported as Sub 1 form filings for which a Sub 2 form filing has not yet been received. For these transactions, the NAIC will notify the responsible reporting insurance company and its state of domicile that it has not received a Sub 2 filing for the SCA investment.

57. The purpose of the Sub 2 filing is to determine whether the value calculated by the reporting insurance company for the SCA investment is appropriate and to approve that or some other value for reporting on the insurer's financial statement blank.

58. An insurance company that concludes an SCA transaction at year-end may be unable to file a Sub 1 form prior to the time it would be required to file a Sub 2 form. Where this is the case, the NAIC is authorized to accept and review a Sub 1 filing from such an insurance company and to accept and review the Sub 2 filing after the Sub 1 filing review has been completed.
59. No filing of an investment in a domestic SCA insurance company valued under paragraph 8.b.i. shall be required to be made with the NAIC.

Consistency in Application of Chosen Valuation Method

60. The valuation method used for a specific SCA company shall be determined by the guidance in paragraph 8. If a reporting insurance company previously selected the Market Valuation Method and wished to change to an Equity Method (or vice versa), they may only do so with the approval of the domiciliary commissioner. Once the approval of the domiciliary commissioner has been obtained, the reporting insurance company shall provide the NAIC with evidence of that approval as part of the Sub 1 or Sub 2 filing.

61. For reporting insurance companies that use the Market Valuation Method, the reporting insurance company shall obtain the discount rate to be applied from the NAIC. The discounts identified in Exhibit E are minimum discounts. The NAIC calculation may result in discounts in market value higher than those shown in Exhibit E.

Assessment and Review of Sub 1 Form

62. Upon receipt of the reporting insurance company's Sub 1 filing, the NAIC shall conduct an assessment in the following manner:

a. If the NAIC is aware of any broad regulatory concerns or issues affecting the reporting insurance company or the reported SCA investment, it shall determine whether such concerns or issues are relevant to valuation of the SCA investment. If so, the NAIC shall take such action as seems appropriate under the circumstances.

b. The NAIC shall ensure that the value reported by the insurance company on a Sub 1 form has been arrived at by application of one of the permitted valuation methods described in paragraph 8. If a reporting insurance company submits a Sub 1 form filing that reports a value calculated under an inappropriate method, the NAIC shall contact the insurer to resolve the discrepancy or it shall recalculate the value of the SCA investment under the most appropriate valuation method and notify the reporting insurance company of such action.

c. The NAIC shall review the factual, business and economic context of the transaction to determine whether (i) the SCA investment appears to be an arms-length business arrangement with a reasonable economic value to the reporting insurance company, (ii) the valuation method chosen is reasonable in view of the factual, business and economic context of the transaction, (iii) the transaction is reasonable in the context of all the known facts surrounding the insurance company and its operations and (iv) the value reported appropriately reflects economic value to the insurance company. The NAIC may consider other factors that appear relevant from the context of the transaction including:

i. The specific tax, accounting or other regulatory treatment sought.

ii. Whether the transaction effects a legally effective, binding and permanent transfer of the risks and rewards of ownership.

iii. The effect of the SCA valuation on the solvency of the insurer.

iv. The degree of affiliation between the insurer and the party from whom such company was acquired, the form of the consideration (cash, property or the exchange of stock), evidence of ability to recover cost and whether the acquisition price represented the result of arms-length dealing between economic equals.

v. The right to dividends or other payments from the SCA and any limitations thereto.

vi. The nature, extent and demonstrable financial value of the business operations of the SCA.
vii. The value of the assets owned by the SCA.

If the NAIC determines that the transaction does not seem to present economic value to the insurance company, or that the transaction tends to obscure issues that might be relevant to an NAIC member or that the information provided is insufficient or unreliable as a basis upon which to make a determination, then the NAIC shall notify the reporting insurance company and the NAIC member of the reporting insurance company's state of domicile and request guidance.

d. The NAIC shall review whether the reporting insurance company has correctly applied the correct valuation guidance under paragraph 8 and made adjustments, if applicable, under paragraph 9.

63. If the SCA investment reported on the Sub 1 form filing is deemed to meet the assessment and reviews described in paragraph 62, the NAIC shall complete the filing in the VISION database. A completed filing will be a Sub 1 filing where the reported SCA investment meets the tests described above. The completed filing will be revised to a value if and when the filer submits a Sub 2 form on the same transaction and the NAIC approves a final value based on the information provided. (Assignment of completion to an SCA investment does not mean, and shall not be interpreted to mean, that the NAIC is expressing an opinion as to the value claimed by the reporting insurance company for the reported SCA investment. The completion implies only that, based on the information provided, the NAIC has determined that the SCA investment meets the tests described in paragraph 62.)

Assessment and Review of Sub 2 Form

64. By August 31 or one month after the audit report date of each year, the NAIC shall initiate a review of all SCA investments for which new Sub 2 form filings have been received as well as an annual update review of Sub 2 SCA investments already logged in the VISION database. The NAIC review shall encompass a review of the most recent annual statutory reporting by the parent insurance company's Schedule Y (to ascertain the identity of the members of the holding company system and to ensure that information for all SCA companies has been submitted), a review of the parent's financial statement blank to review the last reported value for the SCA investments and a review of the VISION database to determine whether SCA debt and SCA preferred securities have been assigned NAIC designations. As part of its analysis, the NAIC shall review the portion of the bond investments carried by the parent or a subsidiary insurer with a Z notation. If the NAIC determines that the portion of the Z bonds shown on the documentation is significant, the NAIC shall not process the Sub 2 filing until the insurance company reports the bonds to permit removal of the Z notation. Beginning with year-end 2019, two new suffixes will apply: YE and IF. YE means that the security is a properly filed annual update that the SVO has determined will not be assigned an NAIC designation by the close of the year-end reporting cycle. The symbol YE is assigned by the SVO pursuant to the carryover administrative procedure described in Part One, Section 3 f) (iii) of the Purposes and Procedures Manual of the NAIC Investment Analysis Office. When the SVO assigns the symbol YE it also assigns the NAIC designation in effect for the previous reporting year. IF means that the security is an initial filing that has been properly filed with the SVO but which the SVO has determined will not be assigned an NAIC designation by the close of the year-end reporting cycle. The symbol IF is assigned by the SVO and communicates that the insurer should self-designate the security for year-end and identify it with the symbol IF. IF, therefore, also communicates to the regulator that the NAIC designation reported by the insurance company was not derived by or obtained from the SVO, but has been determined analytically by a reporting insurance company.

65. Upon completion of the procedures described above, the NAIC will determine whether the value reported by the insurance company on the current SCA filing was calculated in accordance with the instructions for the valuation method chosen and verify that the filed value reflects the adjustments required by paragraph 9.

66. Upon approval of a value (including making necessary adjustments), the NAIC will complete the Sub 2 filing with the approved value in the status field of the VISION database.

67. The NAIC shall report its determination to the insurance company. If a significant discrepancy exists between the value claimed by the reporting insurance company and the value approved by the NAIC, the NAIC shall communicate the discrepancy with the company. If the NAIC cannot come to a conclusion based on the support provided, the filing can be rejected in VISION, and written notification will be provided to the reporting insurance company and the company's state of domicile of this action.
Additional Reporting Instructions

68. A reporting entity that has direct ownership of shares of an upstream intermediate or ultimate parent owns an interest in itself and is required to reduce the value of those shares from the value of the reporting entity. This is referred to as elimination of reciprocal ownership.

69. If the shares of the parent are owned indirectly by a reporting entity, for example, because the reporting entity owns a downstream SCA entity that directly owns shares in the parent, the entity that owns the parent’s shares must reduce its value by the value of the shares in the parent. This is referred to as elimination of the reciprocal ownership.

70. Any parent reporting entity that owns an interest in itself via either direct or indirect ownership of a downstream affiliate, which in turn owns shares of the parent reporting entity, shall eliminate its proportionate interest in these shares from the valuation of such affiliate.

71. Pursuant to paragraph 22, in lieu of separate GAAP audits of SCA entities of the downstream holding company, the insurer can choose to have a GAAP audit performed at the holding company level with a consolidating balance sheet showing GAAP equity of all the SCA entities. The consolidating balance sheet shall then be adjusted for GAAP to SAP differences of the insurance entities as described in this statement. This adjusted amount would then be the reported value of the investment in downstream holding company at the higher-level insurance company.

Investments in the surplus notes of an SCA shall be accounted for in accordance with the provisions of SSAP No. 41R. If the reporting entity also holds an investment in preferred stock or surplus notes, refer to paragraphs 28-32 of this statement.

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:
Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities to provide clarification updates to the SCA review process. Revisions to the “Updating SCA Review Process – Sub 1 filing” and “Updating SCA Review Process – Sub 2 filing” procedural documents update parts of the SCA filing process.

Proposed Revisions:
Due to the length of Exhibit A, only paragraphs with proposed revisions have been copied below.

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

EXHIBIT A – SCA REPORTING PROCESS

50. SCA entities, except for domestic SCA insurance company investments accounted for under paragraph 8.b.i, in which the reporting entity has an equity interest (common or preferred stock), are required to be filed with the NAIC. Nonadmitted assets are not required to be filed in a Sub 2 as long as they were nonadmitted, or had a zero value, for the full reporting period (all interim and annual reporting). Immaterial asset SCAs do not have an automatic exclusion from filing, as immateriality of an SCA will be ascertained by the state of domicile of the insurance reporting entity, but companies are allowed to request an exemption from the domiciliary state to not file
an SCA on the basis that it is immaterial. The filing process does not include investments within the scope of SSAP No. 48.

51. Except for domestic SCA insurance company investments accounted for under paragraph 8.b.i, all SCA investments within the scope of this statement, purchased during any one calendar year, shall be reported to the NAIC on a Sub 1 form within 90 days of the acquisition or formation of the investment; this includes nonadmitted, zero-valued and immaterial SCAs. The NAIC will process that filing in the same year but will not at that time approve or disapprove a value for the SCA investment. By August 31 of each year the following year, the insurance company shall submit a Sub 2 filing for the previously purchased SCA investment reported on a Sub 1 form and later that year, the NAIC will approve a value for the transaction. For SCAs that routinely receive their audit reports after the August 31 deadline, a filing deadline of one month after the audit date shall be applied. Filers must provide previous years’ audit reports to verify an audit report dated after August 31 in order to not be charged a late fee for a Sub 2 filing that is filed after the August 31 deadline. The value approved by the NAIC at the conclusion of the Sub 2 form filing is reported by the insurance company on its financial statement blank. If the insurance company has reported a value for the SCA investment on its financial statement blank that differs from the value approved by the NAIC, the insurer is required to adjust the reported value in its next quarterly financial statement blank unless otherwise directed by the insurer’s state of domicile.

54. The purpose of a Sub 1 filing is to gather basic information about the SCA, determine whether the value claimed is reasonable. If the NAIC determines that the reported transaction meets the tests specified, it will complete the filing in the VISION database. If the NAIC determines that the transaction does not meet the tests specified, it shall not complete the filing in the VISION database and instead notify the reporting insurance company and the state of domicile in writing of its determination.

Subsequent Reporting of SCA Investments

55. By August 31 or one month after the audit report date of each year following the acquisition or formation, and subsequent to the reporting of an SCA investment on the Sub 1 form, the insurance company shall submit a Sub 2 form filing, with all supporting documentation for foreign SCAs provided in English, for the same SCA investment. Additionally, by August 31 or one month after the audit report date of each year, any insurance company that has made a Sub 2 form filing in a previous year must update the information by filing an updated Sub 2 form filing.

67. The NAIC shall report its determination to the insurance company. If a significant discrepancy exists between the value claimed by the reporting insurance company and the value approved by the NAIC, the NAIC shall communicate the discrepancy with the company. If the NAIC cannot come to a conclusion based on the support provided, the filing can be rejected in VISION, and written notification will be provided to the reporting insurance company and the company’s state of domicile of this action. This correspondence will be sent to the domiciliary state. Filers are able to download their review information from the NAIC filing system.

Staff Review Completed by:
Fatima Sediqzad - NAIC Staff
April 2020
Subsidiary, Controlled and Affiliated Entities (SCA) Filing Procedures – Filing a Sub-1 Form

1. Accessing VISION to file an SCA
2. Filing a Sub-1 form (Initial Filing)

Note to filer: Per the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual), Subsidiary, Controlled and Affiliated Entities (SCAs) are required to be filed. A Sub-1 form is required to be filed within 30 days of the acquisition or formation of the investment. A Sub-2 form is required to be filed annually for any existing investment, by June 30th of the next calendar year. Prior to September 5, 2016, these filings were completed in ISIS. After September 5, 2016, they will be completed in VISION. These filing instructions help navigate filings through VISION. For additional questions, please contact the individuals below.

Also see “SCA Filing Procedures-Sub 2” for instructions on how to file a Sub-2 form and an appeal to a Sub-2 form.

Fatima Sediqzad, SCA Valuation & Accounting Policy Advisor fsediqzad@naic.org 816.783.8894
Jill Youtsey, FRS Insurance Reporting Analyst II jyoutsey@naic.org 816.783.8419

Note: Do NOT hit “Cancel” at any time during the filing process; this will discard your filing and you will have to start over!
1. Accessing VISION to File a SCA

A. Log on to the filing website https://vision.naic.org

1. If you need a User ID and Password contact the NAIC Help Desk at 816-783-8500 or via email at securitiessupport@naic.org. All first-time VISION users will need a User ID.

2. Click on the “SCA Filings” tab.

   a. The “SCA Filings” tab details all prior SCA filings and/or initiate a Sub-1 filing

2. Filing a Sub-1 form (Initial Filing)

A. From the “SCA Filings” screen, click on the “Initiate Sub-1” button.

B. Follow the filing wizard:

   1. **Filer and SCA Tab** – Select insurance reporting entity and identify which SCA you are filing.

      a. **Select Filer** – if you have multiple companies you file for, pick the correct Insurance Reporting Entity

      b. **Find Issue** – Enter the SCA’s CUSIP and select “Find”

         i. If you do not have a valid CUSIP or PPN, contact CUSIP Global Services at 212-438-6500 or via email at cusip_ppn@cusip.com. This is a requirement to file an SCA.

      c. **SCA Name** – Enter the legal name of the SCA

      d. **Filing Year** – Enter the year of the audited financials. (Often prior year – 12/31/2015)
e. **Was SCA Company Acquired or Formed?** – Select answer

f. When all of the fields above have been filled in, click “Next”

2. **Valuation Method Tab** – Identify which valuation method the SCA is using

a. **Select SCA Type** – Refer to SSAP No. 97—*Investments in Subsidiary, Controlled and Affiliated Entities* to ensure selection of the correct valuation method:

b. **Subsequent questions are tailored based on SCA Type:**

i. **8(a) – Market Value**

   (a) **Discount percentage:** Sliding scale discount based on ownership percentage.  
   (See Appendix C of SSAP No. 97.)

ii. **8b(i) – US Insurance SCA Entities – (Must be licensed insurance entity)**
(a) **Stock Type** – common or preferred stock ownership

(b) **CoCode** – NAIC company code of the SCA insurance company

iii. **8b(ii) – Non Insurance SCA Entities Statutory Basis**

(a) **Accounting Standard** – US GAAP or Foreign basis as used in audit support

(b) **Stock Type** – common or preferred stock ownership

iv. **8b(iii) – Non Insurance SCA Entities GAAP Basis**

(a) **Accounting Standard** – US GAAP or Foreign basis as used in audit support

(b) **Stock Type** – common or preferred stock ownership

v. **8b(iv) – Foreign Insurance SCA Entities**

(a) **Stock Type** – Common or preferred stock ownership

c. **When all of the questions have been addressed, click “Next”**

3. **SCA Acquisition Details Tab** – Identify what type of business the SCA is, when it was acquired, and report goodwill (if applicable).

a. **Principal Business** – Identify the principal business of the SCA company

b. **Date Shares Acquired** – Include Month / Date / Year

c. **Is Seller a Related Entity as defined under SSAP 25?** – Select Yes / No

*Depending on the answer, there may be a few more questions.*

d. **Goodwill** – Based on the acquisition of the SCA, select:

- No Goodwill
- Positive Goodwill
- Negative Goodwill

*(If positive or negative goodwill, goodwill worksheet will be a required attachment.)*
4. **SCA Acquisition Overview Tab** – Report claimed value of SCA and include filing comments
   
a. **Total Value Claimed** – Value of SCA (Include Goodwill)

b. **Shares owned** – Number of shares insurance reporting entity owns

c. **Value Per Share** – Total value claimed divided by the number of shares owned

d. **Percent Outstanding Shares Owned** – Percentage of shares issued and outstanding that the insurance reporting entity owns

e. **Consideration Paid** – Amount paid for SCA

f. **Does the SCA directly or indirectly own shares of the insurance reporting entity?**
   Relates to reciprocal ownership. *SCA Elimination Worksheet will be required:*
   [http://www.naic.org/sca_subsidiary_controlled_affiliated.htm](http://www.naic.org/sca_subsidiary_controlled_affiliated.htm)

g. **Does the SCA directly or indirectly own shares of an upstream intermediate or ultimate parent?** Relates to reciprocal ownership. *SCA Elimination Worksheet will be required:*
   [http://www.naic.org/sca_subsidiary_controlled_affiliated.htm](http://www.naic.org/sca_subsidiary_controlled_affiliated.htm)

h. **Is the SCA consolidated with other subsidiaries?** The Stat. Adjustment Worksheet will be required:  [http://www.naic.org/sca_subsidiary_controlled_affiliated.htm](http://www.naic.org/sca_subsidiary_controlled_affiliated.htm)

i. **Analyst Name / Phone Number / Email** – Name and contact information for Individual who prepared the filing in case SCA reviewer has questions.

j. **Comments** – Available for additional information for reviewing the SCA.
5. **Review tab**

   a. Review all fields of the SCA to ensure they are filed correctly.

**IMPORTANT NOTES:**

*If something is not filled out correctly, click “Back” and update!!*

*After clicking “Prepare SCA Filing” you WILL NOT be able to make any changes!!*

*DO NOT hit cancel at any point during the filing process - This will discard your filing!!*

*When finished reviewing, click the “Prepare SCA Filing” button*
6. **SCA Filing Detail Tab** – Shows all the filing detail and attach supporting documents

   a. To attach a document
      
      - Click “Edit” under Supporting Documents
      - Click “Attachments” to the file you want to add
        *If you have a document to add that is not listed click “+ Add”*
      - Find your document and upload
      - When finished uploading documents click “Save” under Supporting Documents

   ![Supporting Documents Table]

   b. **Required Sub-1 Documents**
      
      - SCA Sub-1 Acquisition Overview - *Always* required for Sub-1 - “*”

   c. **Other Required Documents**
      
      - Required depending on answers to questions:
        (a) SCA Goodwill Worksheet – If positive or negative goodwill
        (b) SCA Elimination Worksheet – If “Yes” to the Reciprocal Ownership
        (c) SCA Stat. Adjustment Worksheet – If “Yes” to Consolidated

      *Note: If applicable, these are required, but there will not be a “*”.

   d. **Worksheets and other SCA documents available:**
      
      [http://www.naic.org/sca_subsidiary_controlled_affiliated.htm](http://www.naic.org/sca_subsidiary_controlled_affiliated.htm)

   **After attaching all required documents** - Click “Submit” to finalize Sub-1 filing:

   ![Submit Button]

   **After Submitting – You Have Completed the Sub-1 Filing!!!**
Upon submission of the Sub 1 filing in VISION, an NAIC analyst will review it. When the filing has been reviewed, the filer can download the final review results from the filing screen. The filer will click on the filing number under the “SCA Filings” tab of the VISION home screen. Once in the filing screen, the “Export State Information” button will be visible on the screen. When the filer clicks this button, the final review results will open. Filer should save this for their records.
Subsidiary, Controlled and Affiliated Entities (SCA) Filing Procedures – Filing a Sub-2 Form or an Appeal to a Sub-2 Form

1. Accessing VISION to file an SCA

2. Filing a Sub-2 form (Annual Update)

3. Filing an Appeal to a Sub-2 form

Note to filer: Per the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual), Subsidiary, Controlled and Affiliated Entities (SCAs) are required to be filed. A Sub-1 form is required to be filed within 30 days of the acquisition or formation of the investment. A Sub-2 form is required to be filed annually for any existing investment, by June 30th of the next calendar year. Prior to September 5, 2016, these filings were completed in ISIS. After September 5, 2016, they will be completed in VISION. These filing instructions help navigate filings through VISION. For additional questions, please contact the individuals below.

Also see “SCA Filing Procedures-Sub 1” for instructions on how to file a Sub-1 form.

Fatima Sediqzad, SCA Valuation & Accounting Policy Advisor  fsediqzad@naic.org  816.783.8894

Jill Youtsey, FRS Insurance Reporting Analyst II  jyoutsey@naic.org  816.783.8419

Note: Do NOT hit “Cancel” at any time during the filing process; this will discard your filing and you will have to start over!
1. Accessing VISION to File a SCA

A. Log on to the filing website [https://vision.naic.org](https://vision.naic.org)

1. If you need a User ID and Password contact the NAIC Help Desk at 816-783-8500 or via email at [securitiessupport@naic.org](mailto:securitiessupport@naic.org). All first-time VISION users will need a User ID.

2. Click on the “SCA Filings” tab.

   a. The “SCA Filings” tab details all prior SCA filings and/or initiate a Sub-1 filing

2. Filing a Sub-2 form (Annual Update)

A. From the “SCA Filings” screen, click on the Filing Number of the most recent filing for the SCA you wish to file

   1. You can sort the SCA Filings screen by any of the headers, or even search for a particular SCA

   B. Clicking on the Filing Number will bring up SCA Filing Detail

      1. Click on the “Initiate Sub-2” button
C. Follow the filing wizard – *the filing wizard automatically populates with what was previously approved by the SCA analyst*

1. **Filer and SCA tab** – *this tab is used to pick the insurance reporting entity and to identify what SCA you are filing*
   a. **Select Filer** – if you have multiple companies you file for pick the correct Insurance Reporting Entity
   b. **SCA Name** – Only change this if there was a name change for the SCA company
   c. **Financial Statement Reporting Date** – enter the date of the audited financials
   d. When all of the fields above have been filled in, click “**Next**”

2. **Valuation Method tab** – *this tab is used to identify what valuation method the SCA is using*
   a. **Select SCA Type** – Refer to SSAP No. 97—*Investments in Subsidiary, Controlled and Affiliated Entities* to ensure you are selecting the correct valuation method
   (Depending on valuation method other questions might be asked)
b. **Subsequent questions are tailored based on SCA Type:**

   i. **8(a) – Market Value**
      
      (a) **Discount percentage**: Sliding scale discount based on ownership percentage. (See Appendix C of SSAP No. 97.)

   ii. **8b(i) – US Insurance SCA Entities – (Must be licensed insurance entity)**
      
      (a) **Stock Type** – common or preferred stock ownership
      
      (b) **CoCode** – NAIC company code of the SCA insurance company

   iii. **8b(ii) – Non Insurance SCA Entities Statutory Basis**
      
      (a) **Accounting Standard** – US GAAP or Foreign basis as used in audit support
      
      (b) **Stock Type** – common or preferred stock ownership

   iv. **8b(iii) – Non Insurance SCA Entities GAAP Basis**
      
      (a) **Accounting Standard** – US GAAP or Foreign basis as used in audit support
      
      (b) **Stock Type** – common or preferred stock ownership

   v. **8b(iv) – Foreign Insurance SCA Entities**
      
      (a) **Stock Type** – Common or preferred stock ownership

   c. **Admitted Asset** – If asset is admitted choose yes (both admitted and nonadmitted SCAs need to be filed)

3. **SCA Acquisition Overview tab** – this tab is used to show the claimed value of the SCA

   a. **Total Value Claimed** – Value of SCA (Include Goodwill from purchase of SCA)

   b. **Shares Owned** - number of shares the insurance reporting entity owns
c. **Value Per Share** - total value claimed divided by the number of shares owned

d. **Percent Outstanding Shares Owned** - percentage of shares issued and outstanding that the insurance reporting entity owns

e. **Does the SCA directly or indirectly own shares of the insurance reporting entity?** This relates to reciprocal ownership – refer to SSAP No. 97 for more detail (SCA Elimination Worksheet will need completed – found at [http://www.naic.org/sca_subsidiary_controlled_affiliated.htm](http://www.naic.org/sca_subsidiary_controlled_affiliated.htm))

f. **Does the SCA directly or indirectly own shares of an upstream intermediate or ultimate parent?** This relates to reciprocal ownership – refer to SSAP No. 97 for more detail (SCA Elimination Worksheet will need completed – found at [http://www.naic.org/sca_subsidiary_controlled_affiliated.htm](http://www.naic.org/sca_subsidiary_controlled_affiliated.htm))

g. **Is the SCA consolidated with other subsidiaries?** The Stat. Adjustment Worksheet will be required and will help tie out an SCA that has been consolidated (Worksheet found at [http://www.naic.org/sca_subsidiary_controlled_affiliated.htm](http://www.naic.org/sca_subsidiary_controlled_affiliated.htm))

h. **Analyst Name / Phone Number / Email** – Name and contact information for Individual who prepared the filing in case SCA reviewer has questions.

i. **Comments** – Available for additional information for reviewing the SCA.
4. **Review tab**
   a. Review all fields of the SCA to ensure they are filed correctly
      
      i. *If something is not filled out correctly, go back and update at this point because you won’t be able to after you click “Prepare SCA Filing”*
      
      ii. When finished reviewing, click the “Prepare SCA Filing” button

   **IMPORTANT NOTES:**
   
   *If something is not filled out correctly, click “Back” and update!!*

   *After clicking “Prepare SCA Filing” you WILL NOT be able to make any changes!!*

   **DO NOT** hit cancel at any point during the filing process - This will discard your filing!!

   *When finished reviewing, click the “Prepare SCA Filing” button*

---

5. **SCA Filing Detail tab** – This tab will show all the filing details and this is where you will attach all your supporting documents
a. To attach a document:

1. Click “Edit” under Supporting Documents
2. Click “Attachments” to the file you want to add
   - *If you have a document to add that is not listed click the “+ Add” button and attach from there*
3. Find your document and upload – when finished uploading documents click “Save” under Supporting Documents

<table>
<thead>
<tr>
<th>Supporting Documents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Description</td>
</tr>
<tr>
<td><strong>SCA Goodwill Worksheet</strong></td>
</tr>
<tr>
<td><strong>SCA Elimination Worksheet</strong></td>
</tr>
<tr>
<td><strong>SCA Stat. Adjustment Worksheet</strong></td>
</tr>
<tr>
<td><strong>SCA Permitted and Prescribed Practices</strong></td>
</tr>
<tr>
<td><strong>SCA Prior Year Audited Financial Statements</strong></td>
</tr>
</tbody>
</table>

b. Required Sub-2 Documents

1. SCA Prior Year Audited Financial Statements – attach the audit for the SCA filing – *Always required for Sub-2 – “*”*

c. Other Required Documents

1. Required depending on answers to questions:
   (a) SCA Goodwill Worksheet – If you chose Positive or Negative Goodwill, this will need to be included
   (b) SCA Elimination Worksheet – If you answered Yes to the Reciprocal Ownership questions, this will need to be included
   (c) SCA Stat Adj. Worksheet – If you answered Yes to the Consolidated SCA question, this will need to be included

   *Note: If applicable, these are required, but there will not be a “*”.**
d. Worksheets and other SCA documents can be found at

http://www.naic.org/sca_subsidiary_controlled_affiliated.htm

**After attaching all required documents - Click “Submit” to finalize Sub-1 filing:**

[Image of the submit button]

**After Submitting – You Have Completed the Sub-2 Filing!!!**

Upon submission of the Sub 1 filing in VISION, an NAIC analyst will review it. When the filing has been reviewed, the filer can download the final review results from the filing screen. The filer will click on the filing number under the “SCA Filings” tab of the VISION home screen. Once in the filing screen, the “Export State Information” button will be visible on the screen. When the filer clicks this button, the final review results will open. Filer should save this for their records.

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**3. Filing an Appeal to a Sub-2 Filing**

A. From the “SCA Filings” screen, click on the Filing Number of the SCA you wish to file an appeal for

1. You can sort the “SCA Filings” screen by any of the headers, or even search for a particular SCA

<table>
<thead>
<tr>
<th>Filing Number</th>
<th>CUSIP</th>
<th>Issuer Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>1007485</td>
<td>G31544107</td>
<td>CNA EUROPE HLLOS LTD</td>
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<tr>
<td>1006721</td>
<td>142842100</td>
<td>GARIBOUI COFFEE INC</td>
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<td>1006847</td>
<td>066345408</td>
<td>BACARDI CORP</td>
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<td>1005644</td>
<td>530007163</td>
<td>LIBBY CAP PARTNERS INC</td>
</tr>
<tr>
<td>1006766</td>
<td>433523167</td>
<td>HIPPO INC</td>
</tr>
</tbody>
</table>

B. Clicking on the “Filing Number” will bring up SCA Filing Detail

1. Click on the “Initiate Sub-2 Appeal” button
2. **Analyst Name / Phone Number / Email** – Name and contact information for Individual who prepared the filing in case SCA reviewer has questions.

3. **Please provide your company's preferred conclusion and rationale** – enter information to be considered during the appeal process
   
   C. When all of the fields above have been filled in, click “Next”

   D. Review the details and click “Prepare SCA Filing”

   E. On the “SCA Filing Detail” tab, include any supporting documents that go with the appeal.

   F. Click “Submit” to finalize Sub-2 appeal filing.

**Upon submission of the Sub 1 filing in VISION, an NAIC analyst will review it. When the filing has been reviewed, the filer can download the final review results from the filing screen. The filer will click on the filing number under the “SCA Filings” tab of the VISION home screen. Once in the filing screen, the “Export State Information” button will be visible on the screen. When the filer clicks this button, the final review results will open. Filer should save this for their records.**

G:\FRS\DATA\Stat Acctg\3. National Meetings\A. National Meeting Materials\2020\Summer\Meeting\A.2 - 20-17 - Updating SCA Review Process - Sub 2 filing.docx
Issue: SSAP No. 97 Update

Check (applicable entity):

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<tr>
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Description of Issue:
In March 2020, the Working Group adopted agenda item 2018-26 – SCA Loss Tracking – Accounting Guidance, for SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities. This agenda item clarified guidance to state that reported equity method losses of an investment in a subsidiary controlled or affiliated entity (SCA) would not create a negative value in the SCA investment, thus stopping the reporting of the equity method losses at zero. However, to the extent there was a financial guarantee or commitment, it would require appropriate recognition under SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets.

This agenda item provides a minor revision to the end of paragraph 9 to corroborate the revisions adopted in agenda item 2018-26 and remove a lingering reference that guarantees or commitments can result in a negative equity value for the SCA.

Existing Authoritative Literature:

SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities:
(Bolded and underlined for emphasis)

9. The limited statutory basis of accounting for investments in noninsurance SCA entities, subject to paragraph 8.b.i.i. and foreign insurance SCA entities, subject to paragraph 8.b.iv., shall be adjusted for the following:

a. Nonadmit assets pursuant to the following statutory accounting principles as promulgated by the NAIC in the Accounting Practices and Procedures Manual;

   i. SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers
   ii. SSAP No. 16R—Electronic Data Processing Equipment and Software
   iii. SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements
   iv. SSAP No. 20—Nonadmitted Assets
   v. SSAP No. 21R—Other Admitted Assets (e.g., collateral loans secured by assets that do not qualify as investments are nonadmitted under SAP)
   vi. SSAP No. 29—Prepaid Expenses
   vii. SSAP No. 105—Working Capital Finance Investments
b. Expense costs that are capitalized in accordance with GAAP but are expensed pursuant to statutory accounting as promulgated by the NAIC in the *Accounting Practices and Procedures Manual* (e.g., deferred policy acquisition costs, preoperating, development and research costs, etc.);

c. Adjust depreciation for certain assets in accordance with the following statutory accounting principles:

   i. **SSAP No. 16R—Electronic Data Processing Equipment and Software**
   
   ii. **SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements**
   
   iii. **SSAP No. 68—Business Combinations and Goodwill**

d. Nonadmit the amount of goodwill of the SCA in excess of 10% of the audited U.S. GAAP equity of the SCA’s last audited financial statements.

e. Nonadmit amount of the net deferred tax assets (DTAs) of the SCA in excess of 10% of the audited U.S. GAAP equity of the SCA’s last audited financial statements.

f. Nonadmit any surplus notes held by the SCA issued by the reporting entity.

g. Adjust the U.S. GAAP annuity account value reserves of a foreign insurance SCA, with respect to the business it wrote directly, using the commissioners’ annuity reserve valuation method (CARVM) as defined in paragraphs 14 and 15 of Appendix A-820 (including the reserving provisions in the various Actuarial Guidelines which support CARVM). The valuation interest rate and mortality tables to be used in applying CARVM should be that prescribed by the foreign insurance SCA’s country of domicile. If the Foreign SCA’s country of domicile does not prescribe the necessary tables and/or rates, no reserve adjustment shall be made.

13. On at least a quarterly basis, the procedures set forth below shall be followed by a reporting entity in applying an equity method of accounting (as described in paragraphs 8.b.i. through 8.b.iv.), as applicable, to investments in SCA entities:

   e. For entities subject to 8.b.i., 8.b.iii. and 8.b.iv. a reporting entity’s share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by an equity method plus advances made by the investor. **The reporting entity shall discontinue applying an equity method when the investment (including advances) is reduced to zero**¹ and shall not provide for additional losses unless the reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee (guaranteed obligations meeting the definition of liabilities in **SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets** shall be recorded as liabilities). If the investee subsequently reports net income, the reporting entity shall resume applying an equity method only after its share of that net income equals the share of net losses not recognized during the period that an equity method was suspended;

Footnote 2: Although the SCA is reported at zero in the investment schedule, a guarantee liability (either contingent or noncontingent) may be required to be reported under SSAP No. 5R. Additionally, refer to the guidance related to discontinuance of an equity method in paragraphs 15-17 and **INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses**. As detailed in INT 00-24, a reporting entity’s share of losses in an SCA shall be applied to other investments held in the SCA once the SCA (common stock) investment has been reduced to zero.

¹ Refer to the additional guidance related to discontinuance of an equity method in paragraphs 15-17 and **INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses**.
Note that the outcome of these adjustments, as well as guarantees or commitments of the parent entity to provide additional funding, can result in a negative equity valuation of the investment.

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:
Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, as illustrated below, to update language to remove the statement that guarantees or commitments from the insurance reporting entity to the SCA can result in a negative equity valuation of the SCA.

SSAP No. 97:

9. The limited statutory basis of accounting for investments in noninsurance SCA entities, subject to paragraph 8.b.i.i. and foreign insurance SCA entities, subject to paragraph 8.b.iv., shall be adjusted for the following:

a. Nonadmit assets pursuant to the following statutory accounting principles as promulgated by the NAIC in the Accounting Practices and Procedures Manual:
   
   iv. SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers
   
   v. SSAP No. 16R—Electronic Data Processing Equipment and Software
   
   vi. SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements
   
   vii. SSAP No. 20—Nonadmitted Assets
   
   viii. SSAP No. 21R—Other Admitted Assets (e.g., collateral loans secured by assets that do not qualify as investments are nonadmitted under SAP)
   
   ix. SSAP No. 29—Prepaid Expenses
   
   x. SSAP No. 105—Working Capital Finance Investments

b. Expense costs that are capitalized in accordance with GAAP but are expensed pursuant to statutory accounting as promulgated by the NAIC in the Accounting Practices and Procedures Manual (e.g., deferred policy acquisition costs, preoperating, development and research costs, etc.);

c. Adjust depreciation for certain assets in accordance with the following statutory accounting principles:
   
   xi. SSAP No. 16R—Electronic Data Processing Equipment and Software
   
   xii. SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements
xiii. **SSAP No. 68—Business Combinations and Goodwill**

d. Nonadmit the amount of goodwill of the SCA in excess of 10% of the audited U.S. GAAP equity of the SCA's last audited financial statements.

e. Nonadmit amount of the net deferred tax assets (DTAs) of the SCA in excess of 10% of the audited U.S. GAAP equity of the SCA's last audited financial statements.

f. Nonadmit any surplus notes held by the SCA issued by the reporting entity.

g. Adjust the U.S. GAAP annuity account value reserves of a foreign insurance SCA, with respect to the business it wrote directly, using the commissioners' annuity reserve valuation method (CARVM) as defined in paragraphs 14 and 15 of Appendix A-820 (including the reserving provisions in the various Actuarial Guidelines which support CARVM). The valuation interest rate and mortality tables to be used in applying CARVM should be that prescribed by the foreign insurance SCA's country of domicile. If the Foreign SCA's country of domicile does not prescribe the necessary tables and/or rates, no reserve adjustment shall be made.

Note that the outcome of these adjustments, as well as guarantees or commitments of the parent entity to provide additional funding, can result in a negative equity valuation of the investment.

**Staff Review Completed by:**  
Fatima Sediqzad - NAIC Staff  
March 2020
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Clarification Edits - Mortgage Loan Participations

Check (applicable entity):

<table>
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Description of Issue:
This agenda item has been drafted to propose clarification edits to the statutory accounting guidance for a participation in mortgage loans. In summary, questions have been raised regarding the scope of “financial rights and obligations” that a reporting entity lender should possess via a participation agreement and if these extend beyond the right to receive contractual cash flows. Specifically, whether these rights should include items beyond the attachment to cash flows, such as the ability to independently take legal action against the borrower, participate with other lenders in determining whether legal action should be taken, or under normal circumstances, communicate directly with borrower.

As historical info:

- In agenda item 2016-39, guidance was adopted to clarify the types of investments in scope of SSAP No. 37—Mortgage Loans, and confirmed that a reporting entity mortgage loan lending arrangements via a participation agreement and co-lending arrangements (e.g., single mortgage with more than one lender) are in scope of SSAP No. 37. With these structures, the insurer would acquire the mortgage loan via an assignment, syndication or participation agreement between the selling (originating) lender and any co-lenders. This guidance identified that reporting entity lenders through a participation agreement or co-lending situation shall have financial rights and obligations that are similar to those in the direct loan. This action resulted with the following footnote in SSAP No. 37:

  Reporting entity has a “participation agreement” to invest in mortgages issued by another entity. Although the reporting entity is not named on the original mortgage loan agreement, the original issuer sells a portion of the mortgage loan to an incoming participant lender (co-lender) and the sale is documented by an assignment or participation agreement between the selling lender and the co-lender. With these agreements, the co-lender acquires an undivided participation interest in the loan and will receive direct interest in the amount of their participation in the right to repayment of the loan and the collateral given to secure the loan. The financial rights and obligations of the lenders in these agreements shall be similar to those in a direct loan.

- In agenda item 2018-22, guidance was adopted to clarify the provisions of reporting entity lenders through participation agreements. (This guidance was captured in this agenda item per a regulator request). These revisions further expanded the “participation agreement” footnote provisions, but the provisions for financial rights and obligations was retained. Revised SSAP No. 37 footnote:

  Reporting entity has a “participation agreement” to invest in a single mortgage loan. The reporting entity is not the lender or record named as a payee on the mortgage loan, but the lender of record sells a portion of the mortgage loan to the reporting entity through an assignment or participation interest under the participation agreement. Under a participation agreement, the reporting entity acquires an undivided interest in the single mortgage loan proceeds to be received by the lender of record. Under a participation agreement, single mortgage loan proceeds include the periodic mortgage loan principal and interest payments received by the lender of record, and all rights and
proceeds received in the foreclosure of a mortgage, deed of trust, deed in lieu of foreclosure, or other similar proceeding by the lender of record. The amount of the proceeds to be received by the reporting entity is based on the ratio of its participation interest to the then-outstanding single mortgage loan balance. To qualify as a mortgage loan under the scope of this statement, the reporting entity must have a signed participation agreement with the lender of record named in the mortgage loan, the financial rights and obligations of the reporting entity under the participation agreement are the same as the lender of record, the reporting entity’s participation interest in the single mortgage loan proceeds must be pari-passu with the lender of record named on the mortgage loan agreement, and the participation agreement must be properly and promptly recorded on the lender or record’s books and records.

NAIC staff believes that the reference to “rights and obligations” generally reflects the participant’s right to be paid when the borrower pays. As the participant’s relationship is generally with the original lender, they typically cannot sue the borrower, institute foreclosure independent of the other lenders, or under normal circumstances, communicate directly with the borrower.

State regulators have noted mortgage participation agreements which do not provide loan participants the same rights to pursue legal action as the lender of record. Rather, the participants possess equal rights to proceeds – regardless if received in the normal course of business or through legal proceedings. NAIC staff has received questions regarding if the inability to independently pursue legal recourse diminishes the rights of the participant to such a level that it is not on the pari-passu footing of the original lender as required by SSAP No. 37.

NAIC staff believe that if SSAP No. 37 were to require a participant to have the ability to independently pursue legal action against the obligor (separately from the direct lender), or require the ability to communicate directly with the borrower (under normal circumstances), most participation agreements would not qualify within scope of SSAP No. 37. (NAIC SVO staff has also indicated that a participant’s legal relationship is only with the original lender and the participant’s ability to operate independent of the original lender is not a common business practice.) It is anticipated that the provisions of the SSAP footnote guidance were intended to ensure that the reporting entity lender had the rights to foreclosure proceeds via their participation agreement, but it was not anticipated that the reporting entity lender would be able to separately engage in foreclosure actions outside of the direct lender (and other participants) via the provisions of their participation agreement.

This agenda item intends to clarify the provisions to ensure consistency in practice. As NAIC staff believes the intent was to include participation mortgages in scope of SSAP No. 37, the proposed edits have clarified that direct communication and unilateral ability to foreclose are not required elements in the reference for “financial rights and obligations.” However, comments are requested as to whether these provisions were anticipated to be required. If these provisions were intended, all mortgage loan participations that do not provide this capability would be scoped out of SSAP No. 37 and would need to be captured on Schedule BA.

Existing Authoritative Literature:

SSAP No. 37 defines participating mortgages that are in scope. Applicable guidance has been bolded for emphasis.

SUMMARY CONCLUSION

2. A mortgage loan is defined as a debt obligation that is not a security, which is secured by a mortgage on real estate. In addition to mortgage loans directly originated, a mortgage loan also includes mortgage loans acquired or obtained through assignment, syndication or participation (footnote 1). Investments that reflect “participating mortgages,” “mortgage loan fund,” “bundled mortgage loans” or the “securitization of assets” are not considered mortgage loans within scope of this SSAP.

   a. A security is a share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:
i. It is either represented by an instrument issued in bearer or registered form, or if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.

ii. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

iii. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

Footnote 1 -Examples of agreements intended to be captured within this statement:

a. Reporting entity is a “co-lender” in a single mortgage loan agreement that identifies more than one lender (which includes the reporting entity) with the real estate collateral securing all lenders identified in the agreement. For these single-mortgage loan agreements, each lender is incorporated directly into the loan documents. The key differentiating characteristic of a mortgage loan provided under a group “mortgage loan co-lending agreement” rather than a solely owned mortgage loan is that no one lender of the lending group may unilaterally foreclose on the mortgage. With these agreements, the lenders must foreclose on the mortgage loan as a group.

b. Reporting entity has a “participation agreement” to invest in a single-mortgage loan. The reporting entity is not the lender of record named as a payee on the mortgage loan, but the lender of record sells a portion of the mortgage loan to the reporting entity through an assignment or participation interest under the participation agreement. Under a participation agreement, the reporting entity acquires an undivided interest in the single mortgage loan proceeds to be received by the lender of record. Under a participation agreement, single mortgage loan proceeds include the periodic mortgage loan principal and interest payments received by the lender of record, and all rights and proceeds received in the foreclosure of a mortgage, deed of trust, deed in lieu of foreclosure, or other similar proceeding by the lender of record. The amount of the proceeds to be received by the reporting entity is based on the ratio of its participation interest to the then-outstanding single mortgage loan balance. To qualify as a mortgage loan under the scope of this statement, the reporting entity must have a signed participation agreement with the lender of record named in the mortgage loan, the financial rights and obligations of the reporting entity under the participation agreement are the same as the lender of record, the reporting entity’s participation interest in the single mortgage loan proceeds must be pari-passu with the lender of record named on the mortgage loan agreement, and the participation agreement must be properly and promptly recorded on the lender or record’s books and records.

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 historical information is included in the summary of issue.

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 clarify the requirements for participation loans in SSAP No. 37—Mortgage Loans. Revisions clarify that a participant’s financial rights may include the right to take legal action against the borrower (or participate in the determination of legal action), but do not require that the
participant have the right to solely initiate legal action, foreclosure, or under normal circumstances, require the ability to communicate directly with the borrower.

SUMMARY CONCLUSION

2. A mortgage loan is defined as a debt obligation that is not a security, which is secured by a mortgage on real estate. In addition to mortgage loans directly originated, a mortgage loan also includes mortgage loans acquired or obtained through assignment, syndication or participation (footnote 1). Investments that reflect “participating mortgages,” “mortgage loan fund,” “bundled mortgage loans” or the “securitization of assets” are not considered mortgage loans within scope of this SSAP.

a. A security is a share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

   i. It is either represented by an instrument issued in bearer or registered form, or if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.

   ii. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

   iii. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

Footnote 1 - Examples of agreements intended to be captured within this statement:

a) Reporting entity is a “co-lender” in a single mortgage loan agreement that identifies more than one lender (which includes the reporting entity) with the real estate collateral securing all lenders identified in the agreement. For these single-mortgage loan agreements, each lender is incorporated directly into the loan documents. The key differentiating characteristic of a mortgage loan provided under a group “mortgage loan co-lending agreement” rather than a solely owned mortgage loan is that no one lender of the lending group may unilaterally foreclose on the mortgage. With these agreements, the lenders must foreclose on the mortgage loan as a group.

b) Reporting entity has a “participation agreement” to invest in a single-mortgage loan. The reporting entity is not the lender of record named as a payee on the mortgage loan, but the lender of record sells a portion of the mortgage loan to the reporting entity through an assignment or participation interest under the participation agreement. Under a participation agreement, the reporting entity acquires an undivided interest in the single mortgage loan proceeds to be received by the lender of record. Under a participation agreement, single mortgage loan proceeds include the periodic mortgage loan principal and interest payments received by the lender of record, and all rights and proceeds received in the foreclosure of a mortgage, deed of trust, deed in lieu of foreclosure, or other similar proceeding by the lender of record. The amount of the proceeds to be received by the reporting entity is based on the ratio of its participation interest to the then-outstanding single mortgage loan balance. To qualify as a mortgage loan under the scope of this statement, the reporting entity must have a signed participation agreement with the lender of record named in the mortgage loan, the financial rights and obligations of the reporting entity under the participation agreement are the same as the lender of record, the reporting entity’s participation interest in the single mortgage loan proceeds must be pari-passu with the lender of record named on the mortgage loan agreement, and the participation agreement must be properly and promptly recorded on the lender or record’s books and records. For the purposes of this footnote, “financial rights” may include the right to take legal action against the borrower, or participate with other lenders in determining whether legal action should be taken, but typically does not include the right to solely initiate legal action, foreclosure, or under normal circumstances, communicate directly with the borrower.
Staff Review Completed by: Jim Pinegar, NAIC Staff – April 2020

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

**Issue:** Disclosure of Rolled Cash Equivalent Investments

**Check (applicable entity):**

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**Description of Issue:** On May 20, the Working Group adopted agenda item 2019-20: **Rolling Short-Term Investments**, incorporating additional principle concepts **restricting the classification of certain related party or affiliated investments as cash equivalents or short-term investments**. These restrictions would apply for items in scope of **SSAP No. 26R—Bonds, SSAP No. 43R—Loan-Backed and Structured Securities**, or that would be reported as “Other Invested Assets.” With adoption, an additional disclosure element was required stating that short-term investments (or substantially similar investments) which remain on the short-term schedule for more than one consecutive year (i.e. a re-underwritten investment that is renewed) shall be disclosed in the financial statements.

The scope of agenda item 2019-20 covered both cash equivalents and short-term investments and although cash equivalent investments were referenced throughout the agenda item, the adopted disclosure only specifically stated that disclosure was required for short-term investments (or substantially similar investments) that remain on the short-term schedule for more than one year. Due to the importance of identifying certain rolled or renewed cash equivalent investments, the SAPWG requested that an agenda item be drafted to clarify that the disclosure elements as adopted for short-term investments shall also apply to cash equivalent investments.

Additionally, at the request of interested parties, clarification of the disclosure requirements is proposed to identify that the disclosure is satisfied through the use of an identifier code as specified in the applicable reporting instructions in the investments schedules of the statutory financial statements (i.e. Blanks) and not required in a narrative format.

**Existing Authoritative Literature:**

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

**Disclosures**

12. The following disclosures shall be made for short-term investments in the financial statements:

- a. Fair values in accordance with **SSAP No. 100R—Fair Value**;
- b. Concentrations of credit risk in accordance with **SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures**;
- c. Basis at which the short-term investments are stated.
- d. The items in the scope of this statement are also subject to the annual audited disclosures in **SSAP No. 26R—Bonds**, paragraph 30.f.
- e. Identification of short-term investments or substantially similar investments in which remain on the short-term schedule for more than one year.
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 2019-20: Rolling Short-Term Investments. As referenced in the “Description of Issue” section, this agenda item was adopted by the SAPWG in May 2020, incorporating additional principle concepts that would restrict the classification of certain related party or affiliated investments as a cash equivalent or short-term investments. These restrictions apply for items in scope of SSAP No. 26R—Bonds, SSAP No. 43R—Loan-Backed and Structured Securities, or that would be reported as “Other Invested Assets.” With adoption, an additional disclosure element was required, incorporating language stating that short-term investments (or substantially similar investments) which remain on the short-term schedule for more than one consecutive year (i.e. a re-underwritten investment that is renewed) shall be disclosed in the financial statements.

- Agenda item 2019-42: Cash Equivalents – Cash & Liquidity Pools. This agenda item was adopted by the SAPWG in May 2020, incorporating additional provisions that direct certain cash / liquidity pools, meeting defined criteria, to be reported as cash equivalents.

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 SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments to require the identification/disclosure of cash equivalents and short-term investments, or substantially similar investments, which remain on the same reporting schedule for more than one consecutive reporting period. (This revision expands current disclosure requirements to include cash equivalent investments.) Furthermore, the revisions clarify that the disclosure is satisfied through the use of the code on the investment schedules.

SSAP No. 2R – Proposed Updates

18. The following disclosures shall be made for short-term investments in the financial statements:

   a. Fair values in accordance with SSAP No. 100R—Fair Value;
   b. Concentrations of credit risk in accordance with SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures;
   c. Basis at which the short-term investments are stated.
   d. The items in the scope of this statement are also subject to the annual audited disclosures in SSAP No. 26R—Bonds, paragraph 30.f.
   e. Identification of cash equivalents and short-term investments, [or substantially similar investments], in which remain on the same reporting short-term schedule for more than one consecutive reporting period/year. This disclosure is satisfied by use of a designated code in the investment schedules of the statutory financial statements.

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

Status:
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Issue: SSAP No. 43R - Designation Categories for RMBS/CMBS Investments

Check (applicable entity):

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

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Description of Issue: This agenda item reflects updated NAIC designation guidance recently adopted by the Valuation of Securities (E) Task Force (VOSTF) for the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual), for residential mortgage-backed securities (RMBS) / commercial mortgage-backed securities (CMBS).

As adopted by the VOSTF, a new designation category will be utilized when reporting RMBS/CMBS investments. The current financial modeling process remains unaffected, however the NAIC designations, as produced by the financial model (and as previously used for reporting), will now be mapped to a final NAIC designation category. Reporting entities will then utilize the new NAIC designation category for accounting and reporting purposes. The edits proposed in this agenda item update the NAIC designation category mapping instructions in SSAP No. 43R—Loan-Backed and Structured Securities for RMBS/CMBS investments.

For historical reference, the VOSTF originally proposed to eliminate the multi-step modeling (“financial modeling”) practice for RMBS/CMBS investments – primarily in response to the implementation of NAIC designation categories, which would have required 19 additional price breakpoints for RMBS/CMBS investments. The multi-step modeling practice for these instruments is the only remaining approach that utilizes breakpoints to determine NAIC designations. Since its original exposure, the VOSTF modified its proposal and on May 14, adopted revised guidance to the P&P Manual, continuing the financial modeling practice, but in lieu of implementing additional price breakpoints, the output of the financial model will be mapped to a specific NAIC designation category. As an example, the prior modeled NAIC 1 with risk of loss will be mapped to a NAIC 1.D and a NAIC 2 will be mapped to a NAIC 2.B.

Existing Authoritative Literature:

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

Designation Guidance

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

a. Financial Modeling: The NAIC identifies securities where financial modeling must be used to determine the NAIC designation. NAIC designation based on financial modeling incorporates the insurers’ carrying value for the security. For those securities that are financially modeled, the insurer must use NAIC CUSIP specific modeled breakpoints provided by the modelers in determining initial and final designation for these identified securities. Securities where modeling results in zero expected loss in all scenarios are automatically considered to have a final NAIC designation of NAIC 1, regardless of the carrying value. The three-step process for modeled securities is as follows:
i. Step 1: Determine Initial Designation – The current amortized cost (divided by remaining par amount) of a loan-backed or structured security is compared to the modeled breakpoint values assigned to the six (6) NAIC designations for each CUSIP to establish the initial NAIC designation.

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

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

b. All Other Loan-Backed and Structured Securities: For loan-backed and structured securities not subject to paragraphs 27.a. (financial modeling) follow the established designation procedures according to the appropriate section of the Purposes and Procedures Manual of the NAIC Investment Analysis Office. The NAIC designation shall be applicable for statutory accounting and reporting purposes (including determining the carrying value method and establishing the AVR charges). The carrying value method is established as described in paragraph 26. Examples of these securities include, but are not limited to, mortgage-referenced securities, equipment trust certificates, credit tenant loans (CTL), 5*/6* securities, interest only (IO) securities, securities with CRP ratings (excluding RMBS/CMBS), and loan-backed and structured securities with SVO assigned NAIC designations.

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

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


Staff Recommendation: NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 43R—Loan-backed and Structured Securities to reflect the updated final designation guidance for RMBS/CMBS securities. This update will reflect the guidance recently adopted for the Purposes and Procedures Manual of the NAIC Investment Analysis Office.
Proposed Revisions to SSAP No. 43R—Loan-backed and Structured Securities

SSAP No. 43R—Loan-backed and Structured Securities

Designation Guidance

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

a. Financial Modeling: The NAIC identifies securities where financial modeling must be used to determine the NAIC designation. NAIC designation based on financial modeling incorporates the insurers’ carrying value for the security. For those securities that are financially modeled, the insurer must use NAIC CUSIP specific modeled breakpoints provided by the modelers in determining initial and final designation for these identified securities. Securities where modeling results in zero expected loss in all scenarios are automatically considered to have a final NAIC designation of NAIC 1, regardless of the carrying value. The three-step process for modeled securities is as follows:

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

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

iii. Step 3: Determine Final Designation – The final NAIC designation, as determined by the modeled price range, designation that shall be used for investment schedule reporting is determined by comparing the carrying value (divided by remaining par amount) of a security (based on paragraph 27.a.ii.) to the NAIC CUSIP specific modeled breakpoint values assigned to the six (6) NAIC designations for each CUSIP. These six (6) NAIC designations are mapped to NAIC designation categories as shown in the Purposes and Procedures Manual of the NAIC Investment Analysis Office, along with instructions for tranches that have no expected loss under any of the selected modeling scenarios and instructions for non-modeled securities. This final NAIC designation and NAIC designation category shall be applicable for statutory accounting and reporting purposes (including investment schedule reporting and establishing RBC and AVR charges). The final NAIC designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 27.a.ii.).

b. All Other Loan-Backed and Structured Securities: For loan-backed and structured securities not subject to paragraphs 27.a. (financial modeling) follow the established designation procedures according to the appropriate section of the Purposes and Procedures Manual of the NAIC Investment Analysis Office. The NAIC designation shall be applicable for statutory accounting and reporting purposes (including determining the carrying value method and establishing the AVR charges). The carrying value method is established as described in paragraph 26. Examples of these securities include, but are not limited to, mortgage-referenced securities, equipment trust certificates, credit tenant loans (CTL), 5*/6* securities, interest only (IO) securities, securities with CRP ratings (excluding RMBS/CMBS), and loan-backed and structured securities with SVO assigned NAIC designations.

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

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

Issue: Accounting for Perpetual Bonds

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Description of Issue: Questions have arisen regarding accounting treatment for perpetual bonds held as investments within scope of SSAP No. 26R—Bonds. A perpetual bond is a fixed income security, representing a creditor relationship, with a fixed schedule of future payments, however it does not contain a maturity date - thus yielding the definitional term “perpetual.” These bonds are typically not redeemable at the option of the holder but likely possess call options for the benefit of the issuer.

Perpetual bonds possess characteristics very similar to that of perpetual preferred stock in that both offer a projected return for an indefinite of time. The similarities of these two securities extend beyond both having indefinite lives and receiving periodic, scheduled income cash flows (i.e. interest for perpetual bonds and dividends for perpetual preferred stock). Both investments 1) have a higher than average duration from their perpetual cashflows reflecting a greater market value sensitivity, up and down, to interest rate movements, 2) generally are subject to issuer call provisions, and 3) do not possess voting rights. The only primary cashflow difference between perpetual bonds and perpetual preferred stock is seniority in the event of a liquidation (bond typically place higher in the liquidation hierarchy) – which is why perpetual preferred stock may warrant a higher yield to compensate for seniority risk.

Existing Authoritative Literature:

SSAP No. 26R does not contain specific or differing valuation and reporting guidance for perpetual bonds. These investments would be captured in the existing valuation and reporting guidance for bonds that are not mandatory convertible, which anticipate a scheduled maturity date. Under this existing guidance, bonds are held at amortized cost or lower of amortized cost or fair value, depending on NAIC designation of the bond. Due to perpetual bonds lacking a maturity date (and possessing indefinite lives), they are unable to experience accretion or amortization to yield an amortized cost basis.

SSAP No. 26R—Bonds

11. Bonds, as defined in paragraph 3, shall be valued and reported in accordance with this statement, the Purposes and Procedures Manual of the NAIC Investment Analysis Office, and the designation assigned in the NAIC Valuations of Securities product prepared by the NAIC Securities Valuation Office (SVO).

a. Bonds, except for mandatory convertible bonds: For reporting entities that maintain an asset valuation reserve (AVR), the bonds shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value. For reporting entities that do not maintain an AVR, bonds that are designated highest-quality and high-quality (NAIC designations 1 and 2, respectively) shall be reported at amortized cost; all other bonds (NAIC designations 3 to 6) shall be reported at the lower of amortized cost or fair value.

b. Mandatory convertible bonds: Mandatory convertible bonds are subject to special reporting instructions and are not assigned NAIC designations or unit prices by the SVO. The
balance sheet amount for mandatory convertible bonds shall be reported at the lower of amortized cost or fair value during the period prior to conversion. This reporting method is not impacted by NAIC designation or information received from credit rating providers (CRPs). Upon conversion, these securities will be subject to the accounting guidance of the statement that reflects their revised characteristics. (For example, if converted to common stock, the security will be in scope of SSAP No. 30R—Unaffiliated Common Stock, if converted to preferred stock, the security will be in scope of SSAP No. 32—Preferred Stocks.)

Due to the numerous payment similarities between perpetual bonds and perpetual preferred stock, the accounting and reporting guidance for perpetual preferred stock is below. (Note: guidance below is from agenda item 2019-04: SSAP No. 32 – Investment Classification Project.) This agenda item substantially revises SSAP No. 32—Preferred Stock as a part of the Investment Classification Project. This guidance is anticipated for adoption during the Summer 2020 National Meeting)

SSAP No 32R—Preferred Stock

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).
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): While not specific to perpetual bonds, in agenda item 2019-04: SSAP No. 32 – Investment Classification Project, the Working Group has agreed in principle with the accounting for perpetual preferred stock, which from an investor perspective, is materially similar to perpetual bonds.

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 SSAP No. 26R—Bonds to clarify that perpetual bonds shall be reported at fair value, not to exceed any current effective call price. Although this is considered a nonsubstantive change, if a stated effective date is preferred (instead of immediately upon adoption), NAIC staff recommends an effective date of Jan. 1, 2021, with early application permitted. (Although these bonds cannot amortize without a maturity date, NAIC staff notes that the specific reference to fair value may cause a change for reporting entities immediately before year-end. However, it is also noted that these types of bonds are not believed to be overly prevalent.)

SSAP No. 26R – Proposed Updates

Balance Sheet Amount

11. Bonds, as defined in paragraph 3, shall be valued and reported in accordance with this statement, the Purposes and Procedures Manual of the NAIC Investment Analysis Office, and the designation assigned in the NAIC Valuations of Securities product prepared by the NAIC Securities Valuation Office (SVO).

a. Bonds, except for mandatory convertible bonds: For reporting entities that maintain an asset valuation reserve (AVR), the bonds shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value. For reporting entities that do not maintain an AVR, bonds that are designated highest-quality and high-quality (NAIC designations 1 and 2, respectively) shall be reported at amortized cost; all other bonds (NAIC designations 3 to 6) shall be reported at the lower of amortized cost or fair value. For perpetual bonds, the bonds shall be reported at fair value regardless of NAIC designation, not to exceed any current effective call price.

b. Mandatory convertible bonds: Mandatory convertible bonds are subject to special reporting instructions and are not assigned NAIC designations or unit prices by the SVO. The balance sheet amount for mandatory convertible bonds shall be reported at the lower of amortized cost or fair value during the period prior to conversion. This reporting method is not impacted by NAIC designation or information received from credit rating providers (CRPs). Upon conversion, these securities will be subject to the accounting guidance of the statement that reflects their revised characteristics. (For example, if converted to common stock, the security will be in scope of SSAP No. 30R—Unaffiliated Common Stock, if converted to preferred stock, the security will be in scope of SSAP No. 32—Preferred Stocks.)

Effective Date and Transition

36. Revisions adopted April 2019, to explicitly exclude securities for which the contract amount of the instrument to be paid at maturity (or the original investment) is at risk for other than failure of the borrower to pay the contractual amount due, are effective December 31, 2019.
The reporting of perpetual bonds at fair value shall be effective January 1, 2021, with early adoption permitted.

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

Status:

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Issue: Update to Leasehold Improvements

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Description of Issue:

During 2019, the Working Group adopted substantive revisions to SSAP No. 22—Leases, which created SSAP No. 22R. The updated guidance rejects the financing lease treatment that has been adopted in U.S. GAAP but brings in language from ASC Topic 842, which intended to keep SSAP No. 22R as consistent as possible with updated U.S. GAAP. NAIC staff were notified by a company that the revisions to the definition of lease terms in SSAP No. 22R are not consistent with guidance for the depreciable lives of leasehold improvements in SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements and SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities.

As it stands now, “lease term” is defined in SSAP No. 22R as the noncancellable period of the lease together with options to extend or terminate the lease, if the lessee is reasonably certain to exercise the option. In SSAP No. 19 and SSAP No. 73, the guidance for establishing the life of a leasehold improvement does not allow renewal or option periods to be included. This recommended update will allow the guidance in SSAP No. 19 and SSAP No. 73 to conform with SSAP No. 22R. Note that leasehold improvements remain nonadmitted assets.

Existing Authoritative Literature:

The guidance on “lease term” is included in SSAP No. 22R (language matches ASC Topic 842-10-30-1):

24. An entity shall determine the lease term as the noncancellable period of the lease, together with all of the following:

   a. Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option.

   b. Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

   c. Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the lessor.

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

SSAP No. 19:

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter of their estimated useful life or the remaining life of the original lease excluding renewal or option periods. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired.
SSAP No. 73:

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

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

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

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

Staff Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and incorporate revisions to SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements and SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities as noted below. The updated language will allow leasehold improvements to have lives that match the associated lease term, which is guidance that agrees with U.S. GAAP in ASC Topic 842.

SSAP No. 19:

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

SSAP No. 73:

9. Furniture, medical equipment and fixtures, and leasehold improvements shall be depreciated over their estimated useful lives but for a period not to exceed three years, except for a leasehold improvement which shall be amortized against net income over the shorter of its estimated useful life or the remaining lease term, as defined in SSAP No. 22R excluding renewal or option periods, using methods detailed in SSAP No. 19.

Staff Review Completed by Jake Stultz, June 2020

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

**Issue:** Accounting and Reporting of Credit Tenant Loans

**Check (applicable entity):**

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**Description of Issue:**

This agenda item intends to clarify the reporting of credit tenant loans (CTL) for statutory accounting. Although this is an investment (that if meeting certain criteria) may have been historically captured in SSAP No. 43R—Loan-Backed and Structured Securities, due to recent discussions at the Valuation of Securities (E) Task Force, in order to provide timely guidance, it was identified that this issue needs to be considered separately outside of the substantive SSAP No. 43R project. As the SSAP No. 43R project is a substantive assessment, with various aspects being considered, it is noted that the conclusion of that project may extend beyond the timeframe for which clarity on CTLs is needed.

This agenda item focuses on credit tenant loans. There are other variations of similar investments that should also be specifically named/addressed in the AP&P Manual. These include ground lease financings as well as other lease-backed (non-ABS) securities. NAIC staff recommends that the Working Group first consider CTLs, with separate subsequent consideration of other structures.

Pursuant to guidance in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*:

> Mortgage loans that are made primarily in reliance on the credit standing of a major tenant, structured with an assignment of the rental payments to the lender with real property pledged as collateral in the form of a first lien, are referred to as a Credit Tenant Loan. *(Staff Note – This overall definition also matches the NAIC Model 280: Investments of Insurers Model Act (Defined Limits Version)).*

**Credit Tenant Loan (CTL)** – A CTL is a mortgage loan made primarily in reliance on the credit standing of a major tenant, structured with an assignment of the rental payments to the lender with real property pledged as collateral in the form of a first lien. This Manual identifies four categories of CTLs as eligible for reporting on Schedule D conditioned on an SVO determination that the transaction meets the criteria specified by the VOS/TF for Schedule D treatment. A transaction that purports to be a Credit Tenant Loan, including one that is assigned a credit rating by an NAIC CRP, is not eligible for Schedule D reporting unless the SVO confirms that the transaction is eligible for Schedule D reporting and assigns the transaction an NAIC Designation.

It has been long-standing practice for CTLs to be filed with the NAIC SVO for review and assessment. If the SVO identified that the CTL qualifies under the SVO’s legal and structural analysis (which reflects bond characteristics) and meets certain other criteria (such as minimal residual real-estate risk), then it has been granted special treatment and reported in scope of SSAP No. 43R on schedule D. If the CTL did not qualify under the SVO provisions or if it was not filed with the SVO, it would not qualify to be reported as a bond. These CTLs are often referred to as “non-conforming CTLs.” It has been presumed that a non-conforming CTL would be considered a mortgage loan and reported in scope of SSAP No. 37—Mortgage Loans.

The Valuation of Securities (E) Task Force has recently been discussing CTLs as it was identified that CTLs that were not submitted to the SVO and/or did not qualify under the SVO’s structural and legal analysis were being reported on Schedule D with filing exempt designations. Although this identification resulted with discussion at the
Task Force on the existing process, it was also noted that the overall statutory accounting guidance is not clear. The following elements have been identified as potential accounting and reporting issues:

1. There is no clear guidance in the Accounting Practices & Procedures Manual that SVO-identified conforming CTLs are in scope of SSAP No. 43R. It is noted that the CTL structure does not qualify within the SSAP No. 43R definition of a loan-backed and structured security (LBSS), and all that is currently included in SSAP No. 43R is a generic reference to “credit-tenant loans” as an example of an “all other” loan-backed and structured security. This reference is in paragraph 27.b of SSAP No. 43 in the section that addresses “designation guidance.”

2. It is presumed that non-SVO-identified CTLs would have historically been reported as mortgage loans. However, SSAP No. 37 explicitly excludes “securities” from the scope of the standard. Due to the structure of CTLs, and as they have CUSIPs, there is a question whether they are a “security” which would then specifically exclude CTL’s from the mortgage loan guidance.

3. It has been identified that if non-conforming CTLs are reported as mortgage loans, the RBC calculation may be considered punitive for these specific designs. This is because the assessment of a CTL is based on the credit quality of the major tenant, whereas the RBC calculation factors for mortgage loans is a loan-to-value (LTV) assessment. As the RBC calculation does not have an alternative process for CTL structures, under the LTV process, these loans receive high RBC charges.

4. If the non-conforming CTLs are not reported on schedule D and not reported as mortgage loans, they would be captured on Schedule BA – Other Long-Term Invested Assets. Although there are certain classes of assets that could be reported with NAIC designations on Schedule BA, assets with underlying characteristics of mortgage loans do not currently have this capability. As such, if reported under this Schedule BA category under current provisions, these items would receive a 20% RBC for property/casualty and health filers and would receive a 30% charge for life filers. Even if provisions were incorporated to permit NAIC designations for this class of asset (or direct reporting within a different reporting line), this would only allow life insurers to receive a reduction in RBC. There would be no benefit for property/casualty and health filers under existing RBC provisions.

In order to fully assess the proper accounting and reporting, this agenda item presents the following key characteristics of CTLs:

- A CTL generally is long-term in nature in comparison to a commercial mortgage. So, whereas a commercial mortgage loan may be between 5-10 years, a CTL could be between 15-40 years of fixed payments that correspond to the term of the lease and the loan.

- The CTL is structured based on the credit-quality of the corporate tenant which is obligated to pay rent regardless of property casualty, condemnation or obsolescence and to pay all expenses associated with the property, such as taxes, maintenance and utilities. The investment, however, is secured with collateral through a mortgage on the property. With this structure, the reporting entity receives a steady cash flow stream with the additional protection of real estate collateral.

- Conforming CTLs are generally structured to be fully amortized over the term of the loan and lease; however, they are illiquid investments. This principal amortizing component is a key element of the requirements in determining whether a CTL meets the SVO requirements in support of bond classification/NAIC designation. (Technically, if the structure is not substantively amortized over the term, then it is not a Schedule D eligible CTL, per the P&P Manual. However, the phrase “non-conforming CTL” is used to describe the general structure of the transaction.) To provide simple examples (ignoring investment returns or interest payments):
Example 1: If a CTL investment reflected $1,500,000, with the investor receiving $100,000 in annual cash payments over a 15-year lease/loan term, at conclusion of the investment, the principal balance would have been returned to the investor. Although the underlying property would have been provided as collateral as part of the CTL agreement, with the structure of the investment, there is little risk that the property would be transferred to the reporting entity at maturity to satisfy a remaining principal amount due. This is referred to as “residual risk.” The SVO parameters permit a slight amount of residual risk (e.g., 5%) in conforming CTLs. If the investment retains a greater amount of residual risk, then additional mitigation elements must be included in the structure for an SVO “conforming CTL” designation.

Example 2: If a CTL investment reflected $1,500,000, with the investor receiving $600,000 in annual cash payments over a 15-year lease/loan term, at conclusion of the investment, the reporting entity investor would be due $900,000. If the structure was not renewed or refinanced with the tenant (or a new tenant), then the reporting entity investor would receive ownership of the building in lieu of the remaining principal amount owed. The reporting entity investor would then have to sell the building to recoup their investment. This structure reflects a level of residual risk that has been historically deemed unacceptable for bond reporting under the SVO parameters. Rather, this structure has been historically considered to reflect a mortgage loan at inception, with reclassification as real estate if the reporting entity received the property at the conclusion of the investment maturity.

The focus of this agenda item is to inquire whether the conforming CTLs (such as example 1) should be captured in scope of SSAP No. 43R or whether these investments should be captured in SSAP No. 21R—Other Admitted Assets. This agenda item is not proposing that structures that do not conform to current requirements (such as example 2) be considered in scope of SSAP No. 43R. This agenda item also inquires whether structures that are not conforming CTLs (such as example 2) should be reported as mortgage loans or whether these structures should be captured in SSAP No. 21R. This agenda item is not proposing to reconsider the existing SVO guidelines in determining whether a CTL is “conforming” and in determining what is considered to be a suitable amount of “residual risk.” If there is a desire to reassess these provisions, NAIC staff would recommend a separate project with the Task Force, after concluding on desired reporting location and governing SSAP, to review these parameters.

Although it is understood that historical practice has permitted certain SVO verified CTLs that meet legal and structural analyses to be reported on Schedule D, there is a question whether these investments reflect bonds or securitized assets that should be included on the bond schedule. If preferred by the Working Group, revisions can be considered to remove these items from potential Schedule D reporting and instead capture these investments in scope of SSAP No. 21R. Some elements to consider in determining whether SSAP No. 21R would be more appropriate:

- If captured in scope of SSAP No. 21R, all CTLs will be reported in the same schedule, regardless of whether they are considered “conforming” or “non-conforming” CTLs. (In other words, the same reporting schedule would occur regardless of the NAIC SVO assessment.) This reporting process would likely result with improved identification and assessment of CTL investments in the financial statements. Under the current process, since CTLs are bifurcated across reporting schedules, it is not possible to identify the full extent an insurer is invested in CTLs (regardless if confirming or non-conforming).

- If captured in scope of SSAP No. 21R, CTLs could still be filed with the NAIC SVO for the legal and structural analysis and, if qualifying, to obtain an NAIC designation. For these “conforming” CTLs, revisions could be incorporated to permit the NAIC designation to be reported on Schedule BA. This NAIC designation could be used by life insurers to obtain an improved RBC designation. (Although the improved
RBC is not an option under the current RBC formula for non-life entities, from information gathered, most CTL holders are life insurers.)

- Reporting CTLs in scope of SSAP No. 21R would be consistent with previous decisions of the SAPWG to not report non-bond items as bonds simply for RBC purposes. It would also be consistent with the policy statement that obtaining an NAIC designation does not direct statutory accounting or reporting. Pursuant to this policy statement, obtaining an NAIC designation does not change an investment’s applicable SSAP, annual or quarterly reporting schedule or override other SSAP guidance required for the investment to be an admitted asset. This policy statement does identify that there are limited situations in which an SVO-listing could be used for classification purposes that focuses on the underlying structure of the investment. If conforming CTL investments are retained in SSAP No. 43R (and not moved to SSAP No. 21R), it would be recommended that CTLs that meet the SVO structural analysis be captured on a listing that could be referred to in the scope section of SSAP No. 43R. It is noted that the recent issues involving non-conforming CTLs seem to originate from an interpretation that obtaining a CRP rating would allow entities to report these structures as bonds on Schedule D through the filing exemption process. This assessment is incorrect under existing statutory accounting guidance and the existing policy statement.

- Reporting CTLs in scope of SSAP No. 21R would seemingly be consistent with the decision made for structured settlements in 2018. Although structured settlements and CTLs are vastly different investments, they both represent an investment, that is not a bond, but reflects an investment in a cash flow stream that is subject to the underlying credit quality of the payer.

On May 29, 2020, the Valuation of Securities (E) Task Force submitted a referral to the Working Group to permit non-conforming CTLs that receive an NAIC designation from the SVO to be considered in scope of SSAP No. 43R. Excerpts of this referral have been provided below:

The Task Force is referring this memo and proposed amendment to the Statutory Accounting Principles (E) Working Group and requesting the Working Group affirm that they would consider these Non-conforming CTLs to have the characteristics of a bond if assigned an NAIC Designation by the SVO staff. Like the referral from earlier this year on GLFs, these Non-conforming Credit Tennant Loan (CTL) Transactions have historically been reported under the Accounting Practices & Procedures Manual’s SSAP No. 43R – Loan-Backed and Structured Securities under Paragraph 27, b as a type of CTL. The SVO staff recommends affirming that treatment only if the SVO staff can assign an NAIC Designation.

The edits noted in the Task Force referral are revisions to the Purposes and Procedures Manual (P&P) to affirm the Task Force’s role in making all decisions on the use of CRP ratings and provides guidance to insurance company filers on what to do if they are uncertain about the filing procedure for a particular security or class of securities.

NAIC staff highlights that it would be inconsistent with the Policy Statement on Coordination of the AP&P Manual and the P&P Manual of the NAIC IAO to permit CTLs to be classified as a bond simply in accordance with an NAIC designation / CRP rating. However, the provisions in the Policy Statement does identify that such classifications can occur based on an SVO structural assessment of an investment. NAIC SAPWG staff has confirmed with the SVO staff that the review and assignment of an NAIC designation for CTLs requires a structural assessment, and they only receive an NAIC designation if the CTL possess bond characteristics.

Existing Authoritative Literature:

SSAP No. 37—Mortgage Loans

2. A mortgage loan is defined as a debt obligation that is not a security, which is secured by a mortgage on real estate. In addition to mortgage loans directly originated, a mortgage loan also includes mortgage loans acquired or obtained through assignment, syndication
or participation\(^1\). Investments that reflect “participating mortgages,” “mortgage loan fund,” “bundled mortgage loans”\(^2\) or the “securitization of assets” are not considered mortgage loans within scope of this SSAP.

a. A security is a share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

i. It is either represented by an instrument issued in bearer or registered form, or if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.

ii. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

iii. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

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

(Excerpts from scope guidance)

2. Loan-backed securities are defined as securitized assets not included in structured securities, as defined below, for which the payment of interest and/or principal is directly proportional to the payments received by the issuer from the underlying assets, including but not limited to pass-through securities, lease-backed securities, and equipment trust certificates.

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\(^1\) Examples of agreements intended to be captured within this statement:

a. Reporting entity is a “co-lender” in a single mortgage loan agreement that identifies more than one lender (which includes the reporting entity) with the real estate collateral securing all lenders identified in the agreement. For these single-mortgage loan agreements, each lender is incorporated directly into the loan documents. The key differentiating characteristic of a mortgage loan provided under a group “mortgage loan co-lending agreement” rather than a solely owned mortgage loan is that no one lender of the lending group may unilaterally foreclose on the mortgage. With these agreements, the lenders must foreclose on the mortgage loan as a group.

b. Reporting entity has a “participation agreement” to invest in a single-mortgage loan. The reporting entity is not the lender of record named as a payee on the mortgage loan, but the lender of record sells a portion of the mortgage loan to the reporting entity through an assignment or participation interest under the participation agreement. Under a participation agreement, the reporting entity acquires an undivided interest in the single mortgage loan proceeds to be received by the lender of record. Under a participation agreement, single mortgage loan proceeds include the periodic mortgage loan principal and interest payments received by the lender of record, and all rights and proceeds received in the foreclosure of a mortgage, deed of trust, deed in lieu of foreclosure, or other similar proceeding by the lender of record. The amount of the proceeds to be received by the reporting entity is based on the ratio of its participation interest to the then-outstanding single mortgage loan balance. To qualify as a mortgage loan under the scope of this statement, the reporting entity must have a signed participation agreement with the lender of record named in the mortgage loan, the financial rights and obligations of the reporting entity under the participation agreement are the same as the lender of record, the reporting entity’s participation interest in the single mortgage loan proceeds must be pari-passu with the lender of record named on the mortgage loan agreement, and the participation agreement must be properly and promptly recorded on the lender or record’s books and records.

2 The scope of this SSAP is limited to single mortgage loan agreements. Although single mortgage loan agreements can potentially have more than one lender (e.g., co-lenders/participations) and more than one borrower (such as in a tenancy-in-common arrangement), the concept of a “single mortgage loan” does not include arrangements in which a reporting entity acquires more than one mortgage loan in a sole transaction. (For example, if a reporting entity was to acquire an interest in a “bundle” of mortgage loans with various unrelated borrowers and collateral, this agreement would be outside of the scope of this SSAP. However, a bundle of mortgage loans does not include a “bulk purchase” where the reporting entity’s interest in each mortgage loan is legally separate and divisible and the purchase just facilitates the acquisitions of multiple single mortgage loan agreements.)
3. Structured securities are defined as loan-backed securities which have been divided into two or more classes for which the payment of interest and/or principal of any class of securities has been allocated in a manner which is not proportional to payments received by the issuer from the underlying assets.

4. Loan-backed securities are issued by special-purpose corporations or trusts (issuer) established by a sponsoring organization. The assets securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee until the issuer’s obligation has been fully satisfied. The investor only has direct recourse to the issuer’s assets, but may have secondary recourse to third parties through insurance or guarantee for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying assets. Some sponsors do guarantee the performance of the underlying assets.

   a. In determining whether a loan-backed structure is a related party investment, consideration shall be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security. For example, although a loan-backed security may be acquired from a non-related issuer, if the assets held in trust predominantly\(^3\) reflect assets issued by affiliates of the insurance reporting entity, and the insurance reporting entity only has direct recourse to the assets held in trust, the transaction shall be considered an affiliated investment, and the transaction shall also subject to the accounting and reporting provisions in SSAP No. 25—Affiliates and Other Related Parties.

5. Mortgage-referenced securities do not meet the definition of a loan-backed or structured security but are explicitly captured in scope of this statement. In order to qualify as a mortgage-referenced security, the security must be issued by a government sponsored enterprise\(^4\) in the form of a “credit risk transfer” in which the issued security is tied to a referenced pool of mortgages. These securities do not qualify as “loan-backed securities” as the pool of mortgages are not held in trust and the amounts due under the investment are not backed or secured by the mortgage loans. Rather, these items reflect instruments in which the payments received are linked to the credit and principal payment risk of the underlying mortgage loan borrowers captured in the referenced pool of mortgages. For these instruments, reporting entity holders may not receive a return of their full principal as principal repayment is contingent on repayment by the mortgage loan borrowers in the referenced pool of mortgages. Unless specifically noted, the provisions for loan-backed securities within this standard apply to mortgage-referenced securities.

6. Investments within the scope of this statement are also subject to the provisions and disclosure requirements of SSAP No. 25 if the SSAP No. 43R transaction is a related party arrangement\(^5\). Loan-backed and structured securities meet the definition of assets as defined in SSAP No. 4—Assets and Nonadmitted Assets and are admitted assets to the extent they conform to the requirements of this statement and SSAP No. 25.

7. The scope of this statement encompasses all types of loan-backed and structured securities, including, but not limited to, the following:

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\(^3\) In applying this guidance, a reporting entity is not required to complete a detailed review of the assets held in trust to determine the extent, if any, the assets were issued by related parties. Rather, this guidance is a principle concept intended to prevent situations in which related party transactions (particularly those involving affiliates) is knowingly captured in a SSAP No. 43R structure and not identified as a related party transaction (or not reported as an affiliated investment on the investment schedule) because of the involvement of a non-related trustee or SSAP No. 43R security issuer. As identified in SSAP No. 25—Affiliates and Other Related Parties, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party arrangement.

\(^4\) Currently, only Fannie Mae and Freddie Mac are the government sponsored entities that issue qualifying mortgage-referenced securities. However, this guidance would apply to mortgage-referenced securities issued by any other government sponsored entity that subsequently engages in the transfer of residential mortgage credit risk.

\(^5\) As discussed in paragraph 4.a. of this statement, a SSAP No. 43R security may still be considered a related party transaction even if the asset trustee or security issuer is a non-related party.
a. Loan-backed and structured securities acquired at origination,

b. Loan-backed and structured securities acquired subsequent to origination for which it is probable, at acquisition, that the reporting entity will be able to collect all contractually required payments receivable, and are accounted for at acquisition under SSAP No. 103R,

c. Loan-backed and structured securities for which it is probable, either known at acquisition or identified during the holding period, that the reporting entity will be unable to collect all contractually required payments receivable, and

d. Transferor’s beneficial interests in securitization transactions that are accounted for as sales under SSAP No. 103R and purchased beneficial interests in securitized financial assets.

Designation Guidance

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

   a. Financial Modeling: The NAIC identifies securities where financial modeling must be used to determine the NAIC designation. NAIC designation based on financial modeling incorporates the insurers’ carrying value for the security. For those securities that are financially modeled, the insurer must use NAIC CUSIP specific modeled breakpoints provided by the modelers in determining initial and final designation for these identified securities. Securities where modeling results in zero expected loss in all scenarios are automatically considered to have a final NAIC designation of NAIC 1, regardless of the carrying value. The three-step process for modeled securities is as follows:

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

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

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

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6 Securities classified within the type of paragraph 7.a. or 7.b. may be required to change classification to type 6.c. when it becomes probable that the reporting entity will be unable to collect all contractually required payments receivable.

7 The accounting requirements related to these types of securities included in paragraphs 22-25 shall be determined at acquisition or initial transfer.
b. All Other Loan-Backed and Structured Securities: For loan-backed and structured securities not subject to paragraphs 27.a. (financial modeling) follow the established designation procedures according to the appropriate section of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. The NAIC designation shall be applicable for statutory accounting and reporting purposes (including determining the carrying value method and establishing the AVR charges). The carrying value method is established as described in paragraph 26. **Examples of these securities include, but are not limited to**, mortgage-referenced securities, equipment trust certificates, credit tenant loans (CTL), 5*/6* securities, interest only (IO) securities, securities with CRP ratings (excluding RMBS/CMBS), and loan-backed and structured securities with SVO assigned NAIC designations.

Note: This is the only reference to credit tenant loans in the AP&P Manual.

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 following items are noted as recent actions / projects by the Working Group:

- In agenda items 2018-22 and 2016-39, the Working Group clarified the scope guidance in SSAP No. 37. With these revisions (reflected in the cited guidance), the Working Group has clarified that the focus of SSAP No. 37 is on direct, single mortgage loan agreements that are not securities. These revisions have clarified that the scope of the SSAP does not include funds, securitizations, or “bundles” of mortgage loans.

- The Working Group has a current project to substantively review and revise SSAP No. 43R. Pursuant to agenda item 2019-21, the original focus was on “equity” related items (such as collateralized fund obligations), but the scope of the project has been expanded to include a complete review of SSAP No. 43R. The initial discussion draft issue paper was exposed in March 2020 with a comment period ending July 31, 2020. This initial exposure focused initial review of broad groupings of assets and did not address investments addressed in the *Purposes and Procedures Manual*. The issue paper noted that these VOSTF-related items were pending development and would be addressed in subsequent exposures.

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, initially categorized as nonsubstantive and expose the agenda item to solicit comment before directing NAIC staff on the desired guidance for CTLs. There are two general options:

- **Option 1: SSAP No. 43R for Conforming CTLs (this includes CTLs With SVO-Identified Bond Characteristics Acquired Prior to Jan. 1, 2020 as detailed in the P&P Manual)** – With this option, statutory accounting will continue with historical application and keep CTLs that are identified to have bond characteristics, after review by the SVO, in scope of SSAP No. 43R and reported on Schedule D as bonds. If selecting this option, the Working Group should also advise if they would prefer for the nonqualifying CTLs to be in scope of SSAP No. 37—Mortgage Loans and reported on Schedule B, or if they want these investments to be considered an “other invested asset” under SSAP No. 21 and reported on Schedule BA. (Note: The SVO will only review non-conforming CTLs held prior to Jan. 1, 2020 for bond characteristics. As such all non-conforming CTLs acquired after Jan. 1, 2020 will not be in scope of SSAP No. 43R.)
If selecting this option, NAIC staff will propose edits to SSAP No. 43R to explicitly include in scope CTLs that are included on an SVO-Identified listing based on a structural analysis. Furthermore, revisions will be proposed to either SSAP No. 37 or SSAP No. 21R—*Other Invested Assets* to capture CTL type structures that are not on the SVO identified listing.

**Option 2: SSAP No. 21 for All CTLs** – With this option, statutory accounting revisions will be proposed to capture all CTLs in scope of *SSAP No. 21—Other Invested Assets* and reported on Schedule BA. With this approach, all CTLs will be reported on the same schedule, and revisions will be proposed to allow CTLs that are reviewed and approved by the NAIC SVO to be reported with an NAIC designation. This process will be similar to the existing approach for other non-bond items reported on Schedule BA that have underlying characteristics of fixed income instruments. With this approach, there will be no need to reference an SVO-Identified listing of qualifying CTLs in SSAP No. 21R. Pursuant to the *Purposes and Procedures Manual*, CTLs will not qualify as filing exempt, and a CTL would need an SVO-provided NAIC designation if there was a desire to obtain a more favorable RBC. (Only CTLs the SVO determines qualify to receive an NAIC designation will be assigned one and will be identified on a separate listing maintained and published by the SVO.) (Under existing RBC parameters, the ability for a more favorable RBC on Schedule BA based on NAIC designation is only permitted for life entities.)

In addition to exposing a direction, NAIC staff recommends notifying the Valuation of Securities (E) Task Force of this agenda item in response to their referral. With this notification, NAIC staff will request further confirmation that an SVO-Listing could be developed to capture the CTLs that meet the SVO’s structural and legal analysis and possess bond characteristics.

**Staff Review Completed by:**
Julie Gann - NAIC Staff
June 2020
Maintenance updates provide revisions to the *Accounting Practices and Procedures Manual*, such as editorial corrections, reference changes and formatting.

<table>
<thead>
<tr>
<th>SSAP/Appendix</th>
<th>Description/Revision</th>
</tr>
</thead>
<tbody>
<tr>
<td>SSAP No. 5R</td>
<td>Remove redundant paragraph references</td>
</tr>
<tr>
<td>SSAP No. 62R</td>
<td>Add a table that lists the questions addressed in SSAP No. 62R Exhibit A - Implementation Questions and Answers.</td>
</tr>
</tbody>
</table>

**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. 5R—Liabilities, Contingencies and Impairments of Assets**

24. Except for the measurement and recognition of continued guarantee obligations after the settlement of a contingent guarantee liability described in paragraph 25, and the provisions for SCAs detailed in paragraph 25—this standard does not describe in detail how the guarantor's liability for its obligations under the guarantee would be measured subsequent to initial recognition. The liability that the guarantor initially recognized in accordance with paragraph 20 would typically be reduced (as a credit to income) as the guarantor is released from risk under the guarantee. Depending on the nature of the guarantee, the guarantor's release from risk has typically been recognized over the term of the guarantee (a) only upon either expiration or settlement of the guarantee, (b) by a systematic and rational amortization method, or (c) as the fair value of the guarantee changes (for example, guarantees accounted for as derivatives). The reduction of liability does not encompass the recognition and subsequent adjustment of the contingent liability recognized under paragraph 8 related to the contingent loss for the guarantee. If the guarantor is required to subsequently recognize a contingent liability for the guarantee, the guarantor shall eliminate any remaining noncontingent liability for that guarantee and recognize a contingent liability in accordance with paragraph 8.

25. After recognition and settlement of a contingent guarantee liability in accordance with paragraph 8, a guarantor shall assess whether remaining potential obligations exist under the guarantee agreement. If the guarantor still has potential obligations under the guarantee contract, the guarantor shall recognize the remaining noncontingent guarantee that represents the current fair value of the potential obligation remaining under the guarantee agreement. This noncontingent guarantee liability shall be released in accordance with paragraph 24.

**SSAP No. 62R—Property and Casualty Reinsurance**

Add a table that lists the questions addressed in SSAP No. 62R Exhibit A - Implementation Questions and Answers.

**EXHIBIT A – IMPLEMENTATION QUESTIONS AND ANSWERS**

This exhibit addresses common questions regarding implementation of the property and casualty reinsurance accounting standards.
## Index to Questions

<table>
<thead>
<tr>
<th>No.</th>
<th>Question</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Applicability</strong></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>The accounting practices in SSAP No. 62R specify the accounting and reporting for reinsurance contracts. What contracts are considered reinsurance contracts for purposes of applying these accounting practices?</td>
</tr>
<tr>
<td>2</td>
<td>The provisions of this statement will apply to (a) reinsurance contracts entered into, renewed or amended on or after January 1, 1994, and (b) any other reinsurance contracts that are in force on January 1, 1995 and cover insurable events on the underlying insurance policies that occur on or after that date. What contracts would be exempt from the accounting rules included in SSAP No. 62R?</td>
</tr>
<tr>
<td>3</td>
<td>This statement is to be applied to contracts which are amended on or after January 1, 1994. What if the change in terms is not significant, or the terms changed have no financial effect on the contract?</td>
</tr>
<tr>
<td>4</td>
<td>Must the accounting provisions of SSAP No. 62R be applied to an otherwise exempt contract if the ceding entity pays additional premiums under the contract on or after January 1, 1994?</td>
</tr>
<tr>
<td>5</td>
<td>Prospective and retroactive portions of a reinsurance contract are allowed to be accounted for separately, if practicable. Can the retroactive portion of an existing contract be segregated and, therefore, exempted with other retroactive contracts covering insured events occurring prior to January 1, 1994?</td>
</tr>
<tr>
<td><strong>Risk Transfer</strong></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Do the risk transfer provisions apply to existing contracts?</td>
</tr>
<tr>
<td>7</td>
<td>How does the effective date affect the assessment of whether a significant loss to the reinsurer was reasonably possible?</td>
</tr>
<tr>
<td>8</td>
<td>Should risk transfer be reassessed if contractual terms are subsequently amended?</td>
</tr>
<tr>
<td>9</td>
<td>How should the risk transfer assessment be made when a contract has been amended?</td>
</tr>
<tr>
<td>10</td>
<td>For purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract?</td>
</tr>
<tr>
<td>11</td>
<td>If the assessment of risk transfer changes after the initial assessment at contract inception, how should the ceding entity account for the change?</td>
</tr>
<tr>
<td>12</td>
<td>SSAP No. 62R requires that reasonably possible outcomes be evaluated to determine the reinsurer’s exposure to significant loss. What factors should be considered in determining whether a scenario being evaluated is reasonably possible?</td>
</tr>
<tr>
<td>13</td>
<td>In determining the amount of the reinsurer’s loss under reasonably possible outcomes, may cash flows directly related to the contract other than those between the ceding and assuming companies, such as taxes and operating expenses of the reinsurer, be considered in the calculation?</td>
</tr>
<tr>
<td>No.</td>
<td>Question</td>
</tr>
<tr>
<td>-----</td>
<td>----------</td>
</tr>
<tr>
<td>14</td>
<td>In evaluating the significance of a reasonably possible loss, should the reasonably possible loss be compared to gross or net premiums?</td>
</tr>
<tr>
<td>15</td>
<td>How does a commutation clause affect the period of time over which cash flows are evaluated for reasonably possibility of significant loss to the reinsurer?</td>
</tr>
<tr>
<td>16</td>
<td>SSAP No. 62R refers to payment schedules and accumulating retentions from multiple years as features that delay timely reimbursement of claims. Does the presence of those features generally prevent a contract from meeting the conditions for reinsurance accounting?</td>
</tr>
<tr>
<td>17</td>
<td>What if a contract contains a feature such as a payment schedule or accumulating retention but could still result in the reasonable possibility of significant loss to the reinsurer?</td>
</tr>
<tr>
<td>18</td>
<td>Can a reinsurance agreement compensate a reinsurer for losses?</td>
</tr>
<tr>
<td>19</td>
<td>In determining whether a reinsurance contract qualifies under the exception referred to in paragraph 18, how should the economic position of the reinsurer be assessed in relation to that of the ceding entity?</td>
</tr>
</tbody>
</table>

**Accounting Provisions**

<table>
<thead>
<tr>
<th>No.</th>
<th>Question</th>
</tr>
</thead>
<tbody>
<tr>
<td>20</td>
<td>An existing contract that was accounted for as reinsurance no longer qualifies for reinsurance accounting under the accounting rules included in SSAP No. 62R. How should the ceding and assuming companies account for the contract in future periods?</td>
</tr>
<tr>
<td>21</td>
<td>What is the definition of past insurable events that governs whether reinsurance coverage is prospective or retroactive? For example, could a reinsurance contract that covers losses from asbestos and pollution claims on occurrence-based insurance policies effective during previous periods be considered prospective if the reinsurance coverage is triggered by a court interpretation that a loss is covered within the terms of the underlying insurance policies?</td>
</tr>
<tr>
<td>22</td>
<td>Would the answer to the above question change if the reinsurance were written on a claims-made basis?</td>
</tr>
<tr>
<td>23</td>
<td>What is the effect of adjustments to future premiums or coverage in determining whether reinsurance is prospective or retroactive?</td>
</tr>
<tr>
<td>24</td>
<td>A reinsurance contract is entered into after the contract’s effective date. Is the coverage between the contract’s effective date and the date the contract was entered into prospective or retroactive?</td>
</tr>
<tr>
<td>25</td>
<td>How is the date the reinsurance contract was entered into determined?</td>
</tr>
<tr>
<td>26</td>
<td>Are contracts to reinsure calendar-year incurred losses considered blended contracts that have both prospective and retroactive elements?</td>
</tr>
<tr>
<td>27</td>
<td>When the prospective and retroactive portions of a contract are being accounted for separately, how should premiums be allocated to each portion of the contract?</td>
</tr>
<tr>
<td>No.</td>
<td>Question</td>
</tr>
<tr>
<td>-----</td>
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</tr>
<tr>
<td>28</td>
<td>A retroactive reinsurance contract contains a cut-through provision that provides the ceding entity’s policyholders and claimants with the right to recover their claims directly from the reinsurer. May the ceding entity immediately recognize earned surplus associated with this type of contract?</td>
</tr>
<tr>
<td>29</td>
<td>A ceding entity enters into a retroactive reinsurance agreement that gives rise to segregated surplus. If the reinsurer prepays its obligation under the contract, may the ceding entity recognize earned surplus at the time the prepayment is received?</td>
</tr>
<tr>
<td>30</td>
<td>If the ceding entity does not expect to receive any recoveries because the reinsurer has agreed to reimburse claimants under the reinsured contracts directly, would the ceding entity be considered to have recovered or terminated its transferred liabilities?</td>
</tr>
<tr>
<td>31</td>
<td>What accounting entries would a ceding entity make to report a retroactive reinsurance contract?</td>
</tr>
<tr>
<td>32</td>
<td>How should the parties account for an adverse loss development reinsurance contract where, as of the statement date, the attachment level of the contract exceeds the ceding company’s current case and IBNR reserves for the covered accident years (i.e. no surplus gain and no reinsurance recoverable as of the statement date), and the ceding company transferred cash to the reinsurer at the inception of the contract?</td>
</tr>
<tr>
<td>33</td>
<td>How should a ceding company account for payment of the premium for a retroactive reinsurance contract by the ceding company’s parent company or some other person not a party to the reinsurance contract (for example, adverse loss development reinsurance contracts purchased by the parent company in the context of the purchase or sale of the ceding company)?</td>
</tr>
</tbody>
</table>

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

Issue: ASU 2015-10, Technical Corrections & Improvements

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:
FASB issued ASU 2015-10, Technical Corrections & Improvements to update various FASB Accounting Standards Codification for minor corrections that were provided by stakeholders. FASB added a standing project to address feedback received from stakeholders on Codification and to make other incremental improvements to U.S. GAAP. This perpetual project will update Codification for technical corrections, clarifications and improvements.

Existing Authoritative Literature:
The table starting on page 2 summarizes the updates in this ASU, as well as defines the recommended actions for statutory accounting.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): 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 Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2015-10, Technical Corrections & Improvements as not applicable for statutory accounting.

Staff Review Completed by:
Jim Pinegar and Fatima Sediqzad - NAIC Staff
April 2020
The last column lists the status of the GAAP source literature for statutory accounting and the recommended action.

<table>
<thead>
<tr>
<th>Topic</th>
<th>ASC Reference</th>
<th>Abbreviated Summary of Change</th>
<th>Related Paragraphs</th>
<th>SAP Status/Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discontinued Operations</td>
<td>105-10-65-3</td>
<td>Transition related to ASU 2015-10</td>
<td>5</td>
<td>This update is not applicable – no action required.</td>
</tr>
<tr>
<td></td>
<td>205-20-45-1D</td>
<td>If the one-year requirement in paragraph 205-20-45-1E(d) is met, a business or nonprofit activity shall be classified as held for sale as a discontinued operation at the acquisition date if the other criteria in paragraph 205-20-45-1E (effectively ready and being marketed for sale) are probable of being met within a short period following the acquisition (usually within three months).</td>
<td>6-7</td>
<td>Guidance for discontinued operations is in SSAP No. 24 – in that discontinued operations shall be reported with the entity’s reporting of continuing operations. This update is not applicable – no action required.</td>
</tr>
<tr>
<td>Statements of Cashflows</td>
<td>230-10-45-20</td>
<td>Updates the term <em>market value</em> to <em>fair value</em>.</td>
<td>8-11</td>
<td>Security classifications, trading, held to maturity, etc., are not utilized for statutory accounting purposes. However, SSAP Nos. 26R, 37, 43R, already reference fair value in lieu of market value. This update is not applicable – no action required.</td>
</tr>
<tr>
<td></td>
<td>255-10-55-2</td>
<td>Cash receipts and cash payments resulting from purchases and sales of other securities and other assets shall be classified as operating cash flows if those assets are acquired specifically for resale and are carried at fair value in a trading account.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personal Financial Statements</td>
<td>274-10</td>
<td>The example provided was an error and did not correctly illustrate the demonstrated disclosure.</td>
<td>12-14</td>
<td>This update is not applicable – no action required.</td>
</tr>
<tr>
<td>Receivables – Overall</td>
<td>310-10-35</td>
<td>1. Heading changes to certain sections to ease of finding certain information</td>
<td>15-21</td>
<td>Bullets #1 and #3 are not applicable.</td>
</tr>
<tr>
<td></td>
<td>310-10-45</td>
<td>2. Removed additional explanatory language regarding impairment loss based on the fair value of collateral</td>
<td></td>
<td>Bullet #2 is referenced in SSAP No. 37 – which contains language regarding the impairment measurement based on the fair value of collateral less costs to</td>
</tr>
<tr>
<td>Receivables – Nonrefundable Fees and Other Costs</td>
<td>310-20-35 310-20-50</td>
<td>Discusses the immediate expensing and related disclosures of certain origination costs associated with the issuance of a credit card that is not a private label credit card.</td>
<td>22-24</td>
<td>Private label credit cards are not addressed in statutory accounting.</td>
</tr>
<tr>
<td>Receivables – Loans and Debt Securities Acquired with Deteriorated Credit Quality</td>
<td>310-30-35-10</td>
<td>Sentence structure changes for ease of reading. The primary change was the location of the verbiage “based on current information,” when determining impairment of certain loans.</td>
<td>25-26</td>
<td>SSAP No. 26R—Bonds &amp; SSAP No. 37—Mortgage Loans most closely matches the topic covered. However existing language in the AP&amp;P manual is deemed appropriate and does not warrant the change notated.</td>
</tr>
<tr>
<td>Investments – Debt and Equity Securities</td>
<td>320-10-15-7</td>
<td>Sentence structure to clarify that equity securities accounted for under the cost method are excluded fair value reporting.</td>
<td>27-28</td>
<td>Update is not applicable – reporting of securities at an amortized cost of fair value is a function of NAIC designations and if the reporting entity maintains an asset valuation reserve.</td>
</tr>
<tr>
<td>Readily Determinable Fair Value</td>
<td>Master Glossary Term</td>
<td>Updates to the master glossary that the definition of readily determinable fair value may be applied to investments in a mutual fund or in a similar structure if the fair value per share is determined and published and is the basis for current transactions.</td>
<td>29-30</td>
<td>Fair value is more broadly defined in SSAP No. 100R and in addition, fair value reporting of equity securities (including mutual funds) is already required in SSAP No. 30R.</td>
</tr>
<tr>
<td>Topic</td>
<td>Section Numbers</td>
<td>Description</td>
<td>Page Numbers</td>
<td>Notes</td>
</tr>
<tr>
<td>-------------------------------------------</td>
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</tr>
<tr>
<td>Recognition &amp; Derecognition</td>
<td>320-10-25-20 &amp; 320-10-40-3</td>
<td>Updates that state an investor shall account for two structured notes as a single until one is sold, at which time the notes shall be measured in the same way as a participating interest.</td>
<td>31-32</td>
<td>Update is not applicable – reporting of structured securities is defined in SSAP No. 43R, which utilizes NAIC designations and if the reporting entity maintains an asset valuation reserve for deterring the appropriate accounting and reported method. This update is not applicable – no action required.</td>
</tr>
<tr>
<td>Investments—Other—Beneficial Interests</td>
<td>325-40-55-1</td>
<td>Update discusses the treatment for accretion yield should an other-than-temporary impairment occur. Original guidance stated the accretion yield should be revised to ‘market rate.” Updated guidance states the yield is not changes as a result of recognizing OTTI. However, the yield may be changed prospectively for non-credit related factors.</td>
<td>33-34</td>
<td>SSAP No. 43R details the treatment for accretion yield for beneficial interests after an OTTI has been recognized. AP&amp;P guidance states an accretion adjustment shall be made for the remaining life of the beneficial interest – a position more conservative than in this ASU. As such, no changes are recommended. This update is not applicable – no action required.</td>
</tr>
<tr>
<td>Liabilities—Extinguishment of Liabilities</td>
<td>405-20-55-4</td>
<td>Paragraph wording update, removing the language, “under the financial components approach,” which may have implied that an alternative approach was available when analyzing the liability extinguishment in certain in-substance defeasance transactions.</td>
<td>35-36</td>
<td>SSAP No. 103R does not contain such language. As such, the ambiguity of regarding an alternative approach for review for these types of transactions does not exist. This update is not applicable – no action required.</td>
</tr>
<tr>
<td>Asset Retirement and Environmental Obligations</td>
<td>410-30-35-7</td>
<td>Removal of inconsequential wording, “Remediation technology is changing constantly, and, in many cases, new</td>
<td>37-38</td>
<td>While remediation is notated in the AP&amp;P manual, this specific verbiage was not included.</td>
</tr>
<tr>
<td>Category</td>
<td>Reference</td>
<td>Description</td>
<td>Pages</td>
<td>Notes</td>
</tr>
<tr>
<td>--------------------------------------------</td>
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</tbody>
</table>
| Guarantees – Overall                         | 460-10-05-3 | Removal of references to subordination agreements.                                                                                                                                                           | 39-41 | Subordination agreements are excluded from the definition of indemnifications or guarantees in statutory accounting.  
This update is not applicable – no action required. |
| Participating Mortgage Loans                 | 470-30-35-4 | The GAAP codification condensed the accounting practices for two different types of mortgage participations (those related to the results of the operations and those related to market value appreciation).                       | 42-44 | The accounting for loan-backed participating securities is not bifurcated depending on the type of participation. SSAP No. 43R defines the presentation, recognition, impairment, etc. for such activities.  
This update is not applicable – no action required. |
| Participating Mortgage Loans                 | 470-30-35-4A |                                                                                                                                                                                                          |       |       |
| Receivables for Issuance of Equity          | 505-10-45-2 | The update removes non-guidance commentary and adds reference to another authoritative paragraph stating that generally notes received for the issuance of equity typically require a deduction of the receivable from equity. | 45-46 | SSAP No. 72, paragraph 4 details that notes or other receivables for the issuance of stock which have been approved by the domiciliary commissioner and met other criterion, are considered admitted assets. If not met, the note receivable is nonadmitted.  
This update is not applicable – no action required. |
| Revenue Recognition—Multiple Element Arrangements | 605-25-15-3A | The update includes references to additional paragraphs relevant to an entity’s determination of how to allocate arrangement consideration in accordance with the relative selling price method, from ASU 2009-13, Revenue Recognition: Multiple-Deliverable Revenue Arrangements. | 47-48 | Multiple-deliverable revenue arrangements are not applicable to statutory accounting.  
This update is not applicable – no action required. |
<table>
<thead>
<tr>
<th>Topic</th>
<th>Reference</th>
<th>Description</th>
<th>Page</th>
<th>Note</th>
</tr>
</thead>
</table>
| Compensation—Retirement Benefits—Defined Benefit Plans—Pensions | 715-30-55-63 715-80-50-5(e) | Removes an incorrect reference to nonpublic entities (instead of not-for-profit entities) and edits one sentence related to a NFP’s financial statement issuance | 49-51 | Specific guidance for NFP’s is not applicable for SSAP.  
*This update is not applicable – no action required.* |
| Compensation—Stock Compensation—Employee Stock Ownership Plans | 718-40 | Correction of the definition of fair value in the glossary for topic 718-40 (Stock Compensation) to effectively replace “could be” with “would be” in the following: The price that could be received to sell an asset or paid to transfer a liability…”. Additional guidance is given related to a transition period for the update. | 52-56 | SSAP No. 104R details share-based payments and its definition of fair value does not contain the affected language in the ASU update.  
*This update is not applicable – no action required.* |
| Other Presentation Matters | 718-740 | Corrects a reference in the applicable Subtopic regarding measuring actual tax deductions as a result of excess tax benefits. | 57-58 |  
*This update is not applicable – no action required.* |
| Income Taxes—Overall | 740-10 | Replaces the term “uncertain tax positions” with the broader term “uncertainty in income taxes.” Additional guidance is given regarding the scope to which entities the update applies. | 59-62 | Previous guidance regarding uncertain tax positions is still pending for statutory accounting.  
*This update is not applicable – no action required.* |
| Income Taxes—Other | 740-30 | Eliminates the term subsidiary from the glossary of Subtopic 740-30. | 63-67 | Statutory accounting has a separate definition for the term subsidiary.  
*This update is not applicable – no action required.* |
| Business Combinations—Overall | 805-10 | Moves a paragraph that is codified in the incorrect Subtopic to the correct Subtopic. | 68-69 | Previous guidance over an incomplete business combination has been rejected for statutory accounting.  
*This update is not applicable – no action required.* |
<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Section(s)</th>
<th>Description</th>
<th>Page</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Combinations—Identifiable Assets and Liabilities, and Any Noncontrolling Interest</td>
<td>805-20</td>
<td>Amend a paragraph and add a paragraph with no link to a transition paragraph.</td>
<td>70</td>
<td>Relevant paragraphs refer to business combinations, which are accounted for differently under statutory accounting. <strong>This update is not applicable – no action required.</strong></td>
</tr>
<tr>
<td>Not-for-Profit Entities—Business Combinations</td>
<td>958-805</td>
<td>Updates a paragraph reference.</td>
<td>71</td>
<td><strong>This update is not applicable – no action required.</strong></td>
</tr>
<tr>
<td>Derivatives and Hedging—Overall</td>
<td>815-10</td>
<td>Replaces the word “available” with the word “obtainable” to make this paragraph consistent with terminology in Topic 860.</td>
<td>72-73</td>
<td>SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities already utilizes the term obtainable. <strong>This update is not applicable – no action required.</strong></td>
</tr>
<tr>
<td>Derivatives and Hedging—Hedging—General</td>
<td>815-20</td>
<td>Changes an incorrect reference in paragraph 815-20-25-2, which currently references a paragraph that is not used in Codification.</td>
<td>74-77</td>
<td><strong>This update is not applicable – no action required.</strong></td>
</tr>
<tr>
<td>Derivatives and Hedging—Fair Value Hedges</td>
<td>815-25</td>
<td>Adds guidance on loans that are hedged items in a fair value hedge to the “recorded investment” definition.</td>
<td>78-80</td>
<td>Not a term in statutory accounting. <strong>This update is not applicable – no action required.</strong></td>
</tr>
<tr>
<td>Fair Value Measurement—Overall</td>
<td>820-10</td>
<td>Exemption to requirement to measure fair value in Topic 958 originated from an incorrect codification of the basis for conclusions in FASB Statement No. 116, Accounting for Contributions Received and Contributions Made.</td>
<td>81-86</td>
<td><strong>This update is not applicable – no action required.</strong></td>
</tr>
<tr>
<td>Transfers and Servicing—Overall</td>
<td>860-10</td>
<td>Adds a link to the Master Glossary definition of the term “attached call option” and the term “attached call” is updated to “attached call option.”</td>
<td>87-92</td>
<td>The minor (single word) definitional update is not substantially material, to justify adoption. Exhibit A in SSAP No. 103R already appropriately references and defines an “Attached Call” as a “call option…”</td>
</tr>
<tr>
<td>Section</td>
<td>Update Description</td>
<td>Reference</td>
<td>Notes</td>
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<tr>
<td>860-20</td>
<td>Eliminates sentence that refers to initial measurement, which is covered in sections 815-10-30 and 860-20-30.</td>
<td>93-94</td>
<td>Removal of sentence is not necessary. This update is not applicable – no action required.</td>
<td></td>
</tr>
<tr>
<td>944-30</td>
<td>Conforms terminology in Subtopic 944-30 with the revised criteria for deferred acquisition cost capitalization established by ASU 2010-26, Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts.</td>
<td>95-96</td>
<td>Capitalization of deferred acquisition costs is not a concept recognized by statutory accounting. This update is not applicable – no action required.</td>
<td></td>
</tr>
<tr>
<td>958-10</td>
<td>Simplifies and provides a more relevant example for this guidance.</td>
<td>97-98</td>
<td>Specific guidance for NFP’s is not applicable for SSAP. This update is not applicable – no action required.</td>
<td></td>
</tr>
<tr>
<td>958-205</td>
<td>Clarifies and illustrates the accounting for situations resulting in the expiration of donor-imposed restrictions.</td>
<td>99-100</td>
<td>Donor-imposed restrictions is not a concept recognized by statutory accounting. This update is not applicable – no action required.</td>
<td></td>
</tr>
<tr>
<td>958</td>
<td>Eliminates the term “agency transactions” and updates all links to the term “agency transaction” as they have the same definition.</td>
<td>101-107</td>
<td>This update is not applicable – no action required.</td>
<td></td>
</tr>
<tr>
<td>958-605</td>
<td>Eliminates the link to one of two separate definitions of the term “control.” There cannot be two identical terms in the same Subtopic.</td>
<td>108-110</td>
<td>Statutory accounting uses an alternative definition for the term “control.” This update is not applicable – no action required.</td>
<td></td>
</tr>
<tr>
<td>958-810</td>
<td>Clarifies that the economic interest must be in the controlled not-for-profit entity, instead of using the vague phrase “other such organizations.”</td>
<td>111-112</td>
<td>Statutory accounting uses an alternative definition for the term “control.”</td>
<td></td>
</tr>
<tr>
<td>Amendments to SEC Materials</td>
<td>113-118</td>
<td>This update is not applicable – no action required.</td>
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<tr>
<td>Amendments to Status Sections</td>
<td>119-164</td>
<td>This update is not applicable – no action required.</td>
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Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: ASU 2019-09, Financial Services – Insurance; Effective Date

Check (applicable entity):

<table>
<thead>
<tr>
<th>Modification of Existing SSAP</th>
<th>P/C</th>
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<th>Health</th>
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<td>Interpretation</td>
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Description of Issue: FASB issued ASU 2019-09, Financial Services – Insurance to defer the effective date of the amendments in ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts.

ASU 2018-12 was issued to improve U.S. GAAP recognition, measurement, presentation and disclosure requirements for long-duration contracts issued by an insurance entity. ASU 2018-12 had four primary areas of focus:

1. Assumptions - requires assumptions to be updated, and eliminates the U.S. GAAP provisions for risk of adverse deviation and premium deficiency testing.

2. Market Risk Benefits – requires all market risk benefits associated with deposit (or account balance contracts) to be measured at fair value.

3. Deferred Acquisition Costs - requires that deferred acquisition costs be amortized on a constant basis over the expected life of the contract.

4. Disclosures - requires new disclosures, predominantly in the form of rollforwards, to enable users to evaluate the amount, timing and uncertainty of cash flows arising from long-duration contracts.

Early adoption is permitted, however for most public entities ASU 2018-12 is now effective for fiscal years beginning after December 15, 2021. For all other entities, the effective date is for fiscal years beginning after December 15, 2023.

While minor edits were adopted to the Preamble, ASU 2018-12 was rejected for statutory accounting. The sole function of ASU 2019-09 is to extend the effective date for ASU 2018-12.

Existing Authoritative Literature: As previously noted, ASU 2018-12 was rejected for statutory accounting.

References from Appendix D – Cross-Reference to SAP:

<table>
<thead>
<tr>
<th>GAAP Pronouncement</th>
<th>Name</th>
<th>Status</th>
<th>Disposition</th>
<th>Statutory Reference</th>
</tr>
</thead>
</table>

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: As ASU 2019-09 solely addresses the effective date of ASU 2018-12, which was previously rejected for statutory accounting, in the Preamble 50, 51R, 52, 54R, 55, 56, 71, 86. NAIC staff recommends rejecting ASU 2019-09 in Appendix D—Nonapplicable GAAP Pronouncements, as the pronouncement relates to transition of a previously issued GAAP pronouncement.

Convergence with International Financial Reporting Standards (IFRS): N/A in relation to this agenda item.

Staff Recommendation:
NAIC Staff recommends the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2019-09—Financial Services – Insurance as not applicable for statutory accounting. This ASU solely addresses the effective date of ASU 2018-12, which was rejected by the Statutory Accounting Principles (E) Working Group on Aug. 3, 2019.

Staff Note: On June 10, 2020, the FASB exposed a proposed ASU, for a 45-day comment period, that would grant insurance companies that issue long-duration contracts, such as life insurance and annuities, an additional year to implement Accounting Standards Update No. 2018-12, Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts. Under the proposal, the implementation of the insurance standard would be delayed by another year. Public insurers, excluding small public companies, could delay implementing the standard to fiscal years after Dec. 15, 2022, while all others could wait until fiscal years after Dec. 15, 2024. As ASU 2018-12 was rejected for SAP, it is anticipated that this extension will also be rejected as not applicable for statutory accounting once the ASU is final. This notice is just intended to advise of the further extension of the effective date.

Staff Review Completed by: Jim Pinegar, NAIC Staff – April 2020
Issue: ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815

Check (applicable entity):

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Description of Issue: In Jan. 2016, FASB issued ASU 2016-01, Financial Instruments, Recognition and Measurement of Financial Assets and Financial Liabilities, which allows an entity to measure certain equity securities (without a readily determinable fair value) at cost, less any impairments. This alternative measurement method and ASU 2016-01 were rejected for statutory accounting.

ASU 2020-01 addresses stakeholder questions regarding accounting for the transition between the alternative measurement method allowed in ASU 2016-01 (at cost, less impairments) to the equity method of accounting. Investments that are accounted for under the equity method of accounting are excluded from the fair value instrument disclosures in SSAP No. 100R—Fair Value.

Two main issues are discussed in this ASU:

- **Issue 1: Accounting for Certain Equity Securities upon the Application or Discontinuation of the Equity Method of Accounting:** The amendments in ASU 2020-01 clarify that an entity should consider observable transactions that require it to either apply or discontinue the equity method of accounting for the purposes of applying the measurement alternative in accordance with Topic 321-Investments-Equity Securities immediately before applying or upon discontinuing the equity method. Paragraphs were amended in Topics 321 and 323 to state that an entity should remeasure the security upon adopting the equity method of accounting or upon discontinuance of the equity method, respectively. The value would then be applied to retained earnings. (Although the alternative measurement method under ASU 2016-01 was rejected, reporting entities can use the market value method instead of the equity method, if they qualify under SSAP No. 97. Under statutory accounting, a change to or from the equity method of accounting from the market value method must be approved by the commissioner. When this occurs, the investment is adjusted the reporting the equity interest in the SCA entity under the new method, with the difference recognized as an unrealized gain or loss.)

- **Issue 2: Scope Considerations for Forward Contracts and Purchased Options on Certain Securities:** The amendments in this ASU clarify that an entity should not consider whether, upon the settlement of the forward contract or exercise of the purchased option, individually or with existing investments, the underlying securities would be accounted for under the equity method in Topic 323: Investments-Equity Method and Joint Ventures or the fair value option in accordance with the financial instruments guidance in Topic 815: Derivatives and Hedging. An entity would also evaluate the remaining characteristics to determine the accounting for those forward contracts and purchased options. Amendments to Topic 815 were added to explain that the guidance in the Certain Contracts on Debt and Equity Securities subsections apply to those forward contracts and purchased options that are not derivative
instruments, but that involve the acquisition of securities that will be accounted for under Topic 321-Equity Securities.

For statutory accounting, EITF 96-11, Accounting for Forward Contracts and Purchased Options to Acquire Securities Covered by FASB Statement No. 115 was previously rejected. As such, this topic is not part of statutory accounting.

Existing Authoritative Literature:

**SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies** (bolding for emphasis)

6. **Investments in these ventures, except for joint ventures, partnerships and limited liability companies with a minor ownership interest**, shall be reported using an equity method as defined in **SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, paragraphs 8.b.i. through 8.b.iv.** A reporting entity whose shares of losses in a SSAP No. 48 entity exceeds its investment in the SSAP No. 48 entity shall disclose the information required by SSAP No. 97, paragraph 35.a.

10. The **amount to be recorded shall be defined as the initial investment in an investee at cost** (as defined in paragraph 3 of **SSAP No. 68—Business Combinations and Goodwill**) plus subsequent capital contributions to the investee. The carrying amount of the investment shall be adjusted for the amortization of the basis difference (difference between the cost and the underlying GAAP equity), as well as to recognize the reporting entity’s share of: (i) the audited U.S. GAAP basis earnings or losses of the investee after the date of acquisition, adjusted for any distributions received, or (ii) if audited U.S. GAAP basis financial statements of the investee are not available, the earnings or losses of the investee after the date of acquisition, adjusted for any distributions received, based on either one of the valuation methodologies allowed under paragraphs 9.a. or 9.b. A reporting entity’s share of adjustments, excluding changes in capital contributions to the investee, that are recorded directly to the investee’s stockholders’ equity shall also be recorded as adjustments to the carrying value of the investment with an offsetting amount recorded to unrealized capital gains and losses on investments.

**SSAP No. 86—Derivatives** (bolding for emphasis)

18. **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.** **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 44-48 of SSAP No. 100R—Fair Value.** Derivative instruments used in hedging, income generation or replication (synthetic asset) transactions shall be recognized and measured in accordance with the specific provisions within this statement and are admitted assets to the extent they conform to the requirements of this statement.

**SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities** (bolding for emphasis)

4. **An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in SSAP No. 48—Joint Ventures, Partnerships and Limited Liability**

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1 With the identification of whether the reporting entity has a minor ownership interest, reporting entities must also identify whether the investment is a related-party transaction. Pursuant to the concepts reflected in **SSAP No. 25—Affiliates and Other Related Parties,** consideration shall be given to the substance of the transaction and the parties whose action or performance materially impacts the insurance reporting entity holding the security. For example, if the underlying assets within a SSAP No. 48 entity represent assets issued by an affiliate, then the SSAP No. 48 entity shall be considered a related party (affiliate) investment, with the transaction subject to the accounting and reporting provisions of SSAP No. 25. As identified in SSAP No. 25, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party arrangement.
Companies. Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments.

5. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by common management, or (d) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity\(^2\).

6. Control as defined in paragraph 5 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13% and therefore each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting securities of an investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. An investment in an SCA entity may fall below the level of ownership described in paragraph 5, in which case, the reporting entity would discontinue the use of the equity method, as prescribed in paragraph 13.g. Additionally, through an increase in the level of ownership, a reporting entity may become qualified to use the equity method of accounting (paragraph 8.b.), in which case, the reporting entity shall add the cost of acquiring additional interest to the current basis of the previously held interest and shall apply the equity method prospectively, as of the date the investment becomes qualified for equity method accounting. Examples of situations where the presumption of control may be in doubt include the following:

   a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.

   b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.

   c. An entity where the insurer has given up participating rights\(^3\) as a shareholder to the investee.

13.g. An investment in a SCA entity may fall below the level of ownership described in paragraph 5 from the sale of a portion of an investment by the reporting entity, the sale of additional interests by an investee, or other transactions. The reporting entity shall discontinue accruing its share of the earnings or losses of the investee for an investment that no longer qualifies for an equity method. The earnings or losses that relate to the investment interests retained by the reporting entity and that were previously accrued shall remain as a part of the carrying amount of the investment. The investment account shall not be adjusted retroactively under the conditions described in this subparagraph. However, dividends received by the investor in subsequent periods which exceed the reporting entity’s share of earnings for such periods shall be applied as a reduction of the carrying amount of the investment.

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\(^2\) Investments in an exchange traded fund (ETF) or a mutual fund (as defined by the SEC) does not reflect ownership in an underlying entity, regardless of the ownership percentage the reporting entity (or the holding company group) has of the ETF or mutual fund unless ownership of the ETF actually results in “control” with the power to direct or cause the direction of management of an underlying company. ETFs and mutual funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws. ETFs and mutual funds held by a reporting entity shall be reported as common stock, unless the ETF qualifies for bond or preferred stock treatment per the Purposes and Procedures Manual of the NAIC Investment Analysis Office. Reporting entities are not required to verify that SCAs (subject to SSAP No. 97) are represented in the portfolio of securities held in ETFs or mutual funds or to adjust the value of SCAs as a result of investments in ETFs or mutual funds.

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\(^3\) The term “participating rights” refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee's ordinary course of business and is distinguished from the more limited type of rights referred to as “protective rights”. Refer to the sections entitled: “Protective Rights” and “Substantive Participating Rights” in EITF 96-16, Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights. The term “participating rights” shall be used consistent with the discussion of substantive participating rights in this EITF.
Once the reporting entity elects to use a valuation approach for a particular subsidiary, the reporting entity may not change the valuation method to another method without the approval of the domiciliary commissioner. For instance, if an entity selects the market valuation method, it may not change to an equity method or vice versa without approval from the domiciliary commissioner. Further, in order for an entity to transfer from a paragraph 8.a., or 8.b.ii. valuation to a paragraph 8.b.iii. valuation, the SCA shall not exceed the 20% threshold (as defined in paragraphs 8.b.ii.) for three consecutive years prior to making the change. When an investment qualifies for use of another method of accounting, the reporting entity shall adopt the new method of accounting and the investment shall be adjusted to reflect the reporting entity’s equity interest in the SCA entity under the new method. A corresponding amount shall be recorded as an unrealized gain or loss.

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): This ASU was issued to clarify ASU 2016-01, Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, which was rejected by the Working Group at the Summer 2016 National Meeting. ASU 2016-01 was rejected as SAP reporting classifications and valuation measurements differ from GAAP.

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:
Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to reject ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815 for statutory accounting. These revisions noting rejection are proposed to SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies, SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities and SSAP No. 86—Derivatives, as illustrated below.

SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies

28. This statement rejects ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815.

SSAP No. 86—Derivatives


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

48. This statement rejects ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815, ASU 2019-06, Intangibles—Goodwill and Other Business Combinations, and Non-for-Profit Entities, ASU 2011-10, Derecognition of in Substance Real Estate, APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock, AICPA Accounting Interpretations APB 18, The Equity Method of Accounting for Investments in Common Stock: Accounting Interpretations of APB Opinion No. 18, FASB Technical Bulletin No. 79-19, Investor’s Accounting for Unrealized Losses on Marketable Securities Owned by an Equity Method Investee, FASB Emerging Issues Task Force No. 87-21, Change of
Accounting Basis in Master Limited Partnership Transactions, FASB Emerging Issues Task Force No. 96-16, Investor’s Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights, FASB Emerging Issues Task Force No. 98-2: Accounting by a Subsidiary or Joint Venture for an Investment in the stock of Its Parent Company or Joint Venture Partner and FASB Staff Position No. APB 18-1, Accounting by an Investor for Its Proportionate Share of Accumulated Other Comprehensive Income of an Investee Accounted for under the Equity Method in Accordance with APB Opinion No. 18 upon a Loss of Significant Influence.

Staff Review Completed by:
NAIC Staff – Fatima Sediqzad
April 2020
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: ASU 2020-05—Effective Dates for Certain Entities

Check (applicable entity):

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Description of Issue:
FASB issued ASU 2020-05, Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842), Effective Dates for Certain Entities, which updates the effective dates for ASU 2014-19, Revenue from Contracts with Customers (Topic 606) and ASU 2016-02, Leases (Topic 842). Both ASU 2014-19 and ASU 2016-02 have been rejected for statutory accounting. The guidance in ASU 2020-05 defers the effective date for the prior ASUs by one year for companies that have not yet implemented the new guidance.

Existing Authoritative Literature:
The ASUs related to ASC Topic 606 have been rejected in SSAP No. 47—Uninsured Plans and the ASUs related to Topic 842 have been rejected in SSAP No. 22R—Leases.

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

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

Convergence with International Financial Reporting Standards (IFRS): ASC Topic 606 and 842 both result from joint projects FASB and IASB.

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2020-05, Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842), Effective Dates for Certain Entities as not applicable to statutory accounting.

This item is proposed to be rejected as not applicable as ASU 2020-05 only impacts the effective date for U.S. GAAP guidance that has been rejected for statutory accounting.

Staff Review Completed by: Jake Stultz, June 2020

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Issue: Premium Refunds and Other Adjustments

Check (applicable entity):

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

Description of Issue:
This agenda item is to provide more explicit guidance on return of premium and other premium adjustments. The discussion during the exposures of INT 20-08: COVID-19 Premium Refunds, Rate Reductions and Policyholder Dividends, highlighted the need for more explicit guidance regarding policyholder refunds and other premium adjustments for accident and health and property and casualty lines of business. The premium adjustments addressed will also address newer policy form types.

SSAP No. 53—Property and Casualty Contracts – Premiums provides guidance for premium adjustments due to changes to the level of exposure based on insurance risk. SSAP No. 66—Retrospectively Rated Contracts provides guidance for loss sensitive products. Some property and casualty products, which are commonly referred to as data telematics policies, provide premium adjustments for other reasons than what is articulated in the current guidance. One example of a data telematic policy would be the use of an automobile plug-in to determine driving habits of the insured for purposes of policy pricing. As such there is a need to provide principles-based guidance for these types of policies.

Existing Authoritative Literature:
- SSAP No. 53—Property Casualty Contracts—Premiums

SUMMARY CONCLUSION
3. Except as provided for in paragraph 4, written premium is 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 provided by the terms of the insurance contract. Frequently, insurance contracts are subject to audit by the reporting entity and the amount of premium charged is subject to adjustment based on the actual exposure. Premium adjustments are discussed in paragraphs 10-13 of this statement.

4. For workers’ compensation contracts, which have a premium that may periodically vary based upon changes in the activities of the insured, written premiums may be recorded on an installment basis to match the billing to the policyholder. Under this type of arrangement, the premium is determined and billed according to the frequency stated in the contract, and written premium is recorded on the basis of that frequency.

(paragraphs 5-8 omitted)

9. Additional premiums charged to policyholders for endorsements and changes in coverage under the contract shall be recorded on the effective date of the endorsement and accounted for in a manner consistent with the methods discussed in paragraphs 4-8. This is done so that, at any point in time, a liability is accrued for unearned premium related to the unexpired portion of the policy endorsement.
Earned but Unbilled Premium

10. Adjustments to the premium charged for changes in the level of exposure to insurance risk (e.g., audit premiums on workers’ compensation policies) are generally determined based upon audits conducted after the policy has expired. Reporting entities shall estimate audit premiums, the amount generally referred to as earned but unbilled (EBUB) premium, and shall record the amounts as an adjustment to premium, either through written premium or as an adjustment to earned premium. The estimate for EBUB may be determined using actuarially or statistically supported aggregate calculations using historical company unearned premium data, or per policy calculations.

11. EBUB shall be adjusted upon completion of the audit and the adjustment shall be recognized as revenue immediately. Upon completion of an audit that results in a return of premiums to the policyholder, earned premiums shall be reduced.

12. Reporting entities shall establish all of the requisite liabilities associated with the asset such as commissions and premium taxes. These liabilities shall be determined based on when premium is earned, not collected.1

13. Ten percent of EBUB in excess of collateral specifically held and identifiable on a per policy basis shall be reported as a nonadmitted asset. To the extent that amounts in excess of the 10% are not anticipated to be collected, they shall be written off against operations in the period the determination is made.

Earned but Uncollected Premium

14. Reporting entities may utilize a voluntary procedure whereby policies are not cancelled for non-payment of the premium until after an extended cancellation period (example 30 days), as opposed to the shorter statutory cancellation period. There are other instances when a reporting entity provides coverage for periods when the payment has not been received. Prior to the cancellation of the policy the reporting entity acknowledges it is “at risk” and subject to “actual exposure” for a valid claim despite the fact that the reporting entity may not have received payment of the premium for this exposure. Reporting entities shall record earned but uncollected premium as direct and assumed written premium since the reporting entity is “at risk” and subject to “actual exposure” for the extended period of time when the policy is still in force and effective, whether or not the reporting entity collects a premium for this time period. Earned but uncollected premium would be charged to expenses “net gain or (loss) from agents or premium balances charged off” when it is determined to be uncollectible.

- **SSAP No. 54 – Revised—Individual and Group Accident and Health Contracts** provides the following:

  Contracts Subject to Redetermination

27. This statement also applies to other contracts which are subject to redetermination such as Federal (and State) Groups - subject to rate adjustments through audits by the Office of Personnel Management (OPM). Reporting entities are required to give Federal Groups the lowest rates that are being charged to similar groups.

28. Amounts due from insureds or subscribers and amounts due to insureds or subscribers under contracts subject to redetermination meet the definitions of assets and liabilities as set forth in SSAP No. 4—Assets and Nonadmitted Assets and SSAP No. 5R, respectively.

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1 If an entity feels comfortable enough in their ability to collect the premium that an asset is recorded, they should also book the associated liabilities. Once an estimate of the premium has been made and the entity feels certain that it will be collected, it should also book the liabilities that will be due when they receive the cash. If the premiums were unearned and the policyholder had the ability to cancel, the definition of a liability has not been met.
29. Contract redeterminations shall be estimated based on the experience to date. The method used to estimate the liability shall be reasonable based on the reporting entity's procedures, and consistent among reporting periods. An examination of contract requirements in relation to the rates being charged and the current status of applicable audits (e.g., OPM, Centers for Medicare and Medicaid Services (or such other name that this entity shall be known as) and other Federal, state or government department) is a common method used to estimate such contract redeterminations.

30. Premium adjustments for contracts subject to redetermination are estimated for the portion of the policy period that has expired and shall be considered an immediate adjustment to premium. Accrued premium adjustments shall be recorded in premium and considerations receivable with a corresponding entry to written premiums. Accrued return premium adjustments shall be recorded as a liability with a corresponding entry to written premiums, the annual statement liability lines will vary by the type of annual statement the reporting entity files. Managed care/accident and health reporting entities report as aggregate health policy reserves; life and accident and health reporting entities report as aggregate reserves for accident and health contracts; property and casualty reporting entities report as aggregate write-ins for liabilities.

31. If, in accordance with SSAP No. 5R, it is probable that the additional premium adjustment is uncollectible, any uncollectible premium shall be written off against operations in the period the determination is made and the disclosure requirements outlined in SSAP No. 5R shall be made.

32. Premium adjustments for contracts subject to redetermination shall be determined and billed or refunded in accordance with the policy provisions or contract provisions. If such premiums are not billed in accordance with the policy provisions or contract provisions, or the policy provisions or contract provisions do not address the due date of such premiums, the accrual shall be nonadmitted. This is consistent with the guidance for audit premiums established in SSAP No. 6.

SSAP No. 66—Retrospectively Rated contracts is a common area statement and the entire statement is relevant.

SUMMARY CONCLUSION

3. A retrospectively rated contract is one which has the final policy premium calculated based on the loss experience of the insured during the term of the policy (including loss development after the term of the policy) and the stipulated formula set forth in the policy or a formula required by law. The periodic adjustments may involve either the payment of return premium to the insured or payment of an additional premium by the insured, or both, depending on experience. Retrospective rating features are common in certain property and casualty contracts, group life, and group accident and health contracts. Some contracts have retrospective features required by law. Contracts with retrospective rating features are referred to as loss sensitive contracts.

4. Amounts due from insureds and amounts due to insureds under retrospectively rated contracts meet the definitions of assets and liabilities as set forth in SSAP No. 4—Assets and Nonadmitted Assets and SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets, respectively. Amounts due from insureds and amounts due to insureds under retrospectively rated contracts are admitted assets to the extent they conform to the requirements of this statement.

5. Initial premiums shall be recognized in accordance with SSAP No. 51R—Life Contracts, SSAP No. 53—Property Casualty Contracts—Premiums, and SSAP No. 54R—Individual and Group Accident and Health Contracts.

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 development of INT 20-08: COVID-19 Premium Refunds, Rate Reductions and Policyholder Dividends highlighted the need for more explicit guidance regarding policyholder refunds and also highlighted the need for additional guidance regarding changes to property and casualty premium for reasons other than adjustments due to changes to loss sensitivity and adjustments based on the level of insurance risk. Industry comment letters during the exposures
noted the need for more explicit and holistic guidance on this topic, particularly within the property and casualty guidance.

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

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

**Staff Recommendation:**

NAIC Staff recommends that the Working Group move this item to the active listing, initially categorized as nonsubstantive and expose with request for comments / input on the issues described below. In addition, NAIC staff should be directed to draft to guidance to address premium refunds and other policy adjustments for both property and casualty and accident and health lines of business. NAIC staff anticipates coordinating with industry representatives in gathering input for developing principles based guidance, particularly for the varieties of data telematics policies.

**Comments are requested on the following:**

1. NAIC Staff’s preliminary recommendation is that the proposed guidance should follow the existing principles of adjustable premium and shall be recognized as adjustments to premium based on experience to date.

2. Examples of existing products that have premium adjustments for reasons other than the existing guidance or how the existing guidance can be expanded.

3. If accounting treatment that is being applied is different from premium adjustments, please provide overview of key attributes

**Staff Review Completed by:**

Robin Marcotte
NAIC Staff
July 2020
MEMORANDUM

TO: Dale Bruggeman, Chair, Statutory Accounting Principles (E) Working Group

FROM: Kevin Fry, Chair, Valuation of Securities (E) Task Force

CC: Charles Therriault, Director, NAIC Securities Valuation Office
Marc Perlman, Managing Investment Counsel, NAIC Securities Valuation Office (SVO)
Julie Gann, Assistant Director, NAIC Financial Regulatory Services
James Pinegar, Manager II, NAIC Financial Regulatory Services

DATE: May 29, 2020

RE: Referral to the Statutory Accounting Principles (E) Working Group Requesting Affirmation that Non-conforming Credit Tenant Loan (CTL) Transactions that Relied Upon Credit Ratings are included in SSAP No. 43R – Loan-Backed and Structured Securities and Have the Characteristics of a Bond if Assigned an NAIC Designation by the SVO Staff.

1. Summary – Early in 2019 the SVO became aware that certain insurance company filers were submitting through the Filing Exempt (FE) process credit tenant loan (CTL) transactions that contained variants or deviations from the Bond Lease Based and Credit Lease Based CTL legal and structural characteristics not otherwise contemplated or defined in the P&P Manual (Non-conforming CTLs) and transactions which were subsequently defined in the P&P Manuel as ground lease financing (GLF) transactions. For example, several CTLs were submitted to the SVO which contained balloon payments of greater than 5% without residual value insurance or another acceptable mitigant. In another instance, a security was submitted for which the Credit Rating Provider (CRP) analysis explained that its rating relied on the “dark value” of the property to cover payment of principal on the notes. The P&P Manual requires all CTL structures to be submitted to the SVO for review so it can determine if they reflect bond characteristics and, if so, assign an NAIC Designation. The SVO considers GLF transactions, which were previously referred to the Working Group, to be distinct from CTL transactions and their related guidance in the P&P Manual. The SVO studied GLF transactions in detail and ultimately recommended new guidance for them to the Valuation of Securities (E) Task Force (the Task Force) which was adopted on Dec. 8, 2019. The SVO is now making a recommendation to the Task Force on addressing what they are calling Non-conforming CTL transactions that have been submitted through the Filing Exempt (FE) process in reliance on CRP ratings instead of being submitted to the SVO for review, and to prevent future incorrect filing procedures. To effect such changes, the SVO proposed P&P Manual amendments to the policy in Part One, “The Use of Credit Ratings of NRSROS In NAIC Processes,” and in Part Three, “Credit Tenant Loans.”

2. The Referral - The SVO staff recommendation to the Task Force includes additional guidance in the policy on the “The Use of Credit Ratings of NRSROS In NAIC Processes” clarifying that there should be no presumption of permanent eligibility to receive an NAIC Designation based upon an NAIC CRP rating. The policy currently states, “The sole NAIC objective in obtaining and using publicly available credit ratings is to conserve limited regulatory resources; e.g., the resources of the SVO.” Additionally, the policy clarifies that in its use of CRP ratings the NAIC is not, “endorsing the credit rating or analytical product of any CRP.” Therefore, nothing about the use of CRP ratings should be interpreted, as was seemingly the case with Non-conforming CTLs and certain other investments, that the Task Force has approved the use of CRP ratings for the determination of NAIC Designations or for any other purpose, other than conserving SVO staff resources. The new policy guidance further affirms the Task Force’s role in making all decisions on the use of CRP ratings and provides additional guidance to insurance company filers on what to do if they are uncertain about the filing procedure for a particular security or class of securities.
The SVO further recommends a “grandfathering” provision to permit an insurance company filer to file Non-conforming CTLs, which it owned prior to January 1, 2020 and which have CRP ratings, with the SVO for assessment and to authorize the SVO to use its own judgement in assessing eligibility for an NAIC Designation and, if appropriate, to assign an NAIC Designation which need not correspond to the CRP rating.

The Task Force is referring this memo and proposed amendment to the Statutory Accounting Principles (E) Working Group and requesting the Working Group affirm that they would consider these Non-conforming CTLs to have the characteristics of a bond if assigned an NAIC Designation by the SVO staff. Like the referral from earlier this year on GLFs, these Non-conforming Credit Tenant Loan (CTL) Transactions have historically been reported under the Accounting Practices & Procedures Manual’s SSAP No. 43R – Loan-Backed and Structured Securities under Paragraph 27, b as a type of CTL. The SVO staff recommends affirming that treatment only if the SVO staff can assign an NAIC Designation.

Attached is the memorandum and the exposed amendment prepared by the staff for this request. Please direct any questions to Charles Therriault of the SVO.
MEMORANDUM

TO: Kevin Fry, Chair, Valuation of Securities (E) Task Force
    Members of the Valuation of Securities (E) Task Force

FROM: Charles A. Therriault, Director, NAIC Securities Valuation Office (SVO)
       Marc Perlman, Investment Counsel, NAIC Securities Valuation Office (SVO)

CC: Eric Kolchinsky, Director, NAIC Structured Securities Group (SSG) and Capital Markets Bureau

RE: Proposed Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) with Updated Instructions for Non-conforming Credit Tenant Loan (CTL) Transactions that Relied Upon Credit Ratings

DATE: April 30, 2020

1. Summary – Early in 2019 the SVO became aware that certain insurance company filers were submitting through the Filing Exempt (FE) process credit tenant loan (CTL) transactions that contained variants or deviations from the Bond Lease Based and Credit Lease Based CTL legal and structural characteristics not otherwise contemplated or defined in the P&P Manual (Non-conforming CTLs) and transactions which were subsequently defined in the P&P Manual as ground lease financing (GLF) transactions. For example, several CTLs were submitted to the SVO which contained balloon payments of greater than 5% without residual value insurance or another acceptable mitigant. In another instance, a security was submitted for which the Credit Rating Provider (CRP) analysis explained that its rating relied on the “dark value” of the property to cover payment of principal on the notes. The P&P Manual requires all CTL structures to be submitted to the SVO for review so it can determine if they reflect bond characteristics and, if so, assign an NAIC Designation. The SVO considered the GLF transactions to be distinct from CTL transactions and their related guidance in the P&P Manual. The SVO studied GLF transactions in detail and ultimately recommended new guidance for them to the Valuation of Securities (E) Task Force (the Task Force) which was adopted on December 8, 2019. Now we recommend addressing those Non-conforming CTL transactions that have been submitted through the Filing Exempt (FE) process in reliance on CRP ratings instead of being submitted to the SVO for review, and to prevent future incorrect filing procedures. To effect such changes, the SVO proposes P&P Manual amendments to the policy in Part One, “The Use of Credit Ratings of NRSROS In NAIC Processes,” and in Part Three, “Credit Tenant Loans.”

2. Recommendation – The SVO staff recommends that the Task Force include additional guidance in the policy on the “The Use of Credit Ratings of NRSROS In NAIC Processes” clarifying that there should be no presumption of permanent eligibility to receive an NAIC Designation based upon an NAIC CRP rating. The policy currently states, “The sole NAIC objective in obtaining and using publicly available credit ratings is to conserve limited regulatory resources; e.g., the resources of the SVO.” Additionally, the policy clarifies that in its use of CRP ratings the NAIC is not, “endorsing the credit rating or analytical product of any CRP.” Therefore, nothing about the use of CRP ratings should be interpreted, as was seemingly the case with Non-conforming CTLs and certain other investments, that the Task Force has approved the use of CRP ratings for the determination of NAIC Designations or for any other purpose, other than conserving SVO staff resources. The new policy guidance further affirms the Task Force’s role in making all decisions on the use of CRP ratings and provides additional guidance to
insurance company filers on what to do if they are uncertain about the filing procedure for a particular security or class of securities.

The SVO further recommends a “grandfathering” provision to permit an insurance company filer to file Non-conforming CTLs, which it owned prior to January 1, 2020 and which have CRP ratings, with the SVO for assessment and to authorize the SVO to use its own judgement in assessing eligibility for an NAIC Designation and, if appropriate, to assign an NAIC Designation which need not correspond to the CRP rating. The SVO also recommends referring this memo and proposed amendment to the Statutory Accounting Principles (E) Working Group and requesting the Working Group affirm that they would consider these Non-conforming CTLs to have the characteristics of a bond if assigned an NAIC Designation by the SVO staff.

3. Proposed Amendment – The following text in red shows the proposed revisions in Part One and Part Three.
PART ONE

POLICIES OF THE NAIC
VALUATION OF SECURITIES (E) TASK FORCE
THE USE OF CREDIT RATINGS OF NRSROs IN NAIC PROCESSES

NOTE: See “Policies Applicable to the Filing Exemption (FE) Process” below; “NAIC Policy on the Use of Credit Ratings of NRSROs” (especially “Definition – Credit Ratings Eligible for Translation to NAIC Designations”) in Part Two (the definition of “Eligible NAIC CRP Credit Ratings” excludes the use of any credit rating assigned to a security type where the NAIC has determined that the security type is not eligible to be reported on Schedule D or that it is not appropriate for NRSRO credit ratings to be used to determine the regulatory treatment of the security or asset); and “Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities” in Part Three.

Providing Credit Rating Services to the NAIC

57. The NAIC uses credit ratings for a number of regulatory purposes, including, to administer the filing exempt rule. Any rating organization that has been designated a Nationally Recognized Statistical Rating Organization (NRSRO) by the U.S. Securities and Exchange Commission (SEC) and which continues to be subject to federal regulation, may apply to provide Credit Rating Services to the NAIC.

Policy and Legal Disclosure Pertaining to the NAIC Credit Rating Provider (CRP) List

58. The NAIC uses publicly available credit ratings, when available, as one component of the services it provides to state insurance regulators concerned with financial solvency monitoring of insurance company investments.

59. In adopting or in implementing the procedure described in this section, the NAIC acts solely as a private consumer of publicly available credit ratings. The sole NAIC objective in obtaining and using publicly available credit ratings is to conserve limited regulatory resources; e.g., the resources of the SVO. The VOS/TF has established the procedure specified in this section solely to ensure that the NAIC can avail itself of publicly available credit rating opinions.

60. The NAIC is not selecting, approving or certifying NRSROs or other rating organizations or distinguishing among them for any public or policy purpose whatsoever. Nor is the NAIC endorsing the credit rating or analytical product of any CRP or rating organization or distinguishing between CRPs or rating organizations for any specific public purpose. The NAIC disclaims any authority to regulate CRPs or rating organizations.

1 Credit Rating Services is defined as: (a) electronic data feed transmissions of credit ratings assigned by the NRSRO with their corresponding CUSIP number and other pertinent security specific information in English, updated as frequently as provided to other customers; (b) other analytical services or products, in English, provided to other customers; and (c) access to the NRSRO’s rating analysts by SVO staff.
No Waiver/Express Reservation of Authority

61. Nothing in this section should be interpreted or construed as a waiver of the authority of the VOS/TF, in its sole and absolute discretion, to modify or change, in any manner whatsoever, the NAIC Policy on the Use of Credit Ratings of NRSROs, including but not limited to:

- Directing the removal of one or more NRSROs from the NAIC Credit Rating Provider List (subject only to the adjustment of any existing contractual obligations);
- Directing the SVO to study any issue related to NRSRO operations in furtherance of state insurance regulatory policy;
- eliminating the NAIC Credit Rating Provider List; or
- Directing any other action or activity the VOS/TF may deem to be useful or necessary to the creation, maintenance or discharge of state-based regulatory policy.

No Presumption of Permanent Eligibility Based Upon a NAIC CRP Rating

62. Nothing in this Manual should be interpreted or construed as affirming that a security has been explicitly approved by the VOS/TF as being permanently eligible to receive an NAIC Designation solely because it was rated by an NAIC CRP. Investment Securities that have received NAIC Designations based on an Eligible NAIC CRP rating through the filing exempt process could, upon direction from the VOS/TF, become subject to SVO or SSG review or declared ineligible to be assigned an NAIC Designation.

63. Securities that meet the general legal and structural characteristics of any type of Investment Security described in this Manual should be presumed to be governed by the policies specific to that type of Investment Security, including Filing Exemption eligibility, or lack thereof. It is incumbent upon the insurer to seek clarification from the SVO when a classification or regulatory treatment of a security is in doubt. Additionally, the insurer or SVO Director may, together or independently, propose amendments to this Manual as they deem appropriate to further clarify the classification or regulatory treatment of Investment Securities identified in this Manual consistent with the Procedures to Amend This Manual.

64. Insurers or other parties wishing to know the probable regulatory treatment and eligibility of a security are encouraged to utilize the Regulatory Treatment Analysis Service – Emerging Investment Vehicle process in this Manual to initiate such a regulatory review and interpretation by the SVO or SSG.
PART THREE

SVO PROCEDURES AND METHODOLOGY FOR PRODUCTION OF NAIC DESIGNATIONS
NOTE: See “Policies Applicable to Specific Asset Classes” in Part One for policies governing this activity, as well as “Specific Populations of Securities Not Eligible for Filing Exemption” in “Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities” above.

Non-conforming Transactions

70. An insurer that acquired a CTL that contains a variant or deviation from the Bond Lease Based and Credit Lease Based CTL legal and structural characteristics not otherwise contemplated or defined herein (a “Non-conforming CTL”) prior to January 1, 2020, may file it with the SVO. Along with each Non-conforming CTL, the insurer shall submit for review an Audited Financial Statement of the lessee, Credit Lease Based CTL Evaluation Form (including the documents described in the Evaluation Form), a separate memorandum identifying and describing the variants or deviations which make the investment a Non-conforming CTL and all Eligible NAIC CRP Rating analyses of the transaction. Subsequent filings shall require the most recent Eligible NAIC CRP Rating analyses of the transaction, if available from the CRP, and the Audited Financial Statement of the lessee. Upon review of the submission, the SVO may assign an NAIC Designation if the risks posed by the Non-conforming CTL’s variants are, in the opinion of the SVO, adequately mitigated and the Non-conforming CTL would be consistent with an investment security that has characteristics of a bond.

The SVO has complete discretion to make the determination of whether the CTL has characteristics of a bond and the NAIC Designation, including rejecting the transaction as not reflecting bond characteristics, adjusting the NAIC Designation for the transaction downward and away from the Eligible NAIC CRP Rating as the SVO deems analytically appropriate, or requesting additional information the SVO deems necessary for its analysis. If the Non-conforming CTL transaction does not maintain an Eligible NAIC CRP Rating for subsequent filings, the SVO has complete discretion to determine if an NAIC Designation can continue to be assigned. Non-conforming CTL transactions acquired by the insurer after December 31, 2019, shall not be reported as a bond.

71. As directed by the No Presumption of Permanent Eligibility Based Upon a NAIC CRP Rating section of this Manual, the VOS/TF considers securities that generally meet the legal and structural characteristics of Bond Lease Based or Credit Lease Based CTLs, but which do not meet all the specified characteristics, to be CTLs, and therefore not eligible for Filing Exemption and otherwise ineligible for reporting as a bond on Schedule D, except as explained in the paragraph above.
Item 5 - Non-conforming CTL Transactions

2020-020.01 PP Manual Amend - Non-conforming CTL Transactions and Reliance on Credit Ratings.docx
June 17, 2020

Mr. Kevin Fry, Chair
NAIC Valuation of Securities (E) Task Force
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Ms. Carrie Mears, Vice Chair
NAIC Valuation of Securities (E) Task Force
1100 Walnut Street, Suite 1500
Kansas City, MO 64016-2197

Dear Mr. Fry and Ms. Mears:

The ACLI1, PPiA2 and NASVA3 (the “undersigned”) would like to thank you for the opportunity to comment on the April 30, 2020 exposure entitled “Proposed Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) with Updated Instructions for Non-conforming Credit Tenant Loan (CTL) Transactions that Relied Upon Credit Ratings.” Our comments regarding the exposure draft are as follows:

1) The undersigned support the exposure recommendation that Non-conforming CTLs (aka “Residual Balloon CTLs”) be referred to the Statutory Accounting Principles (E) Working Group (“SAPWG”). We understand SAPWG will be addressing this issue at the NAIC summer national meeting in August.

The NAIC Policy Statement on Coordination of the Accounting Practices and Procedures Manual and the Purposes and Procedures Manual of the NAIC Investment Analysis Office includes the following:

1 The American Council of Life Insurers (ACLI) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI’s member companies are dedicated to protecting consumers’ financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI’s 280 member companies represent 94 percent of industry assets in the United States. Learn more at www.acli.com.

2 The Private Placement Investors Association (PPiA) is a business association of insurance companies, other institutional investors, and affiliates thereof, that are active investors in the primary market for privately placed debt instruments. The association exists to provide a discussion forum for private debt investors; to facilitate the development of industry best practices; to promote interest in the primary market for privately placed debt instruments; and to increase accessibility to capital for issuers of privately placed debt instruments. The PPiA serves 44 member companies and works with regulators, NASVA, the American College of Investors Counsel, and the investment banking community to efficiently implement changes within the private placement marketplace. Learn more at www.usppia.com.

3 The North American Securities Valuation Association (NASVA) is an association of insurance company representatives who interact with the National Association of Insurance Commissioners Securities Valuation Office to provide important input, and to exchange information, in order to improve the interaction between the SVO and its users. In the past, NASVA committees have worked on issues such as improving filing procedures, suggesting enhancements to the NAIC's ISIS electronic security filing system, and commenting on year-end processes. Find more information here.
“The assessment of credit risk for an obligation or asset, as specified in the P&P Manual, is a separate and distinct process from the determination of statutory accounting or reporting under the AP&P Manual. The manner in which an NAIC designation is used within statutory accounting guidance is limited to that, if any, specified in a statement of statutory accounting principle (SSAP) and cannot be derived or implied by language in the P&P Manual. Obtaining an NAIC designation does not change an investment’s applicable SSAP, annual or quarterly statement reporting schedule, or override other SSAP guidance required for the investment to be an admitted asset. There are limited instances in which a SSAP specifically identifies, within its scope, the inclusion of specific SVO-identified investments. The SVO review required for an investment to be included on a SVO listing is a separate evaluation process that focuses on the structure of the investment. This process is distinct from the SVO’s assessment of an investment’s credit risk, which results in a NAIC designation. As stated in the Statutory Hierarchy, Section V of the Preamble, the AP&P Manual is the highest level of authoritative guidance.”

In this regard we believe it is appropriate that these securities be referred to the SAPWG for determination of scope. We further believe Residual Balloon CTLs are a type of hybrid security that has some characteristics of a bond and some characteristics of a commercial mortgage. As such, this asset class may require a unique accounting/RBC solution. We look forward to working with NAIC staff and SAPWG to develop a solution that adequately reflects the risks and benefits associated with these transactions.

2) The undersigned also strongly believe the VOS Task Force should delay any proposed changes to the P&P Manual regarding treatment of Residual Balloon CTLs, until SAPWG has adopted appropriate scope and accounting for such transactions. It would be counterproductive to adopt P&P Manual language and then be forced to revise such language, depending upon what SAPWG determines to be appropriate treatment.

For example, should SAPWG determine these are commercial mortgage loans, there is no need for an NAIC designation. Further, statements in paragraph 70 and 71 suggest the SVO has the full power to determine if such securities are bonds. This suggestion runs contrary to NAIC policy and hierarchy. As noted above in the Policy Statement, SAPWG determines scope of investments (unless the SAPWG requires a structural analysis, as with conforming CTLs, where SAPWG has delegated to the SVO a specific role in the confirmation process).

We also call into question the more generic language in paragraph 62 where “upon direction from the VOS/TF, become subject to SVO or SSG review or declared ineligible to be assigned an NAIC designation.” Specifically, we have substantial concerns with regard to the implication that the SVO or VOS/TF would unilaterally declare a security ineligible for an NAIC designation, if it is determined to be a bond by SAPWG. This issue merits further discussion to ensure that it is not at odds with NAIC Policy.

3) Given that this issue now must go before SAPWG for review, and SAPWG’s decision holds implications for capital requirements, the undersigned request that insurers be allowed to continue holding these securities without an SVO-assigned designation, and instead hold capital on Residual Balloon CTLs as bonds and commensurate with any assigned CRP ratings. This would be consistent with the 2019 VOS/TF decision to temporarily exempt CRP-rated, Non-conforming CTLs from being filed with the SVO until a solution is found. We understand that such filing exemption and capital treatment would be temporary in nature, until appropriate accounting guidance from SAPWG and related capital requirements can be codified. The undersigned commit to working constructively with NAIC Staff and...
SAPWG to develop an acceptable solution for Residual Balloon CTLs. Our hope is that final guidance could be adopted and implemented by year-end 2020.

Thank you again for your consideration. The undersigned look forward to working collaboratively in developing an ultimate solution for Residual Balloon CTLs that reflect the unique, hybrid characteristics of the asset class.

Sincerely,

Mike Monahan
Senior Director, Accounting Policy
American Council of Life Insurers

Tracey Lindsey
President
North American Securities Valuation Association

John Petchler
President
Private Placement Investors Association

cc: Charles Therriault, Director, SVO
Denise Genao-Rosado, NAIC SVO
To: Mr. Kevin Fry, Chair  
NAIC Valuation of Securities (E) Task Force  
1100 Walnut Street  
Suite 1500  
Kansas City, MO 64106-2197

Ms. Carrie Mears, CFA®, Vice Chair  
NAIC Valuation of Securities (E) Task Force  
1100 Walnut Street  
Suite 1500  
Kansas City, MO 64106-2197

From: Lease-Backed Securities Working Group


We, the Lease-Backed Securities Working Group, are a combined group of insurance company investors, bankers, and attorneys with many years of experience originating, investing in, and holding three main asset classes: Credit Tenant Loans ("CTLs"), Ground Lease Financings, or "GLFs" – approved by this committee last December for inclusion into the P&P Manual -- and a third class of credit lease-backed bonds which do not meet the definitions set forth in the P&P Manual for the other two asset classes.

On behalf of our group, we respectfully request that the implementation of the proposed amendment(s) set forth in the April 30th memorandum from the SVO be delayed pending a full review of this asset class -- alternately referred to as “Non-Conforming CTLs”, “Other Lease-backed Transactions”, or “Residual Balloon CTLs” -- by all industry participants.

We understand that SAPWG will be presenting an exposure draft addressing the proper classification of this asset class, as well as potentially CTLs and GLFs, at the NAIC summer national meeting in August. We also note that SAPWG is currently undertaking a large-scale review of many asset classes currently included in SSAP 43R, “Structured and Loan-Backed Securities” where all conforming CTL transactions have been reported since 2012.

We further note, as referenced in the comment letter submitted to this committee jointly by the ACLI, NASVA, and the PPIA, that the NAIC Policy Statement on Coordination of the Accounting Practices and Procedures Manual and the Purposes and Procedures Manual of the NAIC Investment Analysis Office includes the following:

> "The assessment of credit risk for an obligation or asset, as specified in the P&P Manual, is a separate and distinct process from the determination of statutory accounting or reporting under the AP&P Manual. The manner in which an NAIC designation is used within statutory accounting guidance is limited to that, if any, specified in a statement of statutory accounting principle (SSAP) and cannot be derived or implied by language in the P&P Manual. Obtaining an NAIC designation does not change an investment’s applicable SSAP, annual or quarterly statement reporting schedule, or override other SSAP guidance required for the investment to be an admitted asset..." (emphasis added)...

Page 1 of 2
As such, we believe that the implementation of the changes proposed to the P&P Manual in the April 30th Memorandum, most especially the proposal that “Non-conforming CTL transactions acquired by the insurer after December 31, 2019, shall not be reported as a bond” is premature, pending review of the classification of a number of securities as part of the broader effort.

We wholeheartedly agree with the goal of clarifying how these securities should be reported, and we remain committed to working closely with SAPWG, the members of VOSTF, as well as Director Therriault and the SVO staff, to accomplish this goal.

As we stated at the outset, our group combines many disciplines and many years of experience covering all aspects of originating, structuring, analyzing and investing in these securities, which provide an important investment alternative for the insurance industry. Our combined expertise can provide a valuable contribution to this effort, and we are happy to provide any assistance we can in the ongoing analysis undertaken by the various committees.

This was done last year successfully with Ground Lease Financings (“GLFs”), which were approved by the Task Force in December and are now included as a new Schedule-D eligible asset in the P&P Manual. Chairman Fry, in the December VOSTF meeting you specifically praised this effort as “the best of what the Task Force does when it works with industry”, and pointed out that the framework used for Ground Lease Financings could (and should) be used as a useful template for clarifying the reporting of this additional class of securities which do not meet the requirements to be classified as either “CTLs” or “GLFs”

We respectfully request that the Task Force delay adopting the changes to the Manual proposed in this amendment until such time as all parties have had the opportunity to undertake a full and thorough review of how these securities should be classified and reported.

Sincerely,

[Signature]

John M. Garrison

On behalf of:
The Lease-Backed Securities Working Group
MEMORANDUM

TO: Dale Bruggeman (OH)
Chair of the Statutory Accounting Principles (E) Working Group

FROM: Commissioner Scott A. White (VA)
Chair of the Financial Condition (E) Committee

DATE: June 12, 2020

RE: Referral Regarding Reporting of “Basis” Swaps

The Financial Condition (E) Committee recently received a request from the American Council of Life Insurers relative to the treatment of certain “basis swaps” under state law as a result of the transition away from the London Interbank Offered Rate (LIBOR) (See attached presentation which includes the request). The request recognized that insurance companies are required to abide by investment guidelines and legal and regulatory constraints established by the state insurance law where most state laws limit insurers’ derivative use to the explicit activities of hedging, replication, and income-generation activities. As discussed in the presentation, as part of a market-wide transition away from LIBOR and toward the Secured Overnight Financing Rate (SOFR), U.S. central clearing counterparties (CCPs) will shift their discounting rate from the Effective Federal Funds Rate (EFFR) to the SOFR using a one-time special valuation cycle. This is expected to occur later this year on Oct. 16. As part of this unique market event, the CCPs will revalue existing cleared swaps and issue basis swaps on a mandatory basis to all parties that clear swaps on the CCPs to restore a counterparty’s original risk profile. The issue is that these swaps may not fit into one of these categories of permissible derivatives under state insurance law and therefore may not be allowed.

On June 12, the Committee issued a memorandum to all commissioners, directors and superintendents to make them aware of the issue and more specifically to indicate the Committee’s support to issue state bulletins allowing insurers to hold such swaps as “permissible derivative investments” for up to one year. The Committee made this determination on the basis that insurers have no control over the distribution of such basis swaps to them, and recognizing that insurers may be disadvantaged if required to dispose of such basis swaps upon receipt.

The original request was that these swaps be treated specifically as effective hedges. However, the Committee did not make a determination on the type of permissible investment and while the Committee did not believe that such a determination was needed for most state laws, a determination will be needed for reporting in the statutory financial statements. The Committee requests the Working Group address that specific reporting issue. If you have any questions, please contact Dan Daveline (ddaveline@naic.org).
Interpretation of the Statutory Accounting Principles (E) Working Group

INT 20-09T: Basis Swaps as a Result of the LIBOR Transition

INT 20-09T Dates Discussed

Email Vote to Expose July 15, 2020

INT 20-09T References

Current:
SSAP No. 86—Derivatives

INT 20-09T Issue

1. This interpretation is to provide statutory accounting and reporting guidance for “basis swaps.” Basis swaps within the scope of this interpretation are defined as compulsory derivatives issued by Central Clearing Parties (CCP), 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).

2. SOFR is a broad measure of the cost of borrowing cash overnight, generally collateralized by Treasury Securities. It represents nearly a risk-free rate that is correlated with other money market rates and is fully transaction based (thus ensuring full transparency), by reflecting a broad measure of overnight U.S. Treasury repurchase transactions. In conjunction with the transition from LIBOR, many alternative reference rates, such as the Effective Federal Funds Rate (EFFR), an interest rate typically utilized by banks representing a charge for overnight loans, used to meet regulatory reserve requirements, are also being transitioned to SOFR. Accordingly, under the general topic referred to as “Reference Rate Reform,” contracts which reference or utilize LIBOR or EFFR, are anticipated to be modified to reference SOFR.

3. The Working Group previously adopted INT 20-01: Reference Rate Reform, which substantially adopted ASU 2020-04 – Reference Rate Reform and applies to all SSAPs with contracts within scope of ASU 2020-04. INT 20-01 allows for contract modifications, due to reference rate reform, to be accounted for as a continuation of the existing contract and thus not requiring remeasurement. Among other things, INT 20-01 allows for 1) certain hedging relationships to continue without requiring redesignation upon a change in certain critical terms (i.e. changing reference rates), and 2) changes in the designated benchmark interest rate to a different eligible benchmark interest rate in a fair value hedging relationship. INT 20-01 recognized that many of these contracts, as part of the discontinuance of LIBOR, will transition to SOFR, an industry recognized preferred benchmark rate.

4. CCPs will make a similar transition, converting open derivative end-of-day valuation calculations from EFFR to SOFR. This transition will occur in two steps, both of which are anticipated to occur on October 16. First, the CCPs will conduct a standard end-of-day valuation cycle based on EFFR. Then, the CCP will conduct a special valuation cycle on those same positions, however utilizing SOFR as the new, ongoing discounting rate. Based on the differences between EFFR and SOFR, the CCP will issue cash adjustments to each account to offset the value adjustments arising from the change in discount rates and additionally will issue mandatory EFFR/SOFR basis swaps, thus restoring the account holder’s original risk profile.

5. SSAP No. 86—Derivatives addresses the recognition and measurement of derivatives used for hedging, income generation, and replication transactions. Additionally, guidance is provided for derivatives not utilized for one of these broad categories (known as “other derivatives”). Derivatives that are classified as “other derivatives” are nonadmitted under SSAP No. 86, whereas derivatives in the other categories are admitted provided they conform to the requirements of the statement.
6. The accounting issues are:
   a. Issue 1: How should EFFR/SOFR basis swaps be classified and reported in the statutory financial statements?
   b. Issue 2: How should EFFR/SOFR basis swaps be valued in the statutory financial statements?

**INT 20-09T Discussion**

7. For Issue 1, the Working Group reached a tentative consensus that mandatory basis swaps issued by CCPs, in response to reference rate reform, shall be classified as a derivative used for “hedging.” In collaboration with industry representatives, Working Group support staff has confirmed that a significant majority of the derivatives transacted through a CCP meet the definition of a hedging transaction. By using this “used for hedging” classification, instead of an “other derivative” classification, the basis swap derivative received will be admitted under SSAP No. 86.

8. For Issue 2, the Working Group reached a tentative consensus that although the instrument shall be considered a hedging derivative, the instrument shall not be considered or reported as an “effective” hedging derivative (using the “hedge accounting” measurement approach permitted in SSAP No. 86), unless the instrument qualifies, with the required documentation, as a highly effective hedge under SSAP No. 86. Unless the effective hedge requirements are met, the instruments shall be reported on Schedule DB, utilizing the category of “Hedging Other.” Pursuant to the guidance in SSAP No. 86, if the basis swap derivative is not an effective hedge, the derivative shall be accounted for at fair value and the changes in fair value shall be recorded as unrealized gains or unrealized losses (referred to as fair value accounting.)

**INT 20-09T Status**

8. Further discussion is anticipated.
2020 Summer National Meeting - Review of GAAP Exposures for Statutory Accounting:

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

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

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<td>Proposed Accounting Standards Update—Financial Services-Insurance (Topic 944):</td>
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<td>Effective Date and Early Application (Targeted Improvements to the Accounting</td>
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1. Proposed Accounting Standards Update—Financial Services - Insurance (Topic 944)

Comment Deadline: August 24, 2020

Information from FASB Exposure Draft:
In 2018, FASB issued ASU 2018-12: Financial Services—Insurance (Topic 944), Targeted Improvements to the Accounting for Long-Duration Contracts modifying the reporting requirements for long-duration contracts issued by insurance entities. The Working Group rejected ASU 2018-12 for statutory accounting (agenda item 2019-06).

In response to the financial and operational challenges resulting from COVID-19, this proposed ASU extends the effective date of ASU 2018-12 by one year for all insurance entities. Additionally, transition relief would be provided by allowing application of the standard to be reflected in the beginning of the prior period present, rather than the beginning of the earlier period presented in the financial statements.

Staff Review and Commentary:
Review ASU under the SAP Maintenance Process as detail in Appendix F—Policy Statements.