NATIONAL MEETING
FALL / DENVER
2024 NAIC

Date 11/4/2024

2024 Fall National Meeting
Denver, Colorado

Statutory Accounting Principles (E) Working Group
Sunday, November 17, 2024
9:00 - 11:00 AM MST
Gaylord Rockies Hotel—Colorado Ballroom A—Level 3

OVERVIEW AGENDA

HEARING AGENDA

	Hearing Page Number	Attachment
1. SAPWG Hearing – Adoption of Minutes—*Dale Bruggeman (OH)*	1	1-3
2. SAPWG Hearing – Review and Adoption of Non-Contested Positions—*Dale Bruggeman (OH)*		
• Ref #2024-11: *ASU 2023-09, Improvements to Income Tax Disclosures*	2	4
• Ref #2024-17: Clearly Defined Hedging Strategy	2	5
• Ref #2024-18: Clarification to NMTC Project	3	6
• Ref #2024-19: *ASU 2024-02, Codification Improvements, Amendments to Remove References to the Concepts Statements*	3	7
3. SAPWG Hearing – Review of Comments on Exposed Items—*Dale Bruggeman (OH)*		
• Ref #2019-21: INT 24-01 - Principles-Based Bond Definition Implementation Questions & Answers	5	8-9
• Ref #2023-28: Collateral Loan Reporting	12	10
• Ref #2024-16: Repack and Derivative Investments	15	11
Comment Letters	18	12

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OVERVIEW AGENDA

MEETING AGENDA

	Meeting Page Number	Attachment
4. SAPWG Meeting – Maintenance Agenda – Pending List—*Dale Bruggeman (OH)*		
• Ref #2024-20: Restricted Asset Clarification	1	A
• Ref #2024-21: Investment Subsidiary Classification	4	B
• Ref #2024-22: ASU 2024-01, Scope Application of Profits Interest and Similar Awards	6	C
• Ref #2024-23: Derivative Premium Clarifications	7	D
• Ref #2024-24: Medicare Part D – Prescription Payment Plan	7	E-F
• Ref #2024-25: SSAP No. 16 ASU Clarification	9	G
• Ref #2024-26EP: Fall 2024 Editorial Revisions	9	H
5. SAPWG Meeting – Any Other Matters Brought Before the Working Group —*Dale Bruggeman (OH)*		
• Review of U.S. GAAP Exposures	10	I
• Update on the IMR Ad Hoc Subgroup	10	None
• Update on the Bond Project Implementation / Bond Small Group	10	None
• Use of 3rd Party Vendors / Checklists to Determine Bond Definition Compliance / Classification	10	None
• IAIS Audit and Accounting Working Group (AAWG Update)	10	None
• Update on Reinsurance Exposures	10	None
• December 17th Meeting	10	None

- **Comment Deadline for Ref #2024-26EP – Monday, December 9, 2024**
- **Comment Deadline for all other items – Friday, January 31, 2025**

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Statutory Accounting Principles (E) Working Group
Hearing Agenda
November 17, 2024

ROLL CALL

Dale Bruggeman, Chair	Ohio	Judy Weaver/Steve Mayhew	Michigan
Kevin Clark, Vice Chair	Iowa	Doug Bartlett	New Hampshire
Sheila Travis/Richard Russell	Alabama	Bob Kasinow	New York
Kim Hudson	California	Diana Sherman	Pennsylvania
William Arfanis/Michael Estabrook	Connecticut	Jamie Walker	Texas
Rylynn Brown	Delaware	Doug Stolte/Jennifer Blizzard	Virginia
Cindy Andersen	Illinois	Amy Malm/Elena Vetrina	Wisconsin
Melissa Gibson/Bill Werner	Louisiana		

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

Note: This meeting will be recorded for subsequent use.

The Statutory Accounting Principles (E) Working Group met in regulator-to-regulator session on October 9, 15 and November 12. These regulator sessions were pursuant to the NAIC Open Meetings Policy paragraph 3 (discussion of specific companies, entities or individuals) and paragraph 6 (consultations with NAIC staff related to NAIC technical guidance of the *Accounting Practices and Procedures Manual*). No actions were taken during these meetings as the discussions related to reinsurance transactions at certain companies and to preview the Fall National Meeting agendas and discussed other items with NAIC staff pursuant to the NAIC open meeting policy.

REVIEW AND ADOPTION OF MINUTES

1. Summer National Meeting **(Attachment 1)**
2. September 12, 2024 **(Attachment 2)**
3. October 4, 2024 **(Attachment 3)**

REVIEW AND ADOPTION of NON-CONTESTED POSITIONS

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

1. Ref #2024-11: *ASU 2023-09, Improvements to Income Tax Disclosures*
2. Ref #2024-17: Clearly Defined Hedging Strategy
3. Ref #2024-18: Clarification to NMTC Project
4. Ref #2024-19: *ASU 2024-02, Codification Improvements, Amendments to Remove References to the Concepts Statements*

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Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-11 (Wil)	**ASU 2023-09, Improvements to Income Tax Disclosures**	**4 – Agenda item**	**No Comments**	**IP – 4**

<u>*Summary:*</u>
On August 13, 2024, the Working Group exposed revisions to reject *ASU 2023-09, Improvements to Income Tax Disclosures* in *SSAP No. 101—Income Taxes*, and to remove the disclosure detailed in SSAP No. 101, paragraph 23b as it is no longer relevant due to changes in existing tax laws.

<u>*Interested Parties' Comments:*</u>
Interested parties support the conclusion on this item and note that since paragraph 23.b has been deleted, paragraph 23. a should be changed to paragraph 23.

<u>*Recommendation:*</u>
NAIC staff recommends that the Working Group adopted the exposed revisions to reject *ASU 2023-09, Improvements to Income Tax Disclosures* in *SSAP No. 101—Income Taxes*, and to remove the disclosure detailed in SSAP No. 101, paragraph 23b, and have incorporated interested parties' recommendation to consolidate paragraph 23a into a single paragraph.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-17 (Julie)	**Clearly Defined Hedging Strategy**	**5 – Agenda item**	**No Comments**	**IP – 6**

<u>*Summary:*</u>
On August 13, 2024, the Working Group exposed revisions *SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees* to update the definition of a clearly defined hedging strategy (CDHS) to reflect the revised guidance pursuant to VM-01. This agenda item has been prepared to update the guidance in SSAP No. 108 for a clearly defined hedging strategy (CDHS) to mirror guidance adopted by the Life Actuarial (A) Task Force in 2022, and in effect starting with the 2023 version of the Valuation Manual. The guidance previously included in SSAP No. 108 referred to the CDHS defined in VM-21, and the actuarial guidance has been modified to ensure consistent definitions of a CDHS in both VM-20 and VM-21 and is now captured within VM-01.

The proposed revisions are limited to the definition of a CDHS in paragraph 7 of SSAP No. 108 as well as references in SSAP No. 108 that refer to VM-21 as the location of the definition of a CDHS.

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

<u>*Recommendation:*</u>
NAIC staff recommends that the Working Group adopt the exposed revisions to SSAP No. 108 to update the definition of a clearly defined hedging strategy (CDHS) to reflect the revised guidance pursuant to VM-01. (Only references to the CDHS are being revised to VM-01. Other references to VM-21 are product specific to variable annuity contracts and shall be retained in SSAP No. 108.)

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Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-18 (Wil)	**Clarifications to NMTC Project**	**6 – Agenda item**	**No Comments**	**IP – 6**

Summary:
On March 16, 2024, the Statutory Accounting Principles (E) Working Group adopted, as final, agenda item 2022-14 which exposed revisions to *SSAP No. 34—Investment Income Due and Accrued*, *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, *SSAP No. 93—Low Income Housing Tax Credit Property Investments*, and *SSAP No. 94R—Transferable and Non-Transferable State Tax Credits* to expand and amend statutory guidance to include all tax credit investments regardless of structure and type of state or federal tax credit program, and all state and federal purchased tax credits.

After adoption of agenda item 2022-14 New Market Tax Credits, NAIC staff received questions from public accounting firms on the accounting guidance and example journal entries provided in the new guidance. It was noted that the SSAP No. 94R accounting guidance appeared inconsistent with the journal entry examples and the guidance in SSAP No. 93R for recognizing allocated tax credits was confusing when compared to the journal entry examples. Both Interested Parties and NAIC staff agreed that the journal entries accurately reflected the accounting for recognition and utilization of tax credits, as such revisions have been drafted to revise the accounting guidance to more accurately match up with the journal entry examples.

It was also noted that a sentence in SSAP No. 48 was inadvertently not updated as part of the New Market Tax Credit project. Updates to this sentence are proposed in the attached Form A.

On August 13, 2024, the Working Group exposed revisions to update the recently adopted accounting guidance in SSAP No. 93 and SSAP No. 94R, and one unrevised sentence in SSAP No. 48.

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

Recommendation:
NAIC staff recommends that the Working Group adopt the exposed revisions to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, *SSAP No. 93—Investments in Tax Credit Structures*, and *SSAP No. 94—State and Federal Tax Credit*, effective as of January 1, 2025.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-19 (Wil)	**ASU 2024-02, Codification Improvements, Amendments to Remove References to the Concepts Statements**	**7 – Agenda item**	**No Comments**	**IP – 6**

Summary:
On August 13, 2024, the Working Group exposed revisions to reject ASU 2024-02 within Appendix D. FASB issued *ASU 2024-02, Codification Improvements—Amendments to Remove References to the Concepts Statements*, which removes references to FASB Concept Statements from the Codification. The main rationale for this amendment is to simplify the Codification by removing Concepts Statements in the guidance and draw a clear distinction between authoritative and nonauthoritative literature. The Board was concerned that references to

Concept Statements would result in users incorrectly inferring that the referenced Concept Statements were authoritative.

The FASB Concept Statements are referenced in the *Accounting Policies and Procedures Manual* within the Statutory Hierarchy as either level 4 or 5, but the revisions in ASU 2024-02 are not applicable to this and other references to FASB Concept Statements in the AP&P Manual.

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

Recommendation:
NAIC staff recommends that the Working Group adopt the exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2024-02, Codification Improvements—Amendments to Remove References to the Concepts Statements* as not applicable to statutory accounting. This guidance is not considered relevant to the existing statutory accounting references to FASB Concept statements.

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REVIEW of COMMENTS on EXPOSED ITEMS

The following items are open for discussion and will be considered separately.

1. Ref #2019-21: INT 24-01 - Principles-Based Bond Definition Implementation Questions & Answers
2. Ref #2023-28: Collateral Loan Reporting
3. Ref #2024-16: Repack and Derivative Investments

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-21 (Julie)	**INT 24-01 - Principles-Based Bond Definition Implementation Questions & Answers**	**8 – Q&A 9 – INT**	**Comments Received**	**IP – 2 & 8 Spectrum – 10**

Summary:

On August 13, 2024, the Working Group exposed the draft Question-and-Answer Implementation Guide (Q&A) for a comment period ending Sept. 27, 2024, to address issues of implementing the Principles-Based Bond Project that have been brought from industry to the Bond / AICPA small group. The Q&A interprets how the SAP guidance should be applied to specific investment structures or investment characteristics.

On October 4, 2024, the Working Group exposed (via evote) an updated Q&A to incorporate three additional topics including, commercial mortgage-backed securities (CMBS) interest-only (IO) strips, commercial mortgage loan (CML) single asset single borrower investments (SASBs), and hybrids. With this exposure, it was identified that interested parties had not provided comment on any of the prior bond implementation questions and answers in the first exposure but had provided comment on the classification of issue papers in the statutory hierarchy. The updated Q&A included minor edits to paragraph 9.2 to eliminate this aspect from the Q&A without changing the intent of the guidance. As the discussion of an issue paper's classification in the statutory hierarchy is broader than the Q&A, discussion of issue paper classification was noted to occur at the Fall National Meeting.

Interested Parties' Comments – Exposure Ending Sept. 27, 2024:

Interested parties appreciate the exposure of the Q&A as it will help address meaningful interpretative issues and facilitate more consistent implementation by insurance companies. Interested parties also would like to highlight the following language in paragraph 7.2:

> *This question highlights an important point. Issue papers are not authoritative accounting guidance. It is intended to provide key context regarding discussions leading to the development of new accounting standards. However, neither the issue paper nor this Q&A document represents authoritative accounting guidance. Any unintended language that conflicts with statements in the SSAP should be disregarded.*

First, interested parties would like to suggest that Issue Papers be recognized as authoritative guidance and included in Level 2, or alternatively Level 4, in the statutory hierarchy of authoritative guidance. Level 2 would place issue papers higher in the hierarchy than the annual statement instructions (Level 3) which arguably is appropriate. Level 4 specifically includes the preamble as authoritative guidance and paragraph 45 of the preamble states, "While it is not intended that there be any significant differences between an underlying issue paper and the resultant SSAP, if differences exist, the SSAP prevails and shall be considered definitive." This part of the preamble implies if a difference exists, and is not addressed by the SSAP, it is authoritative. If this interpretation by interest parties is not consistent with the NAIC's interpretation, it is important that the issue papers be explicitly included in the statutory hierarchy as many are drafted to include interpretative guidance not included in the SSAPs (e.g., feeder funds related to the new principles-based bond definition (PBBD) and superseded US GAAP OTTI impairment guidance that is still applicable for statutory accounting but is not codified within the SSAPs). Further, other areas of the Accounting

Practices & Procedures Manual that suggest issues papers are not authoritative (e.g., Appendix E) would need to be updated for consistency.

Interested parties also believe the Q&A should be included in the statutory hierarchy, perhaps by including them as an interpretation (Level 2) which still serves the purpose of the language in paragraph 7.2 that puts the Q&A in a position subordinate to *SSAP No. 26—Bonds* and *SSAP No. 43—Asset-Backed Securities*.

Interested Parties' Comments – Exposure Ending Oct. 28, 2024:

Interested parties appreciate the exposure of the three additional Q&A topics as they will help address meaningful interpretative issues and facilitate more consistent implementation by insurance companies. Interested parties would like to share five editorial comments:

1) In paragraph 7.4, change "SSAP No. 26R" to "SSAP No. 26" to be consistent with other references to SSAP No. 26 throughout the document.
2) In the "Q" in paragraph 8, change Schedule "D-2-1" to "D-1-2" to properly reflect the ABS schedule.
3) In paragraph 10.3, remove the last "sentence" that ends in a colon. This sentence does not appear needed and ends in a colon which implies everything after paragraph 10.3 does not qualify under the bond definition while paragraph 10.6 includes bonds that do qualify.
4) In paragraph 10.6, make the last sentence a separate paragraph (e.g., 10.7) so it is clear the summary in Exhibit A is applicable to all paragraphs of Q10.
5) As a result of Q10, SSAP No. 41 may need slight revisions to appropriately reflect these new distinctions in classifications. Interested parties are happy to work with NAIC staff and regulators on this as appropriate.

Spectrum Asset Management, Inc – Exposure Ending Oct. 28, 2024:
Regarding the "Implementation Questions and Answers" document, section 10.4:

*"Investments in debt securities treated as regulatory capital by the issuer's primary regulatory authority, and **that do not qualify** under the principles-based bond definition solely because interest can be cancelled in the event of financial stress in a non-resolution scenario without triggering an act of default are capital notes and shall be captured in SSAP No. 41—Surplus Notes. These capital notes are often issued by domestic or foreign banks, and the domestic or foreign bank regulator or the Issuer has the ability to cancel interest or dividends, without future interest accumulation or payment."*

We are specifically concerned about the RBC treatment of certain debt instruments moving to Schedule BA for P&C/Health filers. In particular, we are focused on securities classified as "capital notes" captured in SSAP No. 41 – Surplus Notes to be reported on Schedule BA as this rule change will have unintended and uneconomic consequences for the institutions holding these highly rated instruments.

For example, a highly rated security such as the Allianz 3.2% perpetual restricted Tier 1 notes (rated A3/A by Moody's/S&P) may classify under section 10.4 "capital notes" captured in SSAP 41 – Surplus Notes *(e.g.,* non-cumulative with optional coupon cancellation, albeit extremely remote based on issuer fundamentals and as indicated by the security ratings).

While Life insurers may be able to continue to use Filing Exempt (FE) designations or to file with the SVO to get a similar RBC factor as if it were held on Schedule D, Part 1, Bonds allowing an NAIC 1 bond factor for this instrument to be maintained on Schedule BA, P&C and Health cannot. As a result of this asset moving from Schedule D to Schedule BA, the RBC factor would increase to ~20% for P&C and Health from 1.5% and 1.9%, respectively today.

In our opinion, this reclassification imposes onerous capital requirements on a highly rated instrument (ratings which incorporate both credit and structure). We believe this deviates from the underlying fundamental risk as capital requirements would be higher than those for common equity holdings and could misallocate otherwise sound investments.

As such, we request that this matter be reviewed, and that P&C and Health insurers be able to file with the SVO/use Filing Exempt (FE) designations for RBC for capital notes reported on Schedule BA and suggest a change to P&C/Health RBC risk factors for capital notes, in line with that afforded to Life insurers. Thank you for your consideration as it relates to this matter.

Recommendation:
This discussion has been divided between comments received on the exposed QA guidance and discussion on an issue paper's status in the statutory hierarchy.

1) **Review and Consider Adoption of Bond Definition Q&A Implementation Guide:**

Recommendation: **NAIC staff recommend that the Working Group consider adoption of the exposed Q&A in a new interpretation to *SSAP No. 21—Other Admitted Assets* and *SSAP No. 26—Bonds* with the edits suggested by interested parties. By including as an interpretation, the guidance in the Q&A is captured as Level 2 of the hierarchy. In the event the SSAP guidance was revised and the Q&A did not incorporate consistent revisions, the SSAP guidance would be the authoritative literature.**

In addition to the adoption of the Q&A, NAIC staff recommend that the Working Group send a referral to the P/C and Health RBC (E) Working Group with information on the adopted revisions for the bond definition with identification that the non-bond debt securities will not have the opportunity for RBC based on SVO-Assigned Designations. This referral will inquire whether the RBC Working Groups should consider more granular RBC reporting based on SVO-Assigned Designations.

Lastly, NAIC staff recommend that the Working Group direct NAIC staff to work with industry on a review of *SSAP No. 41—Surplus Notes* to consider slight revisions as requested for the capital notes distinction. It is noted that capital notes are already in scope of that statement.

With regards to the comments from Spectrum Asset Management, NAIC staff does not recommend any revisions to the proposed Q&A. This is because it is not recommended to revise the reporting location simply in response to the RBC charge. Investments shall be accounted for and reported based on the applicable statutory accounting guidance, regardless of the resulting RBC charge. It is also noted that the dynamic where RBC factors on Schedule BA for P/C and health companies do not utilize SVO-Assigned designations is not a new concept. This currently exists for held surplus notes, and those investments permit CRP ratings to influence RBC for life companies. NAIC staff notes that an assessment of whether SVO-Assigned designations should influence RBC for P/C companies occurred prior to COVID (2018-2019 timeframe). However, with the adoption of the principles-based bond definition, and the classification of debt securities that do not qualify as bonds on Schedule BA, NAIC staff recommends a referral to the Capital Adequacy (E) Task Force (and/or the P/C RBC (E) Working Group and Health RBC (E) Working Group) to assess whether SVO-Assigned designations (and CRP ratings for surplus notes) shall be utilized for more granular RBC similar to life insurance entities.

Proposed edits reflected in the proposed INT:

1) In paragraph 7.4, revised "SSAP No. 26R" to "SSAP No. 26".
2) In paragraph 8, change Schedule "D-2-1" to "D-1-2" to properly reflect the ABS schedule.
3) In paragraph 10.3, deleted the last sentence.
4) Made the last sentence in paragraph 10.6, a separate paragraph (e.g., 10.7) (This refers to the Appendix.)
5) A small edit (adding the word "be") has been made to paragraph 3.3c.

2) Discuss Issue Paper Status in Statutory Hierarchy

***Recommendation:* NAIC staff recommend that the Working Group direct a new agenda item to consider capturing issue papers in Level 5 of the statutory hierarchy. Although interested parties have proposed a classification of Level 2, and an alternative classification in Level 4, NAIC staff suggest that consideration of a Level 5 classification is most appropriate to prevent any unintended conflicts with other sources of statutory guidance. The rationale for this position is that issue papers are not updated after adoption and should not be considered more applicable than any other statutory-specific guidance, whether that guidance is deemed to reflect accounting guidance, reporting instructions or information from the SVO manual. The Level 5 classification will put issue papers on the same level as non-authoritative GAAP guidance and literature. NAIC staff believe this is appropriate, as if guidance for a topic is not specifically detailed in any other form of statutory-specific sources, adopted issue papers should be a viable source for guidance along with non-authoritative GAAP.**

As detailed within, from a review of references in the issue papers, various references imply that issue papers can be applied and utilized as long as the guidance within the Issue Paper does not conflict with other guidance. There are a few explicit instances that note they are not authoritative/in the statutory hierarchy. NAIC staff notes that Issue Papers often include discussion of guidance or components that are not incorporated into SSAP, therefore it is imperative for the guidance to only be applicable if consistent with an adopted SSAP. By adding the issue papers to Level 5, this reference would clarify the intent to use issue papers, and the use of information detailed within, eliminating questions on the use of the guidance that is consistent with currently adopted SSAPs.

- By classifying issue papers as Level 5, instead of Level 2, if there is a subsequent reporting revision that is not captured in statutory accounting but only reflected in the annual statement instructions, the updated instructions, which are level 3, shall be followed. If issue papers were classified as Level 2, there could be inherent reporting conflict if the issue paper detailed reporting requirements at the time of adoption as that guidance would not be subsequently updated.

- By classifying issue papers as Level 5, instead of Level 4, issue papers will continue to be below the SAP Preamble and Statement of Concepts. As such, if there are revisions to the Preamble, those revisions will continue to override any potential conflicts with a previously adopted issue paper.

NAIC staff recognizes that existing guidance presents inconsistent references to issue papers causing confusion on how/when they should apply. As noted, there are a few explicit statements that issue papers are not authoritative, but other references imply application and use of Issue Papers when there are no differences between the issue paper and the SSAP. NAIC staff believe it is imperative to stress application only when the guidance is in line with a current adopted SSAP. As SSAPs have not historically been posted publicly, NAIC staff receive questions that cite guidance in issue papers as they are posted publicly. Often in these situations, the citations have been superseded by more current SSAP, so attempting to use the issue paper guidance in those instances would not be in line with current SSAP. The following Preamble excerpt has been within the NAIC *Accounting Practices and Procedures Manual* since original codification (2000 Manual) and implies that finalized issue papers are applicable but defer to the SSAP if differences exist. (This was paragraph 41 in the 2000 Manual and is reflected as paragraph 45 in the 2024 Manual.)

> 41/45. This Manual consists primarily of Statements of Statutory Accounting Principles (SSAPs). SSAPs are the primary Accounting Practices and Procedures promulgated by the NAIC. These statements are the result of issue papers that have been exposed for public comment and finalized. **Finalized issue papers are in Appendix E. While it is not intended that there be any significant differences between an underlying issue paper and the resultant SSAP, if differences exist, the SSAP prevails and shall be considered definitive.**

The following Preamble excerpt has also been within the NAIC *Accounting Practices and Procedures Manual* since original codification (2000 Manual) and indicates in the absence of a SSAP or "established source of statutory accounting principles," other accounting literature may be considered. As issue papers would represent an established source of statutory guidance, this Preamble guidance could be argued to have always supported issue papers as a source that could be considered along with non-authoritative GAAP if other statutory guidance did not exist. (This is paragraph 40 in the 2000 Manual and is reflected as paragraph 44 in the 2024 Manual.)

40/44. Because of developments such as new legislation or the evolution of a new type of business transaction, there sometimes are no established statutory accounting principles for reporting a specific transaction or event. In those instances, it might be possible to report the event or transaction on the basis of its substance by selecting a statutory accounting principle that appears appropriate when applied in a manner similar to the application of an established statutory principle to an analogous transaction or event. In **the absence of a SSAP or another source of established statutory accounting principles, the preparer, regulator or auditor of statutory financial statements may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes the Statutory Accounting Principles Statement of Concepts and GAAP reference material and accounting literature below category c in the GAAP hierarchy as defined in SAS 69**. The appropriateness of other accounting literature depends on its relevance to the particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, the Statutory Accounting Principles Statement of Concepts would be more authoritative than any other sources of accounting literature. Similarly, FASB Concepts Statements would normally be more influential than other sources below category d in the GAAP hierarchy4.

From a review of all issue papers, NAIC staff has identified that the original issue papers that correspond to the original codification of statutory accounting principles through issue papers adopted in 2000 did not include an "Effective Date" section. Beginning with *Issue Paper No. 107—Certain Health Care Receivables and Receivables Under Government Insured Plans*, which was finalized Aug. 8, 2001, an Effective Date section was included. After that issue paper, some form of "Effective Date" guidance was generally included (but not always). From Issue Paper No. 107 through Issue Paper No. 164, when effective date language was included, it was worded like the excerpts below. Although these excerpts identify that the issue papers are not in the statutory hierarchy, they also indicate an expectation that the issue paper's conclusions can be "applied" once the SSAP has been adopted.

Issue Paper No. 107: Finalized Aug. 1, 2001

28. Upon adoption of this issue paper, the NAIC will release a Statement of Statutory Accounting Principle (SSAP) for comment. The SSAP will contain the adopted Summary Conclusion of this issue paper. **Users of the Accounting Practices and Procedures Manual should note that issue papers are not represented in the Statutory Hierarchy (see Section IV of the Preamble) and therefore the conclusions reached in this issue paper should not be applied until the corresponding SSAP has been adopted by the Plenary of the NAIC.** It is expected that the SSAP will contain an effective date of years ending on or after December 31, 2001.

Issue Paper No. 164: Finalized July 30, 2020

23. The adoption of this issue paper by the Statutory Accounting Principles (E) Working Group, and the substantively revised statement of statutory accounting principles (SSAP) occurred on July 30, 2020. The substantive revisions to SSAP No. 32R are detailed in Exhibit A of this issue paper and reflected in the substantively-revised SSAP No. 32R—Preferred Stock. The effective date of the guidance will be identified in the SSAP. **Users of the Accounting Practices & Procedures Manual should note that issue papers are not represented in the Statutory Hierarchy (see**

[4] As specified by AU Section 411, paragraph 11.

Section IV of the Preamble) and therefore the conclusions reached in this issue paper should not be applied until the corresponding SSAP has been adopted by the Plenary of the NAIC.

Although the original process for issue papers was to have them adopted prior to the development and adoption of the SSAP (which could result in differences between the SSAP and issue paper), current practice more often adopts the SSAP revisions, and then uses the issue paper for historical documentation purposes, or they are completed concurrently. The following effective date language is captured in more recent issue papers adopted between 2019-2023. (Noted also in Issue Papers No. 163, 165 and 167.)

Issue Paper No. 162: Finalized Aug. 3, 2019

24. As issue papers are not represented in the Statutory Hierarchy (see Section IV of the Preamble), the subsequent consideration and adoption of this issue paper will not have any impact of the effective date of the substantive revisions adopted to SSAP No. 62R during the 2018 Fall National Meeting.

NAIC staff only identified the following two issue papers that appear to have been expanded to include language as "not authoritative" in the issue paper's effective date language. These are relatively recent issue papers adopted in 2022 and 2023.

Issue Paper No. 166—Updates to the Definition of a Asset (Finalized Aug. 10, 2022)

21. **As issue papers are not authoritative** and are not represented in the Statutory Hierarchy (see Section V of the Preamble), the consideration and adoption of this issue paper will not have any impact on the SAP clarifications adopted to SSAP No. 4 by the Working Group on August 10, 2022.

Issue Paper No. 168—Updates to the Definition of a Liability (Finalized Aug. 13, 2023)

24. **As issue papers are not authoritative** and are not represented in the Statutory Hierarchy (see Section V of the Preamble), the consideration and adoption of this issue paper will not have any impact on the SAP clarifications adopted to SSAP No. 5R by the Working Group on August 13, 2023.

Ultimately, with the historical guidance in the Preamble and issue paper effective date language that indicates application and usage of issue papers when they do not conflict with statutory accounting guidance, NAIC staff notes the issue papers contain relevant reference information and guidance on the intent of SSAP principles / concepts. Consistent with existing references, issue papers should only be used as a source of statutory guidance when the guidance does not conflict with any other source of established statutory guidance captured in a higher level of the statutory hierarchy.

With direction of a new agenda item, proposed revisions will be drafted to capture the issue papers in the Statutory Hierarchy, with revisions to update the introduction to Appendix E, along with any other noted areas in the Preamble or references on "how to use the manual," etc. Currently, NAIC staff does not anticipate revising the effective date language in the historical Issue Papers. Rather, if supported, consideration could occur on a standard header / footer to reference the placement in the statutory hierarchy upon adoption of that change.

Current Appendix E Introduction is as follows:

Introduction

Issue papers are used as the first step in developing new or revised SSAPs, and each contains a recommended conclusion, discussion and relevant literature section. **While issue papers do not constitute an authoritative level of statutory accounting guidance as defined by the statutory hierarchy, they are an important part of the *Accounting Practices and Procedures Manual* (Manual) because they reference the history and discussion of the related SSAP.**

Issue papers are published in the Manual within Appendix E the first year after adoption of the related SSAP, but are then removed from the subsequent year's Manual and posted for public reference on the Statutory Accounting Principles (E) Working Group (SAPWG) web page at *https://content.naic.org/cmte_e_app_sapwg.htm*.

Current Statutory Hierarchy (2024 AP&P Manual):

V. Statutory Hierarchy

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

Level 1

SSAPs, including U.S. GAAP reference material to the extent adopted by the NAIC from the FASB Accounting Standards Codification[1] (FASB Codification or GAAP guidance)

Level 2

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

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

Level 3

NAIC Annual Statement Instructions

Purposes and Procedures Manual of the NAIC Investment Analysis Office

Level 4

Statutory Accounting Principles Preamble and Statement of Concepts[2]

Level 5

Sources of nonauthoritative GAAP accounting guidance and literature, including: (a) practices that are widely recognized and prevalent either generally or in the industry, (b) FASB Concept Statements, (c) AICPA guidance not included in FASB Codification, (d) International Financial Reporting Standards, (e)

[1] Effective September 15, 2009, the FASB Codification is the source of authoritative U.S. generally accepted accounting principles. As of that date, the FASB Codification superseded all then-existing non-SEC accounting and reporting standards. All other nongrandfathered, non-SEC accounting literature not included in the FASB Codification is nonauthoritative. As of September 15, 2009, AICPA Statements of Position are no longer reviewed as part of the statutory maintenance process as they are no longer considered authoritative GAAP literature. If the AICPA were to address an issue that affects the FASB Codification, an accounting standard update (ASU) would be issued and reviewed for applicability to statutory accounting.

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

Pronouncements of professional associations or regulatory agencies, (f) Technical Information Service Inquiries and Replies included in the AICPA Technical Practice Aids, and (g) Accounting textbooks, handbooks and articles

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

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

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2023-28 (Julie)	**Collateral Loan reporting**	**10 – Form A**	**Comments Received**	**IP – 3**

<u>*Summary:*</u>
On August 13, 2024, the Working Group exposed this agenda item with a request for comments on potential Schedule BA collateral loan reporting lines. The Working Group also sponsored a blanks proposal to begin detailing the revisions to Schedule BA and AVR that would occur with these changes. This action followed prior Working Group discussion and actions to allow, as an interim step, collateral loans with underlying mortgage loans to flow through AVR. This instructional change was supported by the Working Group on May 15, and corresponding RBC revisions were adopted on June 18. Correspondence to the Blanks Working Group on this interim step was received on August 7, 2024.

<u>*Interested Parties' Comments:*</u>
The Working Group requested input from regulators and interested parties to certain AVR related elements. Having reviewed the exposure, interested parties recommend several editorial changes that relate to the exposure.

<u>*Schedule BA*</u>

- Remove the italicized items under the sub-categories and incorporate them into the Schedule BA instructions.
- Consider renaming the sub-category 'Backed by Residual Interests' to 'Backed by Residual Tranches or Interests' for consistency with the Schedule BA category for Residuals.

- For the sub-category 'Backed by Debt Securities,' clarify in the instructions that Debt Securities could be reported on either Schedule D or Schedule BA because it fails the bond definition.
- For the electronic-only column 'Percentage of Collateral to the Collateral Loan,' rename the column 'Current Overcollateralization Percentage' for consistency with the Schedule D column.

AVR

- Consider renaming 'Backed by SSAP No. 48 Investments' to 'Backed by Investments in Joint Ventures, Partnerships, or Limited Liability Companies' (as reported in Schedule BA) for consistency.
- Consider renaming 'Backed by Residuals…' to 'Backed by Residual Tranches or Interests…' for consistency with the Schedule BA category for Residuals.
- Clarify if this new Collateral Loan section should be ahead of or after the newly adopted Capital/Surplus Note section of the schedule.
- Consider modification to the instructions to clarify that amounts include only admitted collateral loans.

Interested parties also suggest clarification from the Working Group if there should be a crosscheck between the newly adopted Note 5S Collateral Loans to the revised Schedule BA category for Collateral Loans, as the sub-categories are different.

The Working Group seeks feedback on whether 'collateral loans backed by mortgage loans' should be part of the new collateral loan category or remain under 'investments with underlying characteristics of mortgage loans' for now. While aligning the AVR and Schedule BA would streamline crosschecks, interested parties prefer continuing the current interim solution until the Life Risk-Based Capital Working Group examines the collateral loan section. Interested parties concur that the mortgage section could need to match the lines referenced in LR009 of the Life Risk-Based Capital Report if that working group desires to continue having these items feed LR009 instead of LR008 within the Life Risk-Based Capital Report. The Life Risk-Based Capital Working Group's initial proposal will provide the necessary detailed AVR lines to support data pulls between filings. We look forward to collaborating with NAIC staff and other groups as we finalize categories within the AVR.

Recommendation:

NAIC staff recommend that the Working Group re-expose this agenda item without revisions and resume discussion once comments have been received on the exposed blanks proposal. (The blanks proposal was exposed on November 6, 2024, for a 90-day comment period ending February 6, 2025.) The interested parties' comments predominantly addressed the presentation of changes within Schedule BA and the AVR schedule and not the overall category breakouts or concept for granularity with collateral loan reporting. With the ability to consider these comments before the blanks exposure, these comments were provided to the Blanks staff and they were considered in the drafting of the blanks proposal.

The key aspect that could warrant advance discussion from the current interested parties' comments will be on the treatment of collateral loans backed by mortgage loans. Previous actions in 2024 have permitted an interim step to allow collateral loans backed by mortgage loans to flow through AVR, using lines 38-64 that generally capture SSAP No. 48 "Investments with the Underlying Characteristics of Mortgage Loans." The comments from interested parties have suggested retaining this AVR reporting, rather than including a separate reporting category in the AVR:

- The benefit of using the existing SSAP No. 48 AVR reporting lines is that there are many lines that allows reporting based on the characteristics of the underlying mortgage loans. However, NAIC staff does not know whether all these lines will be utilized and if reporting entities know the specifics of the underlying mortgages backing collateral loans to properly assess and report in these categories.

- The downfall of using this approach is that the population of collateral loans will be bifurcated in AVR and not reported together in the RBC formula. (If reported collectively with collateral loans, they would

flow through to LR008. If reported with other Schedule BA items with underlying mortgage loans, they would flow through to LR009.)

Although NAIC staff suggests Working Group discussion on this dynamic, it may be most beneficial to receive information from interested parties on which reporting line(s) in AVR the collateral loans backed by mortgage loans will be reported in 2024 and how reporting entities determined which reporting line to utilize. If supported, this information can be requested specifically as part of the re-exposure.

Beginning with year-end 2024, a data-captured disclosure in Note 5T will detail the collateral supporting mortgage loans by broad categories. Although it is too late to expand on the data-capturing for year-end 2024, if collateral backed by mortgage loans will be divided significantly in AVR due to differing characteristics, consideration could occur to expand on the note to capture this information, so regulators know how collateral loans backed by mortgage loans are being reported in AVR. The following details the various AVR lines that could be used:

Line Number	INVESTMENTS WITH THE UNDERLYING
	CHARACTERISTICS OF MORTGAGE LOANS
	In Good Standing Affiliated:
38	Mortgages – CM1 – Highest Quality.....
39	Mortgages – CM2 – High Quality ....
40	Mortgages – CM3 – Medium Quality....
41	Mortgages – CM4 – Low Medium Quality
42	Mortgages – CM5 – Low Quality..........
43	Residential Mortgages – Insured or Guaranteed
44	Residential Mortgages – All Other ....
45	Commercial Mortgages – Insured or Guaranteed
	Overdue, Not in Process Affiliated:
46	Farm Mortgages....................................
47	Residential Mortgages – Insured or Guaranteed
48	Residential Mortgages – All Other ....
49	Commercial Mortgages – Insured or Guaranteed
50	Commercial Mortgages –- All Other .....
	In Process of Foreclosure Affiliated:
51	Farm Mortgages....................................
52	Residential Mortgages – Insured or Guaranteed
53	Residential Mortgages – All Other ....
54	Commercial Mortgages – Insured or Guaranteed
55	Commercial Mortgages – All Other ......
56	Total Affiliated (Sum of Lines 38 through 55)
57	Unaffiliated – In Good Standing With Covenants
58	Unaffiliated – In Good Standing Defeased With Government Securities
59	Unaffiliated – In Good Standing Primarily Senior
60	Unaffiliated – In Good Standing All Other
61	Unaffiliated – Overdue, Not in Process .
62	Unaffiliated – In Process of Foreclosure
63	Total Unaffiliated (Sum of Lines 57 through 62)
64	Total with Mortgage Loan Characteristics (Lines 56 + 63)

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Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-16 (Julie)	**Repacks and Derivative Wrapper Investments**	**11 – Agenda item**	**Comments Received**	**IP – 4**

<u>Summary:</u>
On August 13, 2024, the Working Group exposed revisions to *SSAP No. 86—Derivatives* with a proposal to require bifurcation of debt securities with derivative wrappers or components if the item did not reflect a structured note, as defined in SSAP No. 86. The exposed guidance then detailed the accounting and reporting for the bifurcated debt and derivative components. The detailed agenda item discussed origination of this agenda item (credit repack notes) which are debt securities issued by an SPV, that reflects a combined debt security and a derivative. The agenda item also detailed various statutory accounting and reporting aspects if the item was reported as a single debt instrument.

A key aspect to note with the origination of the agenda item was how these debt securities would be accounted for under the principles-based bond definition:

- If the reporting entity held a traditional debt security, backed by the creditworthiness of the issuer, it would be reported as an issuer credit obligation. If that reporting entity also held a derivative (perhaps a cross-currency swap) that impacted what was received under the debt security, the derivative would be reported under SSAP No. 86 and reported on Schedule DB. There would be no change to the reporting of the debt security as a result of the separate derivative instrument.

- However, If the reporting entity sells that debt security to an SPV and reacquires a debt security that reflects cashflows from the original debt issuance and a derivative component/wrapper, the resulting security no longer reflects an issuer credit obligation. Rather, the revised debt security is an asset-backed security, where payment is driven from the cash flows generated from the underlying collateral, as impacted by the derivative. Unless other features were incorporated to create a substantive credit enhancement, this security would fail the ABS requirements and would be considered a non-bond debt security captured in SSAP No. 21 and captured on Schedule BA.

Although initial consideration tried to assess whether certain structures could continue to be classified as issuer credit obligations, it was noted that the derivatives that can be utilized and combined with the debt security can be complex and are not limited to cross-currency swaps that simply exchange cash flows for another currency. It was identified that even with cross-currency swaps, the SPV wrapped debt security could be altered with the timing of cash flows, whereas there would be bullet payments at maturity, rather than periodic receipt of interest in line with what would have been received if the debt security had been held directly by the reporting entity.

Ultimately, the agenda item proposed to revise the long-standing guidance that embedded derivatives shall not be separated from the host contract and accounted for separately as a derivative instrument, and included proposed revisions to separate the debt securities and derivative components/wrappers in all instances (not just credit repacks). These proposed revisions were exposed at the Summer National Meeting for comment.

<u>*Interested Parties' Comments:*</u>
Interested parties note that this agenda item recommends bifurcation of debt securities with derivative wrappers or components if the item does not reflect a structured note. The guidance details the accounting and reporting guidance for the bifurcated debt and derivative components.

This agenda item has been developed to address debt security investments with derivative components that do not qualify as structured notes. Although the original focus was on specific "credit repack" investments, the scope of the agenda item has been expanded to include all debt security investments with derivative wrappers / components.

As an overview of a special purpose vehicle (SPV) "repacking," the structure consists of an SPV acquiring a debt security and reprofiling the cash flows by entering a derivative transaction with a derivative counterparty (known as "credit repacks"). The redesigned debt instrument (reflecting the combined debt security and derivative) is then sold to an investor. NAIC staff has recently received calls on the classification of repacks under the bond definition, but the discussions of these transactions have identified that additional guidance may be warranted to ensure consistent reporting of these transactions within the statutory financial statements. From the discussions, there are initiatives for these combined investments to become more prevalent with U.S. insurance entities, but investment firms have noted that these investments are already common in other countries.

As a key element, repacking (and potentially other derivative wrapped debt structures) takes two separate items (debt security and derivative) and combines them into one instrument that resembles a debt security. This is done at an SPV, with the SPV issuing a new debt security to the reporting entity. From discussions, there are several variations of the derivative components that can be combined with the debt security. Some of them are very simple (such as a cross-currency swap), but others are complex, altering both the amount and timing of cash flows. The structures can be customized allowing for ongoing innovation, benefiting insurers with the ability of entering derivative transactions to appropriately reduce risk, but creating difficulty in the ability to group repacks structures into limited exception guidance.

Interested parties note that U.S. insurance companies do not have significant holdings of credit repack securities and note the following challenges with the exposure:

An insurance company is not the counterparty to the derivative embedded within the SPV and therefore it would be inappropriate to report the derivative on schedule DB for the following reasons:

- The investor does not control or own the derivative directly and reporting the derivative in Schedule DB would be inconsistent with state law. Also, the investor would not have the requisite information to complete Schedule DB (e.g., when they are rolled into a new derivative, terms of the derivative, etc.),

- The insurer may not have the information to apply the requisite hedge accounting requirements including determining whether the derivative qualifies as hedging, income generation, or replication (synthetic asset) transactions and/or, and

- Companies would potentially need a new category within their derivative use plans.

These reasons would create unneeded complexity for companies when the "plain vanilla" derivatives (e.g., cross currency swaps or fixed for floating (or vice versa) swaps) could be used in replicating a bond through a replication strategy.

Lastly, bifurcating the derivative and the bond in such SPVs would presumably create a restricted asset (bond) as the derivative has no margin requirement. This could result in showing a liability for the insurance company which would be inconsistent with the overall approach used in statutory accounting and reporting and/or legal requirements.

Interested parties believe that insurers that own these types of instruments will need to evaluate the debt investment in its entirety to determine if the PBBD has been met. Therefore, we do not believe that further guidance is needed on this topic.

Recommendation:
NAIC staff recognizes that the exposed change to SSAP No. 86 to separate embedded derivatives is a key change from original statutory accounting concepts. Based on the comments received, this change is not supported by interested parties. If preferred by Working Group members, NAIC staff recommends that this proposal be modified to eliminate the exposed revisions to separate embedded derivatives. Instead, NAIC

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recommends that this agenda item be limited to sponsoring blanks revisions to clarify the guidance on the bond disposal/acquisition schedules (as shown in the agenda item) to ensure that the sale of a security to an SPV for which a debt security is acquired back from the SPV with derivative wrappers (or other components) is shown as a disposal and acquisition.

NAIC is not currently recommending revisions to encompass more disclosure or reporting codes to identify debt securities with derivative components that do not reflect structured notes and/or to provide interpretative guidance under the bond definition. NAIC staff can proceed with proposing guidance on these elements if Working Group members believe additional disclosure or guidance for these items are necessary.

The comment letters are included in Attachment 12 (20 pages).

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/11-17-24 Fall National Meeting/Hearing/00 - 11-17-2024 - SAPWG Hearing Agenda.docx

Draft: 8/27/24

Statutory Accounting Principles (E) Working Group
Chicago, Illinois
August 13, 2024

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met in Chicago, IL, Aug. 13, 2024. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Sheila Travis and Richard Russel (AL); Kim Hudson (CA); William Arfanis and Michael Estabrook (CT); Rylynn Brown (DE); Cindy Andersen (IL); Melissa Gibson and Bill Werner (LA); Judy Weaver (MI); Keith Nyhan (NH); Bob Kasinow (NY); Diana Sherman (PA); Jamie Walker (TX); Doug Stolte and Jennifer Blizzard (VA); and Amy Malm and Elena Vetrina (WI). Also participating was David Wolf (NJ).

1. Adopted its May 15 and Spring National Meeting Minutes

Bruggeman directed the Working Group to its May 15 and March 16 minutes. During its May 15 meeting, the Working Group took the following action: 1) adopted support and sponsorship for the Schedule BA modified blanks proposal 2023-12BWG, which incorporates revisions for non-bond debt securities pursuant to the principles-based bond project effective Jan. 1, 2025 (Ref #2023-16); 2) adopted revisions to *Statement of Statutory Accounting Principles (SSAP) No. 107—Risk-Sharing Provisions of the Affordable Care Act,* which: a) removed the transitional reinsurance program and risk corridor disclosures as both programs have expired; and b) removed the portion for the transitional reinsurance program and the risk corridors program from the roll-forward illustration in Exhibit B (Ref #2014-13); and 3) exposed revisions to the principles-based bond project, which detailed discussions of the project. (Ref #2019-21).

Additionally, the Working Group met Aug. 8 in regulator-to-regulator session, pursuant to paragraph 3 (specific companies, entities, or individuals) and paragraph 6 (consultations with NAIC staff related to NAIC technical guidance) of the NAIC Policy Statement on Open Meetings, to discuss the Summer National Meeting agendas.

Sherman made a motion, seconded by Walker, to adopt the Working Group's May 15 (Attachment One-A) and March 16 minutes (*see NAIC Proceedings – Spring 2024, Accounting Practices and Procedures (E) Task Force, Attachment One*). The motion passed unanimously.

2. Reviewed Comments on Non-Contested Positions

The Working Group reviewed comments on non-contested positions (Attachment One-B).

A. Ref #2024-02

Bruggeman directed the Working Group to agenda item *2024-02: Accounting Standards Update (ASU) 2023-01, Leases (Topic 842), Common Control Arrangements* (Attachment One-C). Jake Stultz (NAIC) stated that ASU 2023-01 focuses on two issues, both related to private company stakeholders' concerns about applying Topic 842 to related party arrangements between entities under common control. The first issue provides a practical expedient for private companies and not-for-profit entities that are not conduit bond obligors, and the second issue involves the accounting for leasehold improvements associated with a lease between entities under common control. Stultz stated that interested parties had no comments on this item and that NAIC staff recommend the Working Group adopt, with modification, ASU 2023-01 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*.

B. Ref #2024-03

Bruggeman directed the Working Group to agenda item *2024-03: ASU 2023-08, Accounting for and Disclosure of Crypto Assets* (Attachment One-D). Stultz stated that, on March 16, the Working Group exposed revisions to adopt, with modification, *ASU 2023-08, Intangibles—Goodwill and Other—Crypto Assets (Subtopic 350-60), Accounting for and Disclosure of Crypto Assets* in *SSAP No. 20—Nonadmitted Assets* and with the intent of also nullifying *Interpretation (INT) 21-01: Accounting for Cryptocurrencies* (Attachment One-E). The adoption of this agenda item incorporates guidance in SSAP No. 20 that crypto assets are nonadmitted assets for statutory accounting. Stultz stated that interested parties had no comments on this item and that NAIC staff recommend that the Working Group adopt the exposed revisions to SSAP No. 20 and nullify INT 21-01 upon the adoption of this agenda item, as the revisions to SSAP No. 20 also incorporate and expand guidance previously in INT 21-01.

C. Ref #2024-08

Bruggeman directed the Working Group to agenda item *2024-08: Consistency Revisions for Residuals* (Attachment One-F). Julie Gann (NAIC) stated that on March 16, the Working Group exposed revisions to incorporate consistency revisions for residual tranches and residual security interests. Over the last few years, various revisions have been incorporated for residual interests. These began with revisions to clarify the reporting on Schedule BA (instead of Schedule D-1) along with the residual definition and guidance within each investment SSAP to highlight that residuals shall be captured on Schedule BA. Although these revisions were necessary to immediately address the reporting of residuals, the discussions that accompanied these revisions noted that conforming revisions would be needed coinciding with the effective date of the principles-based bond definition guidance to have consistency in guidance location, terminology, and definitions. Gann stated that, with the revisions to *SSAP No. 21—Other Admitted Assets*, to provide the accounting and reporting for residuals, all residuals, regardless of investment structure, shall follow the guidance detailed in SSAP No. 21 and be reported on Schedule BA. She stated that to ensure consistency in definitions and guidance, this agenda item proposes to centralize residual guidance within SSAP No. 21 and use a consistent approach in the other investment SSAPs to exclude residuals from their scope and direct companies to SSAP No. 21. Gann stated that interested parties support the proposed changes and that NAIC staff recommend that the Working Group adopt the exposed revisions, to be effective Jan. 1, 2025. These changes incorporate consistency revisions for residuals so that all SSAPs refer to SSAP No. 21 for the formal definition and accounting and reporting guidance. This adoption also includes revisions to *SSAP No. 26—Bonds*, *SSAP No. 30—Unaffiliated Common Stock*, *SSAP No. 32—Preferred Stock*, *SSAP No. 43—Asset-Backed Securities*, and *SSAP No. 48—Joint* Ventures*, Partnerships and Limited Liability Companies*. The effective date of Jan. 1, 2025, is necessary to mirror the effective date of the SSAP No. 21 guidance.

D. Ref #2024-09

Bruggeman directed the Working Group to agenda item *2024-09: SSAP No. 2R—Clarification* (Attachment One-G). Gann stated on March 16, the Working Group exposed revisions to *SSAP No. 2—Cash, Cash Equivalents, Drafts and Short-Term Investments*. This agenda item has been developed to update the guidance in SSAP No. 2 to remove a lingering reference to items that have been removed from scope, pursuant to the bond project (asset-backed securities—ABS) or from agenda item 2023-17 (mortgage loans and Schedule BA assets). The edits are focused on the guidance that addresses "rolling" cash equivalents and short-term investments in which there is a continued reference to SSAP No. 43 investments and "other invested assets." This guidance has been revised to

only reflect items in the scope of SSAP No. 2. Gann stated that interested parties have no comments and that NAIC staff recommend that the Working Group adopt the exposed revisions to SSAP No. 2 to eliminate lingering references that imply that ABS, mortgage loans, and other Schedule BA items are permitted to be reported as cash equivalents or short-term investments.

E. Ref #2024-14EP

Bruggeman directed the Working Group to agenda item *2024-14EP: Accounting Practices and Procedures Manual Editorial* (Attachment One-H). Stultz stated that on March 16, the Working Group exposed agenda item 2024-14EP, which proposed to remove the "Revised" and "R" previously intended to identify a substantively revised SSAP from SSAP titles and SSAP references within the *Accounting Practices and Procedures Manual* (AP&P Manual). NAIC staff consider the "Revised" and "R" identifiers to no longer be useful. Stultz stated that interested parties had no comments on this item and that NAIC staff recommend that the Working Group adopt the exposed editorial revisions as exposed.

F. Ref #2023-26

Bruggeman directed the Working Group to agenda item *2023-26: ASU 2023-06, Disclosure Improvements* (Attachment One-I). Wil Oden (NAIC) stated that on March 16, the Working Group exposed revisions to adopt, with modification, *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative*. On Dec. 1, 2023, the Working Group deferred action on ASU 2023-06 to allow NAIC staff further time to consider whether certain aspects of ASU 2023-06 were applicable to statutory accounting. In October 2023, the Financial Accounting Standards Board (FASB) issued ASU 2023-06 in response to a referral from U.S. Securities and Exchange Commission (SEC) Release No. 33-10532, Disclosure Update and Simplification, issued Aug. 17, 2018. The changes detailed in the ASU seek to clarify or improve disclosure and presentation requirements of various topics. Many of the amendments allow users to more easily compare entities subject to the SEC's existing disclosures with those not previously subject to the SEC's requirements, while others represent miscellaneous clarifications or technical corrections of the current disclosure requirements. Two of the more significant items from the SEC referral are the requirement for companies to disclose the weighted average interest rate of debt and provide repurchase agreement (repo) counterparty risk disclosures. The FASB elected to only require the weighted average interest rate disclosure for publicly traded companies due to concerns regarding the complexity of the calculation for private companies. Oden stated that interested parties had no comments on this item and that NAIC staff recommend that the Working Group adopt, with modification, certain disclosures from ASU 2023-06 in *SSAP No. 15—Debt and Holding Company Obligations* and *SSAP No. 86—Derivatives*. The disclosures relevant to repurchase agreements, reverse repurchase agreements, and secured lending will be added to agenda item *2024-04: Conforming Repurchase Agreements* for further consideration as part of the larger project looking at statutory guidance for repurchase agreements and securities lending.

Malm made a motion, seconded by Hudson, to adopt the statutory accounting principles (SAP) concepts and clarifications. The motion passed unanimously.

3. Continued the Exposure of Agenda Item 2024-05

   A. Ref #2024-05

Bruggeman directed the Working Group to agenda item *2024-05: A-791 Paragraph 2.c.* Robin Marcotte (NAIC) stated that on March 16, the Working Group exposed revisions to Appendix A-791, paragraph 2.c. Question and Answer. This agenda item was developed in response to the Valuation Analysis (E) Working Group's referral to the Working Group that recommended making a clarifying edit to Appendix A-791, Life and Health Reinsurance Agreements (A-791), Section 2.c. Question and Answer by removing the first sentence, which reads, "Unlike individual life insurance where reserves held by the ceding insurer reflect a statutorily prescribed valuation premium above which reinsurance premium rates would be considered unreasonable, group term life has no such guide." Marcotte stated that the Valuation Analysis (E) Working Group's referral noted that the sentence was unnecessary and was more of an aside statement in the discussion of group term life; however, the referral raised concerns that this sentence was being misinterpreted. Marcotte stated that interested parties provided no comments.

Mike Monahan (American Council of Life Insurers—ACLI), representing interested parties, stated that the two proposals on risk transfer, agenda items 2024-05 and 2024-06, should be considered together. He stated that interested parties' comments for agenda item 2024-06, which recommended the Working Group delay taking action, were intended to be referenced in agenda item 2024-05.

Walker made a motion, seconded by Clark, to continue the exposure of agenda item *2024-05: A-791 Paragraph 2.c.* until Sept. 27 to allow for further comment.

4. Reviewed Comments on Exposed Items

The Working Group reviewed comments received on previously exposed items (Attachment One-B).

   A. Agenda Item 2019-21

Bruggeman directed the Working Group to agenda item *2019-21: Principles-Based Bond Project*. Gann stated that the Working Group exposed updates to the draft issue paper for the principles-based bond project for a public comment period that ended June 21. The issue paper documents the discussions and decisions within the principles-based bond project and has been updated to reflect the final actions. Additionally, consistency edits and reorganization have been reflected as the authoritative SAP revisions have been adopted. (As a reminder, issue papers are not authoritative; they simply provide background and discussion elements for historical reference.) Changes from the prior exposed version are shown as tracked within the document. Gann stated that NAIC staff recommend that the Working Group adopt the issue paper with modifications to reflect the interested parties' comments (Attachment One-J). Revisions to reflect the comments are shaded yellow in the agenda item. In addition to these changes, in paragraph 36, the last sentence has been revised to be overly clear that the reporting entity shall assess structures when acquired, based on what the issuer intended at the origination. Gann stated that, as a second action, NAIC staff recommend that the Working Group expose a Question-and-Answer Implementation Guide (Q&A) that addresses issues brought from industry to the Bond/American Institute of Certified Public Accountants (AICPA) small group. This Q&A details interpretations of how the SAP guidance should be applied to specific investment structures or characteristics.

Clark made a motion, seconded by Walker, to adopt the exposed revisions to agenda item *2019-21: Principles-Based Bond Project* and expose the Q&A for a public comment period ending Sept. 27. The motion passed unanimously.

B. Agenda Item 2024-01

Bruggeman directed the Working Group to agenda item *2024-01: Bond Definition – Debt Securities Issued by Funds*. Gann stated that on March 16, the Working Group re-exposed revisions to both SSAP No. 26 and the draft issue paper for the principles-based bond project to clarify the guidance for debt securities issued by funds. The revisions intended to eliminate the rules-based provision, in which SEC registration for a fund is required, and instead permit debt securities issued by funds to be classified as issuer credit obligations if the fund represents an operating entity. The revisions included guidance to assist in determining whether a fund represents an operating entity, and the issue paper guidance continued to identify that collateralized fund obligations (CFOs) and other similar structures would be required to be assessed as ABS to determine if they qualify for bond reporting. Gann stated that the Working Group re-exposed this item with a request that state insurance regulators and industry provide comments on the proposed language that assists with clarifying the scope of guidance and the types of debt securities issued by funds that should be considered as operating entities, and the proposed language to better define the extent of debt that may be issued to fund operations. This re-exposure and request for clarification intends to address interpretations from the original exposure that the revised guidance would permit feeder funds (and other structures that raise debt capital) to be classified as issuer credit obligations. Gann stated that NAIC staff recommend that the Working Group expose language to clarify guidance for debt securities issued by funds for a shortened timeframe ending Sept. 6. Based on the comments received, this agenda item could be considered for adoption via e-vote. If needed, an interim call will be held to discuss comments received. Please note that although industry has communicated support for the 'revised language,' the revised language was developed in the interim while working with industry and was not formally exposed. This exposure is considered appropriate to ensure state insurance regulators and all industry representatives have time to review the revised language.

Clark made a motion, seconded by Malm, to expose language to clarify guidance for debt securities issued by funds for a shortened timeframe for a public comment period ending Sept. 6. The motion passed unanimously.

C. Agenda Item 2024-04

Bruggeman directed the Working Group to agenda item *2024-04: ASU 2023-04 – Conforming Repurchase Agreements*. Gann stated that on March 16, the Working Group exposed this agenda item for comments, which had been developed in response to the January 2024 referral received from the Life Risk-Based Capital (E) Working Group. The referral was sent for assistance to address an ACLI request to modify the treatment of repurchase agreements in the life risk-based capital (RBC) formula to converge with treatment for securities lending programs. As detailed within the ACLI-sponsored life RBC proposal, the request is to incorporate a concept of "conforming programs" for repurchase agreements, with the collateral attributed to these programs assigned a 0.2% (.0020) factor instead of a 1.26% (0.0126) factor. Gann stated that interested parties support the ACLI comment letter submitted April 17. Gann stated that NAIC staff have developed a memorandum that walks through the accounting and reporting for securities lending and repurchase agreements with noted questions. NAIC staff have noted inconsistencies in the application of these transactions across companies, particularly when the components are identified as restricted and how they flow through RBC. They recommend clarification of the guidance to mitigate inconsistencies. Gann stated that NAIC staff recommend the exposure of this memorandum with a request for feedback on the documented processes and the noted questions. NAIC staff have met with

industry representatives in the interim and suggest continued interim discussions with the ACLI and other industry representatives on these transactions and appropriate accounting/reporting.

Walker made a motion, seconded by Kasinow, to expose the memorandum with a request for feedback on the documented processes and the noted questions for a public comment period. The motion passed unanimously.

D. Agenda Item 2024-06

Bruggeman directed the Working Group to agenda item *2024-06: Risk Transfer Analysis on Combination Reinsurance Contracts*. Marcotte stated that on March 16, the Working Group exposed agenda item 2024-06 to address the risk transfer aspect of a December 2023 Valuation Analysis (E) Working Group referral. The exposed revisions to *SSAP No. 61—Life, Deposit-Type and Accident and Health Reinsurance* were narrowly focused on risk transfer and incorporated guidance noting that interdependent contract features such as a shared experience refund must be analyzed in the aggregate when determining risk transfer. The Working Group exposure was based on existing guidance that is in both the U.S. generally accepted accounting principles (GAAP) and *SSAP No. 62—Property and Casualty Reinsurance* Exhibit A – Implementation Questions and Answers, question 10, which provides guidance stating that contracts with interdependent features must be analyzed in the aggregate for risk transfer. In addition, a reference to A-791, paragraph 6 was proposed to be added to existing yearly renewable term (YRT) guidance, which would require that the reinsurance contract include provisions that the agreement shall constitute the entire agreement between the parties with respect to the business being reinsured thereunder and that there are no understandings between the parties other than as expressed in the agreement. The Valuation Analysis (E) Working Group, Life Actuarial (A) Task Force, and Reinsurance (E) Task Force were all notified of the exposure. The Valuation Analysis (E) Working Group referral identified some combined YRT and coinsurance contracts with an aggregate experience refund and the inability to independently recapture the different types of reinsurance. The referral noted that the contract must be evaluated in aggregate for risk transfer in such cases. The Valuation Analysis (E) Working Group referral also noted that the complexity of such contracts was not readily apparent to regulatory reviewers, and the Valuation Analysis (E) Working Group wanted to increase awareness of this topic. It noted concerns with companies either taking too large of reinsurance credit or an inappropriate credit.

Marcotte stated that the Working Group received two comment letters. The comment letter from Clare Thinking, Inc. supported the exposure, agreeing that interdependent contract features must be analyzed in aggregate and that the intent of A-791 was that reinsurance credit should not include the possibility of negative surplus impact to the ceding entity. Marcotte stated that the interested parties commented that the exposed language is characterized as a clarification; it is unclear that the proposed changes are strictly clarifications. Specifically, interested parties are concerned that the exposed language could lead to broader interpretive changes across the industry. She stated that the interested parties noted that such combination contracts need to be analyzed individually to determine if risk transfer is met. Marcotte stated that interested parties suggest that further discussion between industry participants, the NAIC, and state insurance regulators on this important topic would ensure mutual understanding of intent. Marcotte noted that several of the comments received were regarding the Valuation Analysis (E) Working Group's referral rather than the exposed language.

Marcotte stated that NAIC staff recommend re-exposing the agenda item until Sept. 27 to allow for discussion at the Fall National Meeting. She recommended that the Working Group specifically request comments on: 1) detail on the extent to which this agenda item would impact existing YRT combination contracts; and 2) specific language regarding the concept that interdependent contract features should be analyzed in aggregate. In

addition, Marcotte recommended that the comments received by the Working Group on the most recent exposure be shared with the same groups notified of the prior exposure.

Monahan stated that the ACLI supports re-exposing this agenda item, which the ALCI views as more than a clarification. He noted that the ACLI will provide examples to the Working Group on the complexities of the issues.

Clark requested more information on the dollar magnitude of the treaties that might not qualify for risk transfer. He noted from initial regulator reviews of Schedule S that there seem to be relatively few contracts. He stated that he views this as a clarification, as it has been widely understood for both GAAP and statutory accounting that interdependent contract features (whether in separate contracts or the same contract) need to be analyzed in aggregate. Clark stated that, in his view, this re-exposure is to gather more information rather than a concern regarding the exposed language. Bruggeman also stated that the exposed language was narrow, and comments addressed to this Working Group should focus on the exposed language.

Sheldon Summers (Claire Thinking, Inc.) stated that his comments were his own opinion. He stated that when the *Life and Health Reinsurance Agreements Mode Regulation* (#791) was adopted, one of the main objectives was that reinsurance agreements that provided surplus relief should only reflect surplus relief that had permanence. Therefore, several of the provisions of Model #791 are meant to ensure that reported surplus relief reflects permanence. For example, renewal expense allowances have to cover expenses. Otherwise, the company would incur expenses greater than what it would receive, which would deplete the surplus over time. Therefore, that type of surplus relief would not be considered permanent. Other provisions also address this major objective. Summers stated that a reinsurance agreement that includes coinsurance that imposes an obligation for a YRT agreement, and the two coverages are interdependent, should be reviewed in their entirety to ensure they meet the objectives of A-791.

Hudson made a motion, seconded by Clark, to re-expose agenda item 2024-06 for a public comment period ending Sept. 27 and directed NAIC staff to forward the comments previously received to the Valuation Analysis (E) Working Group, Life Actuarial (A) Task Force, and Reinsurance (E) Task Force. The motion passed unanimously. The Working Group specifically requested: 1) industry examples; 2) details on both the dollar impact and the number of existing YRT combination contracts that might not meet risk transfer from the exposed revisions; and 3) that specific language regarding the concept that interdependent contract features be analyzed in aggregate.

E. Agenda Item 2024-07

Bruggeman directed the Working Group to agenda item *2024-07: Reporting of Funds Withheld and Modco Assets.* Stultz stated that on March 16, the Working Group exposed a concept agenda item with the intent to develop future revisions to annual statement Schedule S and Schedule F to address the reporting of assets subject to funds withheld and modified coinsurance (modco) arrangements. The initial recommendation is to add a new part to the reinsurance Schedule S in the life/fraternal and health annual statement blanks and Schedule F in the property/casualty (P/C) and title annual statement blanks. The new part would be similar in structure to Schedule DL, include all assets held under a funds withheld arrangement, and include a separate signifier for modco assets. Stultz stated that interested parties acknowledge the importance of transparency in financial reporting with respect to assets backing funds withheld and modco reinsurance transactions and state insurance regulators' preference to be able to understand the assets supporting these contracts. Stultz stated that NAIC staff recommend that the Working Group expose the draft of the new reporting schedules, which add a new part to the reinsurance Schedule S in the life/fraternal and health annual statement blanks and Schedule F in the P/C and title annual statement blanks and direct NAIC staff to continue working with interested parties on this proposal.

Walker made a motion, seconded by Hudson, to expose the draft of the new reporting schedules for a public comment period ending Sept. 27 and direct NAIC staff to continue collaborating with interested parties on this proposal. The motion passed unanimously.

F. Agenda Item 2024-10

Bruggeman directed the Working Group to agenda item *2024-10: SSAP No. 56—Book Value Separate Accounts*. Gann stated that on March 16, the Working Group exposed an agenda item to expand the guidance in *SSAP No. 56—Separate Accounts* to further address situations and provide consistent accounting guidelines for when assets are reported at a measurement method other than fair value. The guidance in SSAP No. 56 predominantly focuses on separate account products in which the policyholder bears the investment risk. In those situations, the assets in the separate account are reported at fair value. SSAP No. 56 provides limited guidance for assets supporting fund accumulation contracts such as guaranteed investment contracts (GICs), which do not participate in underlying portfolio experience, with a fixed interest rate guarantee, purchased under a retirement plan or plan of deferred compensation, established or maintained by an employer, with the direction that these assets shall be recorded as if they were held in the general account. This measurement method is generally referred to as "book value." NAIC staff are aware that there has been an increase in assets reported at "book value" within the separate account. Gann stated that these have been approved under state-prescribed practices and/or interpretations that the reference for fund accumulation contracts captures pension risk transfer (PRT) or registered indexed-linked annuities (RILA) and other similar general-account type products that the state of domicile has approved for reporting in the separate account. Gann stated that interested parties are currently working with NAIC staff and the Interest Maintenance Reserve (IMR) Ad Hoc Group on this agenda item. She stated that NAIC staff recommend that the Working Group expose draft revisions to SSAP No. 56 to allow for initial review and consideration of potential changes to update measurement method guidance and specify the process to transfer assets for cash between the general and book-value separate accounts. In addition to the proposed revisions, NAIC staff questions are shaded in the document requesting additional information from state insurance regulators and industry. These questions focus predominantly on seed money and other asset transfers not captured in the proposed guidance. Gann stated that it is proposed that this item be exposed for a public comment period ending Nov. 8 to allow more time for review and comment generation. Discussion of the comments is anticipated in the interim prior to the 2025 Spring National Meeting.

Walker made a motion, seconded by Clark, to expose draft revisions to SSAP No. 56 to allow for initial review and consideration of potential changes to update measurement method guidance and specify the process to transfer assets for cash between the general and book-value separate accounts for a public comment period ending Nov. 8. The motion passed unanimously.

G. Agenda Item 2024-11

Bruggeman directed the Working Group to agenda item *2024-11: ASU 2023-09, Improvements to Income Tax Disclosures*. Oden stated that on March 16, the Working Group exposed revisions to adopt, with modification, ASU 2023-09, Improvements to Income Tax Disclosures. However, based on the comments from interested parties, the NAIC staff recommendation has been changed from adopt with modification to reject for statutory accounting purposes. Oden stated that NAIC staff agreed with interested parties' comments that the additions from the ASU are duplicative of existing statutory income tax disclosures. NAIC staff have maintained the recommendation of deleting paragraph 23.b. from *SSAP No. 101—Income Taxes*, as both staff and interested parties agree this disclosure is no longer relevant. As the NAIC staff recommendation has been changed, the

updated agenda will be exposed for a public comment period ending Sept. 27 to allow for consideration at the Fall National meeting.

Hudson made a motion, seconded by Weaver, to expose revisions to reject ASU 2023-09, Improvements to Income Tax Disclosures, and delete paragraph 23.b. from SSAP No. 101. The motion passed unanimously.

H. Agenda Item 2024-12

Bruggeman directed the Working Group to agenda item *2024-12: Updates to SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures*. Oden stated that on March 16, the Working Group exposed revisions to remove references to *FASB Statement No. 105, Disclosure of Information about Financial Instruments with Off-Balance-Sheet* (FAS 105) from *SSAP No. 27* and amend the annual statement instructions to clarify its scope and requirements. It came to NAIC staff's attention that SSAP No. 27 references the long out-of-date FAS 105, which had been superseded by *FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities* (FAS 133) prior to the establishment of the Accounting Standards Codification framework. Additionally, NAIC staff noted that the annual statement instructions only provide disclosures for derivative swaps, futures, and options. However, the guidance in SSAP No. 27 is intended to be applicable to all derivative instruments and financial instruments, except those specifically carved out by the reference to FAS 105. Oden stated that NAIC staff recommend amending SSAP No. 27 to specifically list the financial instruments excluded from the SSAP rather than referencing FAS 105 and that the annual statement instructions to add an "Other" derivatives category, disclosure examples, and instructions for non-derivative financial instruments with off-balance sheet credit risks. Oden stated that NAIC staff recommend that the Working Group defer this agenda item while staff continue to work with industry on this agenda item. Bruggeman stated agreement with the deferral, and no action is required.

I. Agenda Item 2022-12

Bruggeman directed the Working Group to agenda item *2022-12: Review of INT 03-02: Modification to an Existing Intercompany Pooling Arrangement.* Marcotte stated that on March 16, the Working Group deferred action on this agenda item, originally introduced in 2022 and proposed nullifying *INT 03-02: Modification to an Existing Intercompany Pooling Arrangement* (Attachment One-K). The INT was initially proposed to be nullified as it is inconsistent with the *SSAP No. 25—Affiliates and Other Related Parties* guidance regarding economic and non-economic transactions between related parties. After discussion, the Working Group exposed revisions to maintain the exception, which allows for the use of the statutory book valuation when using assets (such as bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements.

Marcotte stated that interested parties agree with and support the adoption of the proposed changes; however, the interested parties suggested rewording the disclosure in *SSAP No. 63—Underwriting Pools*, paragraph 13.i. for clarity. Marcotte stated that NAIC staff recommend that the Working Group adopt the exposed revisions to SSAP No. 63 with a modification to paragraph 13.i., which is similar to the edits suggested by interested parties modified to note disclosure should reflect the fair values that differ from statement value. With this adoption, INT 03-02 would also be nullified. Marcotte noted that interested parties supported the revised paragraph 13 wording.

Hudson made a motion, seconded by Weaver, to adopt the exposed revisions to SSAP No. 63 with a modification to paragraph 13.i. and the nullification of INT 03-02 (Attachment One-L). The motion passed unanimously.

5. Considered Maintenance Agenda – Pending Listing

Walker made a motion, seconded by Hudson, to expose the following SAP concepts and clarifications to statutory accounting guidance for a public comment period ending Sept. 27, except for agenda item 2024-15, which was exposed for a public comment period ending Nov. 8. The motion passed unanimously.

A. Agenda Item 2022-14

Bruggeman directed the Working Group to agenda item *2022-14: New Market Tax Credit Project*. Oden stated this is the issue paper for the new market tax credit (NMTC) project that the Working Group adopted at the Spring National Meeting. Agenda item 2022-14 adopted conceptual changes to *SSAP No. 93—Low-Income Housing Tax Credit Property Investments* and *SSAP No. 94—Transferable and Nontransferable State Tax Credits*, which included expanding the scope of SSAP No. 93 to include all qualifying types of tax credit investments, regardless of structure or underlying tax credit program. The scope of SSAP No. 94 was also expanded to include purchased state and federal tax credits along with updates to the accounting guidance. He stated that the issue paper documents the discussion and decisions on this project, including updates and revisions, and includes a final tracked changes version of SSAP No. 93 and SSAP No. 94, as well as a flowchart that may be useful for industry when evaluating the new decision trees for SSAP No. 93. Oden stated that NAIC staff recommend the Working Group expose the draft issue paper for a public comment period ending Sept. 27 for consideration at the Fall National Meeting.

B. Agenda Item 2024-18

Bruggeman directed the Working Group to agenda item *2024-18: Clarifications to NMTC Project.* Oden stated that this agenda item involves clarifications to the adopted guidance from agenda item 2022-14, adopted at the Spring National Meeting. Oden stated that, after adoption, several certified public accounting (CPA) firms raised questions about the accounting guidance in SSAP No. 93 and SSAP No. 94. He stated that NAIC staff agreed with their points, discussed them with interested parties, and drafted revisions to the accounting guidance in both SSAP No. 93 and SSAP No. 94 to align with the journal entry examples that had been added to each SSAP. Additionally, NAIC staff noted that a sentence in SSAP No. 48 had not been updated as part of the NMTC project, and revisions to that sentence have been included in this agenda item. Oden stated that NAIC staff recommend that the Working Group move this item to the active listing, categorize it as a SAP clarification, and expose revisions to SSAP No. 48, SSAP No. 93, and SSAP No. 94, effective Jan. 1, 2025.

C. Agenda Item 2023-24

Bruggeman directed the Working Group to agenda item *2023-24: Current Expected Credit Losses (CECL)*. Oden stated that this is the issue paper that the Working Group directed staff to prepare on CECL. As a reminder, on Jan. 10, the Working Group adopted 2023-24, which proposed revisions to various SSAPs to reject *ASU 2016-13, Measurement of Credit Losses on Financial Instruments* (CECL), and other CECL-related ASUs for statutory accounting purposes. Upon adoption, the Working Group directed NAIC staff to prepare an issue paper documenting pre-CECL impairment guidance. Since many SSAPs adopted pre-CECL impairment guidance, the Working Group wanted to ensure that any guidance superseded by CECL was readily available for future use. Oden stated that NAIC staff recommend the Working Group expose the draft issue paper for a public comment period ending Sept. 27 for consideration at the Fall National Meeting.

D. Agenda Item 2024-15

Bruggeman directed the Working Group to agenda item *2024-15: ALM Derivatives.* Gann stated that this is a new concept agenda item addressing asset-liability matching (ALM) derivatives and arose from the IMR Ad Hoc Group. Gann stated that when *INT 23-01: Net Negative (Disallowed) Interest Maintenance Reserve* was developed, it was identified that some life companies have been including gains and losses from derivatives in IMR that were not considered accounting-effective under SSAP No. 86 but were deemed economically effective. These derivatives are recorded at fair value, with gains and losses running through surplus. Upon termination, if deemed economically effective, the realized gains and losses were reversed to IMR and amortized over time by some life entities.

This practice has been deemed inconsistent and is now being reviewed. Gann stated that this agenda item contemplates a new SSAP similar to *SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees*, which deals with derivative hedging for variable annuity guarantees and allows deferring gains and losses for those specific derivatives. She stated that the agenda item proposes developing a new SSAP to address similar issues for ALM derivatives in which the derivative gains and losses would be deferred and not go through IMR.

Gann stated that this is a concept exposure without revisions to existing guidance. She stated that the agenda item seeks feedback on developing statutory accounting guidance for deferring derivative gains and losses that hedge interest rate risk, like the process used in IMR but more formalized. She noted that the exposure also requests input on whether there should be an aggregate limit on "soft assets," such as negative IMR, electronic data processing (EDP) equipment, deferred tax assets, and goodwill. Gann stated that this will likely be a complex long-term discussion, potentially taking a few years to develop fully. She stated that the public comment period ends Nov. 8, and there is no plan to discuss it at the Fall National Meeting. Gann recommended that NAIC staff continue working with industry to better understand derivative programs, which include two broad types and effectiveness tests.

Bruggeman noted that derivatives that are not accounting effective are carried at fair value; therefore, their unrealized gain or loss results are already shown in surplus, and therefore, having the realized gain or loss be reversed to IMR when the derivate ends seemed counterintuitive. He noted that this is a good time for the Working Group to discuss aggregate limitations on soft assets.

Andersen asked how common these types of derivatives are. Gann stated that approximately nine companies are using the guidance from SSAP No. 108, and while not many companies are using IMR for derivatives, those that do have significant amounts involved. Gann stated that per the NAIC staff review of the 2023 narrative disclosures on negative IMR, disclosures were not consistently fully completed. However, she does expect improvement in 2024, as the disclosures will now be data-captured. Based on the NAIC staff review, only 14 companies were identified as reporting derivatives in IMR. As a caveat, reporting entities that had previously reported derivative gains in IMR were allowed to continue reporting derivative losses under INT 23-01, which is effective until year-end 2025.

Bruggeman noted that the derivative loss amounts deferred and admitted as negative IMR were material for some of those entities. Clark stated that more reporting entities would likely apply the guidance if such guidance were codified. Wolf stated that the deferral could be either realized gains or losses; therefore, the practice may provide either a benefit or a detriment. Bruggeman requested a state insurance regulator review of this agenda item during the exposure period.

E. Agenda Item 2024-16

Bruggeman directed the Working Group to agenda item *2024-16: Repacks and Derivative Wrapper Investments*. Gann stated that this agenda item was developed to address debt security investments with derivative components that do not qualify as structured notes. Although the original focus was on specific "credit repack" investments, the agenda item has been expanded to ensure that all debt security investments with derivative wrappers/components are captured. Gann stated that a credit repack involves an entity selling a debt instrument to a Special Purpose Vehicle (SPV), which then wraps it with a derivative and sells it back. These structures fall into the ABS category but fail the bond definition due to a lack of substantive credit enhancement. Gann noted that she does not believe that these are prevalent in the U.S. but are apparently more common in Europe. Gann also noted that the lack of transparency regarding derivative structures within financial statements is a concern with these types of investments. Proposed changes suggest separating derivatives from bond structures on Schedule D with industry support. Companies should treat transactions involving bond changes as dispositions and reacquisitions. Gann stated that NAIC staff recommend that the Working Group expose proposed edits to SSAP No. 86 to establish guidance that requires separate accounting and reporting of derivatives captured in debt security structures. She stated that this is a significant change from existing guidance, which explicitly precludes the separation of embedded derivatives. In addition to these changes, minor revisions are proposed to SSAP No. 26 and the annual statement instructions to clarify application guidance. Gann stated that NAIC staff will draft an issue paper to document these revisions. She stated that the initial proposed public comment period ends Sept. 27 to allow for discussion at the Fall National Meeting.

F. Agenda Item 2024-17

Bruggeman directed the Working Group to agenda item *2024-17: SSAP No. 108 – VM-01*. Gann stated that this agenda item has been prepared to update the guidance in *SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees* for a clearly defined hedging strategy (CDHS). She stated that this update relates to the derivative guidance mentioned previously. Originally, it incorporated the definition of a CDHS adopted by the Life Actuarial (A) Task Force in Valuation Manual (VM)-21, Requirements for Principle-Based Reserves in Variable Annuity. This definition has since moved to VM-01, Definitions for Terms in Requirements, so this proposal is to update SSAP No. 108 to refer to VM-01 instead of VM-21 to ensure consistency. Gann stated that NAIC staff recommend that the Working Group move this item to the active listing and expose revisions to SSAP No. 108 to update the definition of a CDHS to reflect the revised guidance pursuant to VM-01 for a planned exposure until Sept. 27 to allow for consideration at the Fall National Meeting.

G. Agenda Item 2024-19

Bruggeman directed the Working Group to agenda item *2024-19: ASU 2024-02, Codification Improvements.* Oden stated that this agenda proposes removing references to FASB concept statements from the codification. He stated that NAIC staff recommend exposing revisions to reject this within *Appendix-D— Nonapplicable GAAP Pronouncements* as not applicable for statutory accounting since these references are not frequently used and are intentionally included when necessary. Oden stated that the exposure would end Sept. 27 to allow for consideration at the Fall National Meeting.

6. Considered Maintenance Agenda – Active Listing

   A. Agenda Item 2023-28

Bruggeman directed the Working Group to agenda item *2023-28: Collateral Loan Reporting*. Gann stated that NAIC staff are proposing a new reporting line for collateral loans. Currently, collateral loans do not go through asset valuation reserve (AVR) but are reported directly. She stated that some companies report them in different AVR reporting lines for improved RBC. Gann stated that NAIC staff are proposing more granular reporting lines and note disclosures for collateral loans based on underlying collateral. The goal is to have this change in effect by Jan. 1, 2026. She stated that NAIC staff intend to expose this proposal and get feedback before adoption and that NAIC staff recommend exposure of this agenda item with a request for comments on potential Schedule BA collateral loan reporting lines. She stated that, with exposure, NAIC staff recommend sponsoring a blanks proposal to begin detailing the revisions to Schedule BA and AVR that would occur with these changes. As the resulting AVR and RBC factors would be contingent on the actions of the Capital Adequacy (E) Task Force (and its RBC working groups), NAIC staff recommend that the Working Group direction notify those groups of this action.

Walker made a motion, seconded by Clark, to expose agenda item 2023-28, which includes sponsoring a blanks proposal to begin detailing the revisions to Schedule BA and AVR that would occur with these changes.

7. Discussed Other Matters

   A. Review of U.S. GAAP Exposures

Stultz identified one GAAP item currently exposed by the FASB (Attachment One-M). He stated that comments are not recommended at this time and that NAIC staff recommend a review of the final issued ASUs under the SAP Maintenance Process as detailed in *Appendix F—Policy Statements*.

   B. Update on *Valuation Manual* Adoptions

Marcotte stated that none of the revisions reported in the memorandum as adopted updates to the *Valuation Manual* by the Life Actuarial (A) Task Force require Working Group coordination under the NAIC Policy Statement on Coordination with the Valuation Manual (Attachment One-N).

   C. Update on the IMR Ad Hoc Subgroup

Gann stated preliminary assessments have occurred to review how companies treated the admitted negative IMR in cash flow testing (CFT). From this limited review, companies are not consistently reflecting negative IMR in CFT. Information was shared with the chief financial regulators on examples of correct, incorrect, and potential misreporting, which has been noted to assist with the review of domiciliary companies. She stated that state insurance regulators are requested to contact NAIC staff with any questions (Attachment One-O).

   D. Update on the Bond Project Implementation/Bond Small Group

Gann stated that the adopted statutory accounting and reporting revisions related to the principles-based bond definition are effective Jan. 1, 2025. She stated that an NAIC-provided self-study educational program is available to all participants without a course fee for 2024, and a course fee is expected for non-regulators in 2025. Gann stated that the course is designed to begin any Monday, and anyone wanting to register must do so no later than

the Wednesday prior to the Monday on which they would like to start the course. She stated that the course must be completed within the week and is estimated to take approximately three hours. Gann said the enrollment link can be found on the NAIC Education & Training website. Gann stated that a small group comprised predominantly of state insurance regulators and AICPA representatives, with a few other interested parties, was formed to discuss application questions of the bond definition on specific investment designs or characteristics. The small group's discussions have resulted in a proposed Q&A Implementation Guide that was exposed for comment earlier under the hearing agenda. She stated that, as deemed necessary, further discussions may expand the Q&A.

E. Update on the IAIS AAWG

Gann stated that the International Association of Insurance Supervisors (IAIS) has released a draft application paper on public disclosure and supervisory reporting on climate risk and draft supporting materials on macroprudential and group supervisory issues and climate risk. She stated that feedback on these materials is invited by Sept. 30, and a public background session will be held Aug. 27. Gann stated that this update simply intends to inform Working Group members and interested parties of these ongoing NAIC staff actions to monitor and participate in the IAIS Audit and Accounting Working Group (AAWG). She stated that state insurance regulators can contact NAIC staff if they have any questions on discussions or if additional information is required.

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

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2024/11-17-24 fall national meeting/hearing/01 - summer national meeting minutes 8-13-2024.docx

Draft: 9/19/24

Statutory Accounting Principles (E) Working Group
E-Vote
September 12, 2024

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded Sept. 12, 2024. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Michael Estabrook (CT); Rylynn Brown (DE); Cindy Andersen (IL); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Diana Sherman (PA); Jamie Walker (TX); Jennifer Blizzard (VA); and Amy Malm (WI).

1. Adopted Agenda Item 2024-01, Revisions to Adopted Bond Guidance

The Working Group considered an e-vote to adopt revisions to the bond guidance adopted in *SSAP No. 26—Bonds* (effective Jan. 1, 2025) and *Issue Paper No. 169—Principles-Based Bond Definition* to revise guidance that restricted issuer credit obligation classification to debt securities issued by U.S. Securities and Exchange Commission (SEC)-registered funds. The revisions permit debt securities issued by funds that represent operating entities to be classified as issuer credit obligations. The guidance is specific that reporting entities are not permitted to use leverage limits allowed by SEC-registered funds in classifying debt securities and that debt securities issued from all non-SEC-issued funds must be assessed in accordance with the primary purpose of the issuance. Debt securities issued to raise debt capital are not permitted to be classified as issuer credit obligations and must be assessed as asset-backed securities (ABS).

The revisions considered for adoption were exposed at the Summer National Meeting with a shortened public comment period that ended Sept. 6. With exposure, it was identified that if no comments or only supportive comments were received, the Working Group would consider this exposure via e-vote. In response to this exposure, an interested party's comment letter stated support for the exposure (Attachment 1).

Clark made a motion, seconded by Bartlett, to adopt the exposed revisions to SSAP No. 26 and Issue Paper No. 169, with a Jan. 1, 2025, effective date. The motion passed with 11 Working Group members responding affirmatively (Attachment 2).

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

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/09-12-24 - Evote Adoption/09-12-2024 Evote After TPR.docx

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Statutory Accounting Principles (E) Working Group
E-Vote
October 4, 2024

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded Oct. 4, 2024. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Kim Hudson (CA); William Arfanis (CT); Rylynn Brown (DE); Bill Werner (LA); Judy Weaver (MI); Doug Bartlett (NH); Jamie Walker (TX); and Amy Malm (WI).

1. Exposed an Updated Q&A Implementation Guide (Agenda Item 2019-21)

The Working Group considered an e-vote to expose an updated bond definition question and answer (Q&A) implementation guidance for a comment period ending Oct. 28. The primary revisions to the Q&A were to include three additional topics addressing commercial mortgage-backed securities (CMBS) interest-only (IO) strips, commercial mortgage loan single-asset, single-borrower (SASB) investments, and hybrids.

The Q&A was previously exposed at the Summer National Meeting for a comment period that ended Sep. 27. No comments were received on the specific questions and answers. However, a comment was received on the classification of issue papers within the statutory hierarchy. As this is a broader issue than the Q&A, a discussion on this aspect is planned for the Fall National Meeting. Minor edits were also incorporated into paragraph 9.2 of the Q&A to eliminate concerns on this topic within the Q&A document. These edits do not change the intent of the Q&A guidance.

Clark made a motion, seconded by Arfanis, to expose the updated Q&A for a comment period ending Oct. 28 to allow for discussion at the Fall National Meeting. The motion passed, with nine Working Group members responding affirmatively.

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

https://naiconline-my.sharepoint.com/personal/jgann_naic_org/Documents/10-04-2024 Evote Exposure TPR (2).docx

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

Issue: ASU 2023-09, Improvements to Income Tax Disclosures

Check (applicable entity):

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

Description of Issue: In December 2023, the Financial Accounting Standards Board (FASB) issued *Accounting Standards Update (ASU) 2023-09, Improvements to Income Tax Disclosures* (the ASU) to enhance the transparency and decision usefulness of income tax disclosures. The ASU amends and expands the disclosures for rate reconciliation between income tax expense and statutory expectations for both public and private entities. Per the ASU, "The objective of these disclosure requirements is for an entity, particularly an entity operating in multiple jurisdictions, to disclose sufficient information to enable users of financial statements to understand the nature and magnitude of factors contributing to the difference between the effective tax rate and the statutory tax rate." Public entities are required to provide detailed quantitative and qualitative disclosures, while private are only required to provide qualitative rate reconciliation disclosures on certain specified categories. Additionally, the ASU also requires all entities to provide additional disclosures on income tax expense and income taxes paid, and removes the disclosure requirement for positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date (ASC 740-10-50-15d), and the cumulative amount of each type of temporary difference related to unrecognized deferred tax liabilities (ASC 740-30-50-2b).

Existing Authoritative Literature:
SSAP No. 101—Income Taxes:

Disclosures

21. Statutory financial statement disclosures shall be made in a manner consistent with the provisions of paragraphs 43-45 and 48 of FAS 109. However, required disclosures with regard to a reporting entity's GAAP valuation allowance shall be replaced with disclosures relating to the statutory valuation allowance adjustment and the nonadmittance of some portion or all of a reporting entity's DTAs. The financial statements shall include the disclosures required by paragraph 47 of FAS 109 for non-public companies. Paragraphs 22-28 describe the disclosure requirements as modified for the difference between the requirements of FAS 109 and those prescribed by this statement.

22. The components of the net DTA or DTL recognized in a reporting entity's financial statements shall be disclosed as follows:

a. The total of all DTAs (gross, adjusted gross, admitted and nonadmitted) by tax character;

b. The total of all DTLs by tax character;

c. The total DTAs nonadmitted as the result of the application of paragraph 11;

d. The net change during the year in the total DTAs nonadmitted;

e. The amount of each result or component of the calculation, by tax character of paragraphs 11.a., 11.b.i., 11.b.ii., and 11.c., and the ExDTA ACL RBC Ratio, the ExDTA Surplus plus Contingency Reserves/Required Aggregate Risk Capital Ratio, or the Adjusted Gross DTA/Adjusted Capital and Surplus Ratio used in the applicable *Realization Threshold*

Limitation Table (the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table, or the Other Non-RBC Reporting Entity Table) in paragraph 11.b., as applicable; and

f. The impact of tax-planning strategies on the determination of adjusted gross DTAs and the determination of net admitted DTAs, by percentage and by tax character, and whether the tax-planning strategies include the use of reinsurance-related tax planning strategies.

23. To the extent that DTLs are not recognized for amounts described in paragraph 31 of FAS 109, the following shall be disclosed:

a. A description of the types of temporary differences for which a DTL has not been recognized and the types of events that would cause those temporary differences to become taxable;

b. The cumulative amount of each type of temporary difference;

c. The amount of the unrecognized DTL for temporary differences related to investments in foreign subsidiaries and foreign corporate joint ventures that are essentially permanent in duration if determination of that liability is practicable or a statement that determination is not practicable; and

d. The amount of the DTL for temporary differences other than those in paragraph 23.c. that is not recognized in accordance with the provisions of paragraphs 31 of FAS 109.

24. The significant components of income taxes incurred (i.e., current income tax expense) and the changes in DTAs and DTLs shall be disclosed. Those components would include, for example:

a. Current tax expense or benefit;

b. The change in DTAs and DTLs (exclusive of the effects of other components listed below);

c. Investment tax credits;

d. The benefits of operating loss carryforwards;

e. Adjustments of a DTA or DTL for enacted changes in tax laws or rates or a change in the tax status of the reporting entity; and

f. Adjustments to gross deferred tax assets because of a change in circumstances that causes a change in judgment about the realizability of the related deferred tax asset, and the reason for the adjustment and change in judgment.

25. Additionally, to the extent that the sum of a reporting entity's income taxes incurred and the change in its DTAs and DTLs is different from the result obtained by applying the federal statutory rate to its pretax net income, a reporting entity shall disclose the nature of the significant reconciling items.

26. A reporting entity shall also disclose the following:

a. The amounts, origination dates and expiration dates of operating loss and tax credit carryforwards available for tax purposes;

b. The amount of federal income taxes incurred in the current year and each preceding year, which are available for recoupment in the event of future net losses; and

c. The aggregate amount of deposits admitted under Section 6603 of the Internal Revenue Service Code.

27. For any federal or foreign income tax loss contingencies as determined in accordance with paragraph 3.a. for which it is reasonably possible that the total liability will significantly increase within 12 months of the reporting date, the reporting entity shall disclose an estimate of the range of the reasonably possible increase or a statement that an estimate of the range cannot be made.

28. If a reporting entity's federal income tax return is consolidated with those of any other entity or entities, the following shall be disclosed:

a. A list of names of the entities with whom the reporting entity's federal income tax return is consolidated for the current year; and

b. The substance of the written agreement, approved by the reporting entity's Board of Directors, which sets forth the manner in which the total combined federal income tax for all entities is allocated to each entity which is a party to the consolidation. (If no written agreement has been executed, explain why such an agreement has not been executed.) Additionally, the disclosure shall include the manner in which the entity has an enforceable right to recoup federal income taxes in the event of future net losses which it may incur or to recoup its net losses carried forward as an offset to future net income subject to federal income taxes.

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

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

Convergence with International Financial Reporting Standards (IFRS):
None.

Staff Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing of the maintenance agenda categorized as a SAP clarification and expose revisions, as detailed below, to reject *ASU 2023-09 Improvements to Income Tax Disclosures* in *SSAP No. 101—Income Taxes*. NAIC staff does recommend that the Working Group remove the disclosure detailed in paragraph 23b as it is no longer considered relevant due to changes in federal tax law.

The disclosure detailed in ASC 740-30-50-2(b) (SSAP No. 101, paragraph 23b) was removed by ASU 2023-09 as it requires disclosure of the cumulative amount of each type of temporary tax difference when a deferred tax liability is not recognized for undistributed foreign earnings. Based on discussion within the ASU, Stakeholders indicated that the changes as a result of the Tax Cuts and Jobs Act reduces the relevance of the existing disclosure of the cumulative temporary differences related to foreign subsidiaries when a deferred tax liability is not recognized. As the rationales detailed within the ASU would also be relevant under statutory accounting, we have recommended that paragraph 23b disclosures be removed.

The disclosure detailed in ASC 740-10-50-15(d) (SSAP No. 101, paragraph 27) was removed by ASU 2023-09 due to a conflict with Chapter 8 of the FASB Concepts Statement 8, however the FASB Concepts Statements have not been adopted within the statutory accounting framework. As this conflict does not exist within statutory accounting, we do not recommend removal of the disclosure detailed in SSAP 101 paragraph 27.

Staff Review Completed by:
NAIC Staff – William Oden, February 2024

Status:
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed revisions to adopt, with modification, *ASU 2023-09 Improvements to Income Tax Disclosures* in *SSAP No. 101—Income Taxes*, as illustrated below.

Spring National Meeting - Proposed Revisions to SSAP No. 101:

Disclosures

23. To the extent that DTLs are not recognized for amounts described in paragraph 31 of FAS 109, the following shall be disclosed:

a. A description of the types of temporary differences for which a DTL has not been recognized and the types of events that would cause those temporary differences to become taxable;

b. ~~The cumulative amount of each type of temporary difference;~~

26. A reporting entity shall also disclose the following:

a. The amounts, origination dates and expiration dates of operating loss and tax credit carryforwards available for tax purposes;

b. The amount of federal income taxes incurred in the current year and each preceding year, which are available for recoupment in the event of future net losses; and

c. The aggregate amount of deposits admitted under Section 6603 of the Internal Revenue Service Code.

d. Income (or loss) from continuing operations before income tax expense (or benefit) disaggregated between domestic and foreign shall.

~~d.~~e. Income tax expense (or benefit) from continuing operations disaggregated by federal (national), state, and foreign. Income taxes on foreign earnings that are imposed by the jurisdiction of domicile shall be included in the amount for that jurisdiction of domicile (that is, the jurisdiction imposing the tax).

f. The amount of income taxes paid (net of refunds received) disaggregated by federal (national), state, and foreign.

~~e.~~g. The amount of income taxes paid (net of refunds received) to each individual jurisdiction in which income taxes paid (net of refunds received) is equal to or greater than 5% of total income taxes paid (net of refunds received)

29. Nothing in this statement is intended to discourage an entity from reporting additional information specific to the disclosures detailed below to further an understanding of the entity and the related disclosures. If not already disclosed in paragraph 24, the reporting entity shall disclose the following:

a. The nature and effect of specific categories of reconciling items, as listed below, and individual jurisdictions that result in a significant difference between the tax rate and the effective tax rate. The objective of this disclosure requirement is for an entity, particularly an entity operating in multiple jurisdictions, to disclose sufficient information to enable users of financial statements to understand the nature and magnitude of factors contributing to the difference between the effective tax rate and the tax rate.

i. State and local income tax, net of federal (national) income tax effect

ii. Foreign tax effects

iii. Effect of changes in tax laws or rates enacted in the current period

iv. Effect of cross-border tax laws

v. Tax credits

vi. Changes in valuation allowances

vii. Nontaxable or nondeductible items

viii. Changes in unrecognized tax benefits.

Relevant Literature

38. This statement adopts, with modification, *ASU 2023-09 Improvements to Income Tax Disclosures*. The statutory modifications include:

a. Did not include public entity only disclosures as statutory accounting does not a the private/public company concept. Additionally, the public entity rate reconciliation was determined to be too onerous to apply to all insurance companies.

~~a.~~b. Did not delete the disclosure detailed in paragraph 27 from this statement as the conceptual conflict between the disclosure and FASB Concepts Statement 8, Chapter 8, does not exist within statutory accounting.

On August 13, 2024, the Statutory Accounting Principles (E) Working Group exposed revisions, as detailed below, to reject ASU 2023-09 Improvements to Income Tax Disclosures in *SSAP No. 101—Income Taxes* and delete the disclosure in SSAP No. 101 paragraph 23b as it is no longer considered relevant due to changes in federal tax law.

Summer National Meeting - Proposed Revisions to SSAP No. 101:

Disclosures

23. To the extent that DTLs are not recognized for amounts described in paragraph 31 of FAS 109, the following shall be disclosed:

a. A description of the types of temporary differences for which a DTL has not been recognized and the types of events that would cause those temporary differences to become taxable;

b. ~~The cumulative amount of each type of temporary difference;~~

Relevant Literature

38. This statement rejects *ASU 2023-09 Improvements to Income Tax Disclosures*. The disclosure detailed in paragraph 23b was deleted from statutory accounting guidance as the Tax Cuts and Jobs Act made this disclosure effectively irrelevant.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/11-17-24 Fall National Meeting/Hearing/04 - 24-11 - ASU 2023-09 Improvements to Income Tax Disclosures.docx

Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
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Issue: Clearly Defined Hedging Strategy

Check (applicable entity):

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

Description of Issue: This agenda item has been prepared to update the guidance in *SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees* for a clearly defined hedging strategy (CDHS) to mirror guidance adopted by the Life Actuarial (A) Task Force in 2022, and in effect starting with the 2023 version of the Valuation Manual. The guidance previously included in SSAP No. 108 referred to the CDHS defined in VM-21, and the actuarial guidance has been modified to ensure consistent definitions of a CDHS in both VM-20 and VM-21 and is now captured within VM-01.

The proposed revisions are limited to the definition of a CDHS in paragraph 7 of SSAP No. 108 as well as references in SSAP No. 108 that refer to VM-21 as the location of the definition of a CDHS.

Existing Authoritative Literature:

- ***SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees***

7. As identified in paragraph 2, eligibility for the special accounting provision within this standard is strictly limited to variable annuity contracts and other contracts involving certain guaranteed benefits similar to those offered with variable annuities that are reserved for in accordance with VM-21. This special accounting provision requires the reporting entity to engage in highly effective fair value hedges that follow a Clearly Defined Hedging Strategy, as defined in VM-21, meeting all required provisions of VM-21 allowing the reporting entity to reduce the amount of the Conditional Tail Expectation (CTE) Amount. In order to qualify as a Clearly Defined Hedging Strategy (which may be dynamic, static, or a combination thereof), the strategy must meet the principles outlined in VM-21, be in place (implemented) for at least three months[1], and shall at a minimum, identify:

    a. Specific risks being hedged[2],

    b. Hedge objectives,

    c. Risks not being hedged,

    d. Financial instruments that will be used to hedge the risks,

    e. Hedge trading rules, including permitted tolerances from hedging objectives,

[1] As detailed in VM-21, before a new or revised hedging strategy can be used to reduce the amount of the Conditional Tail Expectation (CTE) otherwise calculated, the hedging strategy should be in place (effectively implemented) for at least three months. As detailed in VM-21, the reporting entity may meet the time requirement by having evaluated the effective implementation of the hedging strategy for at least three months without actually having executed the trades indicated by the hedging strategy (e.g., mock testing or by having effectively implemented the strategy with similar annuity products for at least three months.)

[2] The specific risk being hedged shall include a measure of the hedge coverage (e.g., percentage of interest rate sensitivity being hedged).

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f. Metric(s) used for measuring hedging effectiveness,

g. Criteria that will be used to measure effectiveness,

h. Frequency of measuring hedging effectiveness,

i. Conditions under which hedging will not take place, and

j. The individuals responsible for implementing the hedging strategy.

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 and expose revisions to SSAP No. 108 to update the definition of a clearly defined hedging strategy (CDHS) to reflect the revised guidance pursuant to VM-01. (Only references to the CDHS are being revised to VM-01. Other references to VM-21 are product specific to variable annuity contracts and shall be retained in SSAP No. 108.)

<u>Proposed revisions to SSAP No. 108:</u>

6.b.ii Certification by a financial officer of the company (CFO, treasurer, CIO, or designated person with authority over the actual trading of assets and derivatives) that the hedging strategy meets the definition of a Clearly Defined Hedging Strategy within ~~VM-21~~<u>VM-01</u> and that the Clearly Defined Hedging Strategy is the hedging strategy being used by the company in its actual day-to-day risk mitigation efforts. This provision does not require reporting entities to use a hedging strategy in determining VM-21 reserves, nor does it require entities to use the special accounting provision within this standard. However, it does require reporting entities that use the special accounting provisions within this standard to certify that the hedging strategy within scope of this standard is a Clearly Defined Hedging Strategy and is reflected in the establishment of VM-21 reserves.

7. As identified in paragraph 2, eligibility for the special accounting provision within this standard is strictly limited to variable annuity contracts and other contracts involving certain guaranteed benefits similar to those offered with variable annuities that are reserved for in accordance with VM-21. This special accounting provision requires the reporting entity to engage in highly effective fair value hedges that follow a Clearly Defined Hedging Strategy, as defined in ~~VM-21~~<u>VM-01</u>, meeting all required provisions of VM-21 allowing the reporting entity to reduce the amount of the Conditional Tail Expectation (CTE) Amount. In order to qualify as a Clearly Defined Hedging Strategy (which may be dynamic, static, or a combination thereof), the strategy must meet the principles outlined in VM-21, be in place (implemented) for at least three months[3], and shall at a minimum, identify:

[3] As detailed in VM-21, before a new or revised hedging strategy can be used to reduce the amount of the Conditional Tail Expectation (CTE) otherwise calculated, the hedging strategy should be in place (effectively implemented) for at least three months. As detailed in VM-21, the reporting entity may meet the time requirement by having evaluated the effective implementation of the hedging strategy for at least three months without actually having executed the trades indicated by the hedging strategy (e.g., mock testing or by having effectively implemented the strategy with similar annuity products for at least three months.)

a. The ~~S~~specific risks being hedged[4],

b. The hedging~~Hedge~~ objectives,

c. The materials ~~R~~risks that are not ~~being~~ hedged,

d. The f~~F~~inancial instruments ~~that will be~~ used to hedge the risks,

e. The hedging strategy's ~~Hedge~~ trading rules, including permitted tolerances from hedging objectives,

f. The metrics, criteria and frequency for measuring effectiveness, ~~Metric(s) used for measuring hedging effectiveness,~~

~~g. Criteria that will be used to measure effectiveness,~~

~~Frequency of measuring hedging effectiveness,~~

~~h.~~g. The ~~C~~conditions under which hedging will not take place, and for how long the lack of hedging can persist,

h. The group or area, including whether internal or external, ~~The individuals~~ responsible for implementing the hedging strategy, ~~.~~

i. Areas where basis, gap or assumption risk related to the hedging strategy have been identified, and

~~i.~~j. The circumstances under which hedging strategy will not be effective in hedging the risks.

23.a. Discussion of hedged item, including information on the guarantees sensitive to interest rate risk, along with information on the designated hedging instruments being used to hedge the risk. Discussion of the hedging instruments shall identify whether a hedging instrument is a single instrument or portfolio, as well as information on the hedging strategy (including whether there have been changes in strategy from the prior reporting period, along with detailed information on the changes), and assessment of hedging effectiveness and compliance with the "Clearly Defined Hedging Strategy" of ~~VM-21~~VM-01. Identification shall occur on whether the hedged item is intended to be fully hedged under the hedging strategy, or if the strategy is only focused on a portion of the liability characteristics or a portion of the interest rate sensitivity. Hedging strategies shall be identified as highly effective or not highly effective. If the strategy for a particular hedging relationship excludes a specific component of the gain or loss, or related cash flows, from the assessment of hedge effectiveness, details on the excluded components shall be disclosed.

Staff Review Completed by: Julie Gann, NAIC Staff—May 2024

On August 13, 2024, the Statutory Accounting Principles (E) Working Group moved this item to the active listing as a SAP clarification, and exposed revisions to SSAP No. 108, as shown above, to update the definition of a clearly defined hedging strategy to mirror guidance previously adopted by the Life Actuarial (A) Task Force. This item was exposed until September 27, 2024 to allow for consideration at the 2024 Fall National Meeting.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/11-17-24 Fall National Meeting/Hearing/05 - 24-17 - SSAP No. 108 - VM-01.docx

[4] The specific risk being hedged shall include a measure of the hedge coverage (e.g., percentage of interest rate sensitivity being hedged).

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Issue: *Clarification of Accounting Guidance for Recognition of Tax Credits*

Check (applicable entity):

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

Description of Issue:
On March 16, 2024, the Statutory Accounting Principles (E) Working Group adopted, as final, agenda item 2022-14 which exposed revisions to *SSAP No. 34—Investment Income Due and Accrued*, *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, *SSAP No. 93—Low Income Housing Tax Credit Property Investments*, and *SSAP No. 94R—Transferable and Non-Transferable State Tax Credits* to expand and amend statutory guidance to include all tax credit investments regardless of structure and type of state or federal tax credit program, and all state and federal purchased tax credits.

After adoption of agenda item 2022-14, NAIC staff received questions from public accounting firms on the accounting guidance and example journal entries provided in the new guidance. It was noted that the SSAP No. 94R accounting guidance appeared inconsistent with the journal entry examples and the guidance in SSAP No. 93R for recognizing allocated tax credits was confusing when compared to the journal entry examples. Both interested parties and NAIC staff agreed that the journal entries reflect the proper accounting for both the recognition and utilization of tax credits, as such revisions have been drafted to revise the accounting guidance to match the journal entry examples more accurately.

It was also noted that a sentence in SSAP No. 48 was accidentally not updated as part of the New Market Tax Credit project. Updates to this sentence are proposed below.

Existing Authoritative Literature:
SSAP No. 93—Low Income Housing Tax Credit Property Investments (Superseded 1/1/2025)
SSAP No. 94R—Transferable and Non-Transferable State Tax Credits (Superseded 1/1/2025)

SSAP No. 93R—Investments in Tax Credit Structures (Effective 1/1/2025)
SSAP No. 94R—State and Federal Tax Credits (Effective 1/1/2025)

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

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

Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to *SSAP No. 93R—Investments in Tax Credit Structures, SSAP No. 94R—State and Federal Tax Credit*, and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, to be effective as of January 1, 2025.

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Staff Review Completed by: William Oden – June 2024

Status:
On August 13, 2024, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 93—Investments in Tax Credit Structures*, *SSAP No. 94—State and Federal Tax Credit*, and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*.

Drafting Note: The SSAP guidance shown below includes the revisions adopted in agenda item 2022-14, which are effective 1/1/2025.

Proposed Revisions to SSAP No. 93R:

14. Tax credits and other tax benefits, not to include amortization of the investment, shall be reflected as follows:

a. Tax credits shall be recognized in the period that they are allocated to the reporting entity for tax purposes:

i. ~~Federal tax credits that can be utilized in the year allocated shall be reported in the income statement as an offset to federal taxes in accordance with *SSAP No. 101—Income Taxes*. Federal tax credits that cannot be utilized in the year allocated and are carried forward to a future tax year shall be reported as a deferred tax asset (DTA) in accordance with SSAP No. 101.~~If utilized in the same year allocated, federal tax credits shall be recognized and reported as a reduction to federal income tax liabilities and federal income tax expense. If the allocated tax credits are not utilized in the year allocated, they shall be reported as a deferred tax asset (DTA) and change in DTA in accordance with *SSAP No. 101—Income Taxes*.

ii. ~~State tax credits that can be utilized in the year allocated shall be reported in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax-reporting year in which the credit is utilized. State tax credits that cannot be utilized in the year allocated and are carried forward to a future tax year shall be reported gross of any related state tax liabilities and reported in the category of other-than-invested assets (not to be reported net).~~If utilized in the same year allocated, state tax credits shall be recognized and reported as a reduction to the related state tax liability and state premium tax or state income tax, whichever is applicable. If the allocated tax credits are not utilized in the year allocated, they shall be reported gross of the related state tax liability in the category of other-than-invested assets (not to be reported net).

iii. ~~Use~~ Utilization of tax credits in settlement of tax liabilities ~~carried forward in a future period~~ shall be reflected ~~as an offset to~~net of the corresponding income or premium tax liability in the ~~tax~~ reporting ~~year~~ period in which the tax credit is utilized.

iv. Tax credits allocated from tax credit investments, as defined within this SSAP, and held by reporting entities meet the definition of assets as specified in SSAP No. 4 and are admitted assets to the extent that they comply with the requirements of this statement. The admissibility of tax credits is subject to SSAP No. 101.

b. Federal tax benefits other than tax credits (e.g., tax benefits from investment depreciation) shall be recognized in the year allocated pursuant to SSAP No. 101. When utilized, the federal tax benefits are recognized as a component of income tax expense.

c. State tax benefits other than tax credits shall be recognized in the year allocated gross of any related state tax liabilities pursuant to SSAP No. 101. When utilized, the state tax benefits are recognized as a component of taxes, licenses, and fees.

Proposed Revisions to SSAP No. 94R:

9. Tax credits shall be recognized in the period that they are purchased or allocated to the reporting entity for tax purposes:

a. ~~Federal tax credits that can be utilized in the year allocated or purchased shall be reported in the income statement as an offset to federal taxes in accordance with *SSAP No. 101—Income Taxes*.~~ Federal tax credits ~~that cannot be utilized in the year allocated or purchased and are carried forward to a future tax year shall~~are to be recognized and reported as a deferred tax asset (DTA) in accordance with *SSAP No. 101—Income Taxes*~~SSAP No. 101~~.

b. ~~State tax credits that can be utilized in the year allocated or purchased shall be reported in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax-reporting year in which the credit is utilized.~~ State tax credits ~~that cannot be utilized in the year allocated or purchased and are carried forward to a future tax year shall~~ are to be recognized reported gross of any related state tax liabilities ~~and reported~~ in the category of other-than-invested-assets (not to be reported net).

10. ~~Use~~ Utilization of ~~carried forward~~ tax credits in settlement tax liabilities ~~in a future period~~ shall be reflected ~~as an offset to~~ net of the corresponding income or premium tax liability in the ~~tax~~ reporting ~~year~~ period in which the tax credit is utilized.

Proposed Revisions to SSAP No. 48:

1. This statement establishes statutory accounting principles for investments in any joint ventures, partnerships, and limited liability companies, including investments in certified capital companies (CAPCO) per *INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)*, whether or not it is considered to be controlled by or affiliated with the reporting entity. Single real estate property investments that are wholly-owned by an LLC that is directly and wholly-owned by the reporting entity, and that meet the criteria established in *SSAP No. 40R—Real Estate Investments*, are excluded from this statement. This statement does not address the accounting for investments in joint ventures, partnerships, and limited liability companies that invest in tax credit programs and are in the scope of *SSAP No. 93R—Investments in Tax Credit Structures*. However, investments in joint ventures, partnerships, and limited liability companies which allocate tax credits but ~~certain state Low-Income Housing Tax Credit Property Investments that~~ do not fall within the scope of SSAP No. 93R are covered by the requirements of this statement.

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Issue: *ASU 2024-02—Codification Improvements—Amendments to Remove References to the Concepts Statements*

Check (applicable entity):

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

Description of Issue:
FASB issued *ASU 2024-02, Codification Improvements—Amendments to Remove References to the Concepts Statements*, which removes references to FASB Concept Statements from the Codification. The main rationale for this amendment is to simplify the Codification by removing Concepts Statements in the guidance and draw a clear distinction between authoritative and nonauthoritative literature. The Board was concerned that references to Concept Statements would result in users incorrectly inferring that the referenced Concept Statements were authoritative.

The FASB Concept Statements are referenced in the *Accounting Policies and Procedures Manual* within the Statutory Hierarchy which notes that FASB Concept Statements as either Level 4 or 5. However, the revisions in ASU 2024-02 are not relevant to this and other references to FASB Concept Statements in the AP&P Manual.

Existing Authoritative Literature:
None

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

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

Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2024-02, Codification Improvements—Amendments to Remove References to the Concepts Statements* as not applicable to statutory accounting. This guidance is not considered relevant to the existing statutory accounting references to FASB Concept statements.

Staff Review Completed by: William Oden – May 2024

Status:
On August 13, 2024, the Statutory Accounting Principles (E) Working Group exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2024-02, Codification Improvements—Amendments to Remove References to the Concepts Statements* as not applicable to statutory accounting.

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PRINCIPLES-BASED BOND DEFINITION
IMPLEMENTATION QUESTIONS AND ANSWERS

Last Updated: October 2, 2024

Status: On August 13, 2024, the Statutory Accounting Principles (E) Working Group exposed this Question-and-Answer Implementation Guide for a comment period ending September 27, 2024. This Q&A provides interpretations on how the principles-based bond guidance should be applied to specific structures or investment characteristics.

On September 27, 2024, no explicit comments on the exposed questions and answers were received. On Oct. 6, 2024, the Working Group exposed an updated Q&A to include three additional items and to incorporate minor edits to paragraph 9.2 for a shortened comment period ending Oct. 28, 2024.

The principles-based bond definition was adopted in August 2023 with an effective date of January 1, 2025. This corresponding implementation question and answer guide was developed in response to questions received on implementation application.

Index to Questions:

Question No.	Question	SSAP No. 26 Paragraph Reference	Page Number
1	When assessing whether a security has substantive credit enhancement, how should future cash flows be considered? Should future expected cash flows be incorporated into the overcollateralization disclosure?	6a & 10a	2
2	Are securities issued by foreign governments or foreign government agencies considered Issuer Credit Obligations?	7a	2
3	Are "Municipals" always Issuer Credit Obligations?	7c & 11	3
4	Should common types of "Sports Deals" be classified as ICO or ABS?	7-8	4
5	Do cashflows produced by non-financial assets backing an ABS have to actually be used to make interest and principal payments throughout the life of the debt security for an investment to qualify as a non-financial backed ABS under the meaningful cash flow test?	8	5
6	How should CMBS Interest Only (IO) strips be assessed under the PBBD?	8-10	6
7	How should debt securities that reflect Single Asset Single Borrower (SASB) Commercial Mortgage Loan (CML) securitizations be assessed under the PBBD?	8-10	6
~~6~~8	Do synthetic or referenced pool structures within an ABS disqualify the ABS for reporting on Schedule D-2-1?	9	~~6~~7
~~7~~9	Can expected but non-contractual cash flows (e.g. from future leases) be considered in determining the meaningful cash flow practical expedient for non-financial ABS?	9b	~~6~~8
10	How should hybrid securities be accounted and reported?	13	8
~~8~~11	When do non-bond debt securities need to be assessed for admittance based on underlying collateral?	SSAP No. 21, P 22	~~8~~9

1. Q – When assessing whether a security has substantive credit enhancement, how should future cash flows be considered? Should future expected cash flows be incorporated into the overcollateralization disclosure? [SSAP No. 26, paragraph 6a & 10a]

1.1 A – There are two components to this question: 1) how to consider future cash flows in assessing substantive credit enhancement; and 2) how to disclose the overcollateralization percentage. For the first component, the purpose of the substantive credit enhancement concept is to determine whether the creditor is in a different economic position than owning the underlying collateral directly. This includes evaluating all forms of economic value that the creditor has recourse to, including "hard," saleable assets, contractual or expected future cash flows, operating entity guarantees or other sources, and determining whether there is another party that absorbs substantive losses in economic value before the creditor experiences any losses. Note however, **if** a reporting entity performs a quantitative assessment to support its conclusion, it should not double-count economic value. For example, in a lease-backed ABS, if the reporting entity incorporates future lease payments into its analysis, it should also consider the future, depreciated value of the "hard assets" rather than the current saleable value.

1.2 The second component of the question is how to complete the overcollateralization percentage disclosure on Schedule D, which is required for Non-Financial ABS that do not meet the practical expedient criteria and Financial ABS that are not self-liquidating. It was noted that including a quantification of all forms of economic value discussed in 1.1, which may include not only "hard," saleable assets but also future cash flows or operating entity guarantees, would be cumbersome to complete for each applicable investment, both at origination and an ongoing basis. It would also make the disclosure difficult to interpret, as it would not be apparent whether the overcollateralization is in the form of assets that could be liquidated upon default, or future cash flows which may be less readily able to be liquidated. Based on the discussion, it was determined that it would be most expedient, as well as most useful to annual statement users, for the overcollateralization percentage to only include "hard," saleable assets. For example, if a structure involved the leasing of railcars, and the structure had railcars and the associated lease cashflows pledged to the ABS Issuer as collateral, only the value of those railcars to the outstanding debt would be included in the disclosure. (This calculation is based on the value of the railcars, and not their future leasing potential.) Overcollateralization determined by the discounting of future cash flows is not permitted to be included in the disclosure.

1.3 Reporting entities shall report 'zero' when there is no "hard asset" overcollateralization in a structure on Schedule D. The column should not be left blank. A zero response is not standalone evidence that a structure does not qualify for bond reporting. A debt security can qualify for bond reporting without "hard asset" overcollateralization.

2. Q – Are securities issued by foreign governments or foreign government agencies considered Issuer Credit Obligations? [SSAP No. 26, paragraph 7a]

2.1 A – The examples of issuer credit obligations (ICO) in paragraph 7 are not all inclusive. Governmental entities are operating entities based on their substance, which does not change based on country. Securities issued as obligations of foreign governments or foreign government agencies are expected to be considered ICOs, unless the substance is more aligned with ABS. Schedule D-1-1 includes a reporting line for "Non-U.S. Sovereign Jurisdiction Securities." Foreign securities that reflect ABS, similar to US agency backed RMBS for example, are also expected to be considered ABS. Such ABS are anticipated to be reported on D-1-2 on the most appropriate reporting line that does not reflect a guarantee by the U.S. government.

3. Q – Are "Municipals" always Issuer Credit Obligations? [SSAP No. 26, paragraph 7c & 11]

3.1 A – The question received inquired on the classification of "municipals" noting the various structures and designs, and the explicit reporting lines on Schedule D-1-1 for general obligation and special revenue municipal structures. The answer to this question is that the naming convention of investment structures does not determine whether the investment qualifies for reporting as a bond or whether the investment is an issuer credit obligation (ICO) or asset-backed security (ABS). The first step in determining if an investment qualifies as a bond is whether it reflects a creditor-relationship in substance. The second step is determining whether the structure is an ICO or ABS, and that determination focuses on the primary source of cash flows that provides payment of interest and principal to the debtholder. Municipal securities are subject to the same assessment as other structures as to whether the cash flows are generated by the operations of an operating entity (the municipality) or whether the cash flows are generated from collateral outside of the operations of the municipality in determining whether the security shall be classified as ICO or ABS. However, this distinction is not always clear for several types of common municipal securities which warrants some additional interpretive guidance to promote consistency and streamline implementation efforts. The following summarizes preliminary assessments based on common designs of these structures. These assessments are contingent on the actual substance of the investment and shall not be inferred based on naming convention if the investment being reviewed does not conform to the traditional design.

a. General Obligation Municipal Bonds – These bonds are backed by the full faith and credit of the government issuer (municipality), which is an operating entity with the power to tax residents to pay bondholders. These securities, as general obligations of an operating entity (the municipality), would qualify as ICOs as explicitly stated in Paragraph 7c of SSAP 26, and shall be reported in the "Municipal Bonds – General Obligation" reporting line.

b. Special Revenue Municipal Bonds – These bonds are not backed by the government's general taxing power but by revenues from a specific municipality-owned project or source, such as highway tolls, water and sewer, electric utility, lease fees or usage charges. Payment of interest and principal depends on the adequacy of the revenues derived from the project. Although the operating asset and/or its associated cash flows are often walled off in a bankruptcy remote SPV in order to facilitate more efficient financing of such projects, the primary purpose is still to raise debt capital to fund a component of a municipality's operations. Both Paragraph 7c and 11 of SSAP 26 explicitly contemplate securities of this type qualifying as ICO, and shall be reported in the "Municipal Bonds – Special Revenue" reporting line.

c. Tax Revenue Bonds – These bonds are backed from certain dedicated tax revenues overseen by the municipality, such as sales taxes, gasoline or tobacco taxes, hotel or tourist taxes, special tax assessments or incremental property taxes. Payment of interest and principal depends on the adequacy of tax revenue. Although the obligation is secured only by a single revenue source, rather than the full faith and credit of the municipality, it is still backed by the municipality's taxing authority and is ultimately used to facilitate the raising of financing to be used in funding the needs and responsibilities of the municipality. Tax revenue bonds are determined to have the substance of an ICO and should be reported in the "Municipal Bonds – Special Revenue" reporting line.

d. Housing Bonds – These securities may be issued by a state or local government housing authority to facilitate construction or rehabilitation of multi-family apartments for low to moderate income residents. The bonds are secured by a pledge of rental or lease revenues and/or mortgage payments. These bonds generally only have recourse to the assets or mortgages pledged. These securities are not backed by the operations of the municipality, the financing is not being used to fund any operations of the municipality and the primary source of repayment are non-municipal collateral

assets. Based on these observations, their substance appears to more closely reflect that of an ABS and shall be assessed for bond qualification under the ABS requirements. If qualifying as ABS, these structures shall be reported on Schedule D-1-2, likely as a non-guaranteed, non-agency, mortgage-backed security.

e. Conduit Bonds – These debt securities are issued by a government entity as a conduit for the benefit of a business or non-governmental enterprise, such as a manufacturing company, developer, college, hospital or non-profit organization. Revenues pledged by the business or enterprise are used to pay interest and principal on the investments. The government issuer is not responsible for making payments on the bonds if the business or enterprise defaults. These debt securities will need to be assessed to determine whether the structure qualifies as an ICO or ABS. If the structure is backed by the creditworthiness of a single operating entity (such as a college), then the structure is expected to be an ICO. If qualifying as an ICO, the specific reporting line used should the one that most closely reflects the nature of the investment. If historical reporting and/or market conventions would consider the ICO investment to be a municipal security, then it would be reasonable for the investment to be reported as a special-revenue municipal bond. However, this reporting is contingent on the ICO classification. If the structure represents an ABS (such as a conduit bond secured by housing assets or mortgages pledged), it should not be reported as a municipal on Schedule D-1-1 simply due to historical reporting or market convention as a municipal bond.

4. Q – Should common types of "Sports Deals" be classified as ICO or ABS? [SSAP No. 26, paragraphs 7-8]

4.1 A – There are two main types of leaguewide sports financing vehicles, with the key difference being whether or not noteholders have recourse to the individual sports teams.

4.2 <u>Leaguewide Deals **with** Recourse to Teams</u> - The League sets up an SPV or Trust that serves to aggregate debt issued by multiple teams within the League. The SPV (Trust) issues a Note, representing the aggregation of each underlying team's debt obligation. Through the SPV, Noteholders have recourse back to each individual team for its respective debt on a several (but not joint) basis. The Notes are also secured by Franchise rights for each team that participates in the financing and all revenues from current and future League media contracts and typically other ancillary revenue streams (e.g. online/streaming revenues, royalty fees from sports gear sold to fans, etc.). No cross-collateralization among teams or their respective revenue streams, but Noteholders have some protection from the League (which exercises considerable control over individual teams) and a pledge of team ownership rights as collateral. Should any individual team default, the League could (and in all practicality, would) step in to orchestrate a sale of the team, otherwise Noteholders could take ownership of the team.

4.3 The question raised was whether this type of deal would fall under the ICO or ABS criteria. Each team represents an operating entity, and each are individual obligors for their pro rata portion of the financing. Though the direct issuer is an SPV, it is being used to facilitate the efficient raising of debt capital by the individual teams/operating entities, as opposed to redistributing or transforming the underlying risk. In addition, the league itself is an operating entity, and though it is not a direct obligor on the financing, it has a significant role in the facilitation of the financing, its actions can significantly impact the paying ability of the individual teams and it has levers it can and would pull to ensure debtholders receive payment. Through discussion of this example, it was determined that the substance was more aligned with that of an ICO than an ABS. Under one perspective, the league could be viewed as a single-operating entity with all of its affiliated teams being part of that operating entity. This would allow the debt to be considered a "single operating entity backed obligation" under Paragraph 7g of SSAP 26. Under another perspective, debtholders effectively hold debt obligations of each of the individual teams. If each team were to individually issue their debt to the noteholders, rather than through a coordinated offering, the noteholders

would be in no different economic situation and each individual security would qualify as an ICO. As a result, this investment is effectively a series of "single operating entity backed obligations" under Paragraph 7g. Based on these observations, it was determined that this type of deal is an ICO in substance.

4.4 Leaguewide Deals **without** Recourse to Teams - Each participating team sells its share of all current and future contracted media revenues (and other ancillary revenues) to a newly created, bankruptcy remote subsidiary of the team in a true sale. The subsidiary then pledges the purchased assets to an SPV/Trust set up by the League. The SPV/Trust then issues Notes to investors. The structure has many features associated with ABS securities, including a bankruptcy-remote legal opinion, a true sale legal opinion, debt service reserves, and a payment waterfall (with Noteholders receiving priority of payment). The Notes are secured by revenues generated from the media contracts and other ancillary revenues (e.g. online/streaming revenues, royalty fees from sports gear sold to fans, etc.).

4.5 Unlike the previous example, these securities do not have recourse to an operating entity. They have all of the characteristics of a securitization of a revenue stream. Therefore, they must be evaluated under the ABS criteria. Also, there is a performance obligation for the cash flows to become collectible, as the product must be provided in order for the revenue to be generated (i.e. games must be played). As a result, the collateral are deemed to be non-financial assets, requiring the security to be assessed under the non-financial ABS criteria.

5. Q – Do cashflows produced by non-financial assets backing an ABS have to actually be used to make interest and principal payments throughout the life of the debt security for an investment to qualify as a non-financial backed ABS under the meaningful cash flow test? [SSAP No. 26, paragraph 8]

5.1 A – The principles-based bond definition is clear that the collateral supporting non-financial ABS must have a means of producing meaningful cash flows through other than sale or refinancing. However, it does not specify whether those cash flows must actually be used to pay the principal and interest in all scenarios. For example, it is not uncommon for an ABS to allow cash flows to be paid to equity holders prior to the debt tranches being repaid, so long as no covenants or triggering events have been breached. The example given was a continuation of the leaguewide sports deal **without** recourse to the individual teams as discussed in Question #4 in which the ABS was backed by current and future contracted media revenues (non-financial assets). The notes were issued as non-amortizing bullet maturities (e.g., 100% balloon payments). Therefore, the base case expectation is that the bonds will be refinanced at maturity. However, after full analysis, it was identified that the non-financial assets backing the structure generated substantially more cash flows over the life of the debt security than what would be needed to provide all interest and principal payments and would produce enough cash flows to "turbo" amortize and pay 100% of principal and interest in a short time frame if refinancing were not to occur. Additionally, there exist covenants (e.g. upon a significant decrease in media revenue) which, if triggered, would cause all cash flows to be diverted away from the equity holders and used to "turbo" amortize the debt. The question is, does the fact that the base case expectation is that the cash flows will not be used to pay down the debt result in the ABS lacking meaningful cash flows? Based on these discussions, it was determined that this situation would not preclude a conclusion that meaningful cash flows exist. Despite the meaningful cash flows not being used to pay the debt in the base case, the creditor still has rights to them and would collect them prior to experiencing any loss upon default. Therefore, all such cash flows available to creditors may be included in the assessment of meaningful cash flows.

6. Q – How should CMBS Interest Only (IO) strips be assessed under the PBBD? [SSAP No. 26, paragraphs 8-10]

6.1 A – The question pertains to the classification of CMBS IO strips that are paid from the excess spread of a CMBS structure. Excess spread is the excess of the interest collected on the underlying commercial mortgages over the contractual interest to be paid on the issued securitized tranches. In these instances, the IO strip is "linked" to either a specific tranche (such as a specific B-rated or AAA-rated tranche), or the IO strip could be linked to a combination of the issued tranches (from the residual tranche through the top AAA tranche). The tranche or tranches to which an IO is linked refers to the notional amount of principal from which the IO interest is calculated. Regardless of which tranche an IO is linked to, it is paid pari-passu with AAA rated tranche. The calculation of the IO strip interest to be paid is the product of the remaining principal of the linked debt tranche and the contractual rate of the IO strip and the contractual rate is equal to the difference between the weighted average coupon of the underlying loans, and the weighted average coupon of the issued securitization tranches. The contractual rate of the IO strip is recalculated each period based on the loan and debt tranche balances that remain outstanding. For example, if weighted average coupon on the underlying loans is 9.2% and the weighted average coupon on the securitization tranches is 8%, the contractual rate on the CMBS IO is 1.2%. If the IO strip is linked to the BBB tranche and the BBB tranche has a principal value of $1,000, there would be a monthly coupon payment of $1.00 [(1.2% / 12 months) * 1,000]. The CMBS IO holder would receive their contractual interest pari-passu with the AAA tranche, meaning they would receive all contractual interest prior to any of the subordinated securitization tranches being entitled to receive interest. When losses or principal payments are applied to the linked securitization tranche, the notional amount on which the CMBS IO interest is calculated is reduced until fully paid or written off.

6.2 In assessing these structures under the bond definition, IO strips should be considered in the same manner as a debt security that reflect both principal and interest components. That is, for a CMBS security (a financial asset-backed security), the structure would be required to have substantive credit enhancement to qualify for bond classification. For these CMBS structures, even if the IO tranches may always be paid pari-passu with the AAA tranche, an assessment must still occur on whether there is substantive credit enhancement. If the IO tranche is linked to a debt tranche, or a combination of debt tranches, that have substantive credit enhancement, then the IO is also considered to have substantive credit enhancement resulting in an ABS bond classification. If the IO tranche is linked to a tranche that does not have substantive credit enhancement, or a combination of debt tranches that includes a tranche that does not have substantive credit enhancement (such as the residual tranche), the IO strip would also not be considered to have substantive credit enhancement and shall be classified as a non-bond debt security. This is because it would lack substantive credit enhancement to absorb losses before the notional balance from which the IO interest is calculated is reduced. As a result, principal losses on the underlying loans would result in an economic loss to the IO if there is no credit enhancement to absorb them.

7. Q – How should debt securities that reflect Single Asset Single Borrower (SASB) Commercial Mortgage Loan (CML) securitizations be assessed under the PBBD? [SSAP No. 26, paragraphs 8-10]

7.1 A – The question pertains to SASB commercial mortgage-backed security (CMBS) structures which involve securitizing a single mortgage loan collateralized by one property owned by a single borrower. Although structures can vary, SASBs are usually associated with high-value properties with many long-term tenants where the mortgage loan is too large for a single lender to hold. By securitizing the loan into rated, tradeable securities, it facilitates access to a broader lender base than would exist for commercial mortgage loans. SASB CMBS structures can issue multiple tranches with different priorities of payment, or they can issue one single tranche (i.e., uni-tranche) that simply passes through the cash flows of the underlying mortgage. In either scenario, the principal and interest payments on the underlying loan provide the cash flows to service the principal and interest on the issued debt securities. Usually, the principal and

interest on the commercial mortgage loan and the issued securities are equal except for fees and expenses for servicing and structuring paid by the ABS Issuer.

7.2 Under the PBBD concepts, SASBs should be assessed as asset-backed securities (ABS), as the repayment of principal and interest is derived from the cash flows of the underlying collateral and not the general creditworthiness of an operating entity. SASB CMBS structures are not expected to qualify for reporting as issuer credit obligations reflecting a debt security fully supported by an underlying contractual obligation of a single operating entity pursuant to SSAP No. 26, paragraph 7g. Although the ultimate cash flows for repayment are expected to be derived from the leasing of the property, the lease cash flows are typically not pledged and there are typically multiple lessees, thus not qualifying under paragraph 7g. Under the ABS criteria, a SASB CMBS reflects a financial asset-backed structure (as a mortgage loan is a financial asset), therefore the debt security must qualify under the substantive credit enhancement concept to qualify for bond reporting. Determination of whether the debt issuance has substantive credit enhancement is contingent on the actual structure (multi-tranche or uni-tranche) and position of the security within the structure.

7.3. The senior tranches (those above the most junior tranche) in a multi-tranche SASB are expected to qualify under the substantive credit enhancement criteria, as the subordinated tranches will absorb losses first. Assuming the subordination is significant enough to be considered substantive, the subordination of the lowest tranche puts the reporting entity that holds a more senior tranche in a different economic position than if the mortgage loan was held directly.

7.4 The lowest tranche of a multi-tranche SASB, any tranche in which the subordinated tranches below it do not provide substantive credit enhancement, and uni-tranche SASBs are not expected to qualify for reporting as a bond as they do not meet the requirement for substantive credit enhancement. For these situations, the reporting entity is not in a different economic position than if they held the underlying mortgage loan directly. This is true regardless of the LTV or overcollateralization of the property compared to the underlying mortgage loan as the bond definition does not contemplate a broad look-through of the underlying collateral to indirect subordination. This is most clearly illustrated in Example 1 of Exhibit A of SSAP 26R which does not contemplate looking through the mortgage loan collateral to overcollateralization of the mortgage loans themselves through recourse to the underlying properties. While this is a legitimate source of overcollateralization, it represents overcollateralization of the mortgage loans in relation to the underlying properties, not overcollateralization of the debt securities in relation to the mortgage loans. The investor is in the same economic position as holding the mortgage loans directly. Therefore, these structures fail the substantive credit enhancement requirement and do not qualify for reporting as a bond.

7.5 SASB structures that do not qualify for reporting as a bond shall be captured as non-bond debt securities on Schedule BA within the reporting line specific for "Debt Securities That Lack Substantive Credit Enhancement." Life reporting entities can file these debt securities within the NAIC SVO to obtain an NAIC designation that can be used for RBC.

~~6~~8. Q – Do synthetic or referenced pool structures within an ABS disqualify the ABS for reporting on Schedule D-2-1? [SSAP No. 26, paragraph 9]

~~6~~8.1 A – The principles-based bond definition refers to ABS as being repaid with cash flows produced by collateral "owned" by the issuer. The term "owned" as used for this purpose is not necessarily intended to align with a legal view of ownership, but rather, all economic value to which the creditor has recourse. This may include rights to assets or payments derived through assignment, or other provisions. An example that has become common due to evolving banking regulations was discussed whereby a bank has a portfolio of auto loans but wants to transfer their credit risk without transferring or selling their loans. The bank creates a special purpose trust (or vehicle) to which the bank issues a "credit linked note" (effectively equivalent to a "credit risk transfer") which references the performance of the bank's portfolio of auto loans.

The securities issued by the special purpose trust (e.g., debt tranche(s) and an equity tranche) are exposed to the reference pool of collateral and the payments received are linked to the credit and principal payment risk of the underlying borrowers captured in the reference pool. The specific underlying collateral, and whether it resides within the ABS, or if the ABS references a collateral item/pool that generates cash flows is not a determining factor as long as the ABS Issuer has contractual rights to the cash flows produced to repay the debt. An ABS Issuer that owns derivatives in the structures (such as a credit default swap or total return swap) that solely transfers the performance of the referenced pool into the ABS structure does not automatically disqualify ABS classification, but the assessment of derivatives within a structure must be closely considered. Structures with derivatives that influence payments based on variables unrelated to the ultimate collateral would not qualify as a creditor relationship in substance. Further, consideration should be given to *SSAP No. 86—Derivatives* in determining whether structures with derivatives are subject to specific guidance, such as that for structured notes.

~~7~~9. Q – Can expected but non-contractual cash flows (e.g. from future leases) be considered in determining the meaningful cash flow practical expedient for non-financial ABS? [SSAP No. 26, paragraph 9b]

~~7~~9.1 A – The example given was a single-family rental where the lease duration is shorter than the duration of the debt security, subjecting the investor to re-leasing risk. The insurer has a high degree of confidence based on its understanding of the market that the property will be able to be re-leased and that the leases (including consideration of unleased time) will produce sufficient cash flows to satisfy all of the interest and at least 50% of the original principal. The question is whether this example qualifies under the practical expedient. Paragraph 9b explicitly states that only contractual cash flows are to be considered in assessing qualification under the practical expedient. As such, evaluating qualification under the practical expedient should not include any future leases that are not yet in place and this example would therefore not qualify. However, this does not necessarily mean that the full analysis will require significantly more effort than using the practical expedient in this case. In fact, the analysis the insurer performed to determine that all of the interest and at least 50% of the principal would be satisfied through expected lease payments is likely sufficient to conclude that there are meaningful cashflows, even though the practical expedient is not met.

~~7~~9.2 This question was brought forward because, although Paragraph 9b is explicit that only contractual cash flows are included, a paragraph in a prior draft of the issuer paper addressing this topic omitted the word "contractual". This has since been corrected. This question highlights an important point. Issue papers ~~are not authoritative accounting guidance. It is~~ intend~~ed~~ to provide key context regarding the discussions leading to the development of new accounting standards. However, ~~neither the issue paper nor this Q&A document represents authoritative accounting guidance. A~~any unintended language that conflicts with statements in the SSAP should be disregarded.

~~7~~9.3 As one more element of clarity coming from the discussions on this topic, the meaningful cash flow practical expedient is that less than 50% of the original principal relies on sale or refinancing risk. In some cases, this has been phrased in the inverse, that all interest and more than 50% of the original principal must be satisfied by the contractual cash flows at investment acquisition for the investment to qualify under the practical expedient. These two phrasings would be expected to have the same meaning, but for the avoidance of doubt, the standard should be interpreted that any outstanding amounts that rely on sale or refinancing at maturity, whether characterized as principal or accrued interest, must be less than 50% of the original principal in order to qualify under the practical expedient.

10. Q – How should hybrid securities be accounted and reported? [SSAP No. 26, paragraph 13]

10.1 A – SSAP No. 26 prior to the principles-based bond definition explicitly scoped in a class of assets referred to as "hybrid securities" which are defined as "securities whose proceeds are accorded some degree

of equity treatment by one or more of the nationally recognized statistical rating organizations (NRSRO) and/or which are recognized as regulatory capital by the issuer's primary regulatory authority. Hybrid securities are designed with characteristics of debt and equity and are intended to provide protection to the issuer's senior note holders. Hybrid securities are sometimes referred to as capital securities." During the development of the principles-based bond definition, it was decided to remove the explicit scope-in and instead rely on the new principles to determine whether bond classification is appropriate. As these securities come in several forms, additional clarity on where to report such securities is warranted.

10.2 Equity Securities: Investments that represent shares, units, or an ownership interest in a company or other entity but do not reflect common stock that were previously considered hybrids under SSAP No. 26 are equity investments and shall be captured as preferred stock in scope of *SSAP No. 32—Preferred Stock*. Investments in debt securities are not permitted to be reported in scope of *SSAP No. 30—Unaffiliated Common Stock* or SSAP No. 32.

10.3 Debt Securities: Investments in debt securities previously considered hybrids under SSAP No. 26 (including those debt securities with cumulative interest features) **that qualify** under the principles-based bond definition shall be reported as bonds on Schedule D. An example may include certain debt securities which NRSROs allow to be treated as equity but for which all the principles-based bond definition requirements are present. To be clear, a set maturity date for a debt security is not a requirement for bond classification if the bond otherwise qualifies under the definition. (Perpetual bonds that qualify under the bond definition are permitted as bonds.) Debt securities that do not qualify under the bond definition shall be captured as follows:

10.4 Investments in debt securities treated as regulatory capital by the issuer's primary regulatory authority, and **that do not qualify** under the principles-based bond definition solely because interest can be cancelled in the event of financial stress in a non-resolution scenario without triggering an act of default are capital notes and shall be captured in *SSAP No. 41—Surplus Notes*. These capital notes are often issued by domestic or foreign banks, and the domestic or foreign bank regulator or the Issuer has the ability to cancel interest or dividends, without future interest accumulation or payment.

10.5 Debt securities other than capital notes (as defined in 10.4 above) that permit the issuing entity to cancel interest without future interest accumulation or payment and without triggering an act of default, or that incorporate other equity components that do not permit bond classification under the principles-based bond definition are non-bond debt securities and shall be captured in scope of *SSAP No. 21—Other Admitted Assets*.

10.6 Debt securities issued by regulated institutions where only the issuer's primary regulator may have regulatory power to cancel or convert to equity all or a portion of the debt and/or its related interest payments, solely **in a resolution scenario** were not previously considered hybrid securities and should continue to be reported as Schedule D bonds, as Issuer Credit Obligations under SSAP 26, so long as all principles-based bond definition requirements are met. Exhibit A to this Q&A provides a summary of common types of securities and how they are to be treated under this Q&A

~~8~~11. Q – When do non-bond debt securities need to be assessed for admittance based on underlying collateral? [SSAP No. 21, paragraph 22]

~~8~~11.1 A – All debt securities that do not qualify as bonds, regardless of the reason for which they do not qualify, shall be assessed as to the primary source of repayment. If the primary source of repayment is derived through underlying collateral, then the collateral must qualify as an admitted asset in order for the non-bond debt security to be admitted. For example, if the source of repayment is derived from mortgage loans, and the structure failed because it did not reflect a creditor relationship, have substantive credit enhancement or meaningful cash flows, the debt security is permitted to be admitted if the mortgage loans

would have qualified as admitted assets if held directly. If the source of repayment is derived from railcar leases, and the structure failed because it did not reflect a creditor relationship, have substantive credit enhancement or meaningful cash flows, the debt security shall be nonadmitted as directly held railcars would not qualify as admitted assets.

Exhibit A – Summary of Securities for Application under Question

Bank Debt/Capital & Hybrid Securities Matrix	Bank Issuers					All Issuers	
				Additional Tier 1 Capital			
	Sr. Unsecured OpCo Debt	Sr. Unsecured HoldCo Debt	Tier 2 Capital (Subordinated Debt)	Debt Form	Perpetual Preferred Form	Debt Issued for Partial Equity Treatment from NRSROs	Debt Issued for Partial Equity Treatment from NRSROs
In scope of "hybrid securities" definition in Q&A?	No	**Yes***	**Yes***	**Yes***	**Yes***	**Yes**	**Yes**
Issuer Can Cancel Interest (or Dividend) Non-Cumulatively w/out Default**	No	No	No	**Yes**	**Yes**	**Yes**	**No**
Regulator Can Force Cancellation of Interest (or Dividends) Non-Cumulatively w/out Default	No	No***	No***	**Yes**	**Yes**	No	No
Regulator Can Force Write-down or Equity Conversion of Debt	No	**Yes**	**Yes**	**Yes**	**Yes**	No	No
Proposed Accounting Treatment	SSAP 26 Bond Schedule D, Part 1	SSAP 26 Bond Schedule D, Part 1	SSAP 26 Bond Schedule D, Part 1	SSAP 41 Capital Notes Section of Schedule BA	SSAP 32 Preferred Stock Schedule D, Part 2	SSAP 21 Non-Bond Section of Schedule BA	SSAP 26 Bond Schedule D, Part 1

*Bank regulators require a specific amount of debt that is subject to "bail-in" during a resolution. Additional Tier 1 Captial, Tier 2 Capital and Total Loss Absorbing Capacity (the latter of which includes Sr. Unsecured HoldCo Debt) are all subject to bail-in requirements and count towards various solvency ratio tests.

**Older verions of bank capital exist where the Issuer can defer interest on a cumulative basis without triggering a default. These securities would be treated as SSAP 26 Schedule D, Bonds, as would any security with cumulative interest features.

***Interest amount can be cancelled or reduced following a write-down of debt in resolution scenario only.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Hearing/11 - QA Doc - as 8-7-24.docx

Interpretation of the Statutory Accounting Principles (E) Working Group

Principles-Based Bond Definition Implementation Questions & Answers

INT 24-01T Dates Discussed

August 13, 2024, October 4, 2024, November 17, 2024

INT 24-01 References

Current:
SSAP No. 21—Other Admitted Assets
SSAP No. 26—Bonds

INT 24-014T Issue

1. The principles-based bond definition was adopted in August 2023 with an effective date of January 1, 2025. In response to questions presented, question-and-answer implementation guidance was developed to assist with consistent assessment and application under the principles-based bond definition.

INT 24-01T Discussion

2. The Working Group reached a tentative consensus that Exhibit A provides question-and-answer guidance consistent with the intent of the principles-based bond definition, including application of debt securities that qualify for bonds under SSAP No. 26 and guidance for debt securities that do not qualify as bonds under SSAP No. 21.

INT 24-01T Status

3. This INT, and the question-and-answer guidance in Exhibit A, is effective January 1, 2025. Consideration of further components may occur if future questions are received on the application of the principles-based bond guidance.

4. No further discussion is planned.

Exhibit A – Principles-Based Bond Definition Implementation Questions & Answers

Index to Questions:

Question No.	Question	SSAP No. 26 Paragraph Reference	Page Number
1	When assessing whether a security has substantive credit enhancement, how should future cash flows be considered? Should future expected cash flows be incorporated into the overcollateralization disclosure?	6a & 10a	~~2~~3
2	Are securities issued by foreign governments or foreign government agencies considered Issuer Credit Obligations?	7a	~~2~~3
3	Are "Municipals" always Issuer Credit Obligations?	7c & 11	~~3~~4
4	Should common types of "Sports Deals" be classified as ICO or ABS?	7-8	~~4~~5
5	Do cashflows produced by non-financial assets backing an ABS have to actually be used to make interest and principal payments throughout the life of the debt security for an investment to qualify as a non-financial backed ABS under the meaningful cash flow test?	8	~~5~~6
6	How should CMBS Interest Only (IO) strips be assessed under the PBBD?	8-10	~~6~~7
7	How should debt securities that reflect Single Asset Single Borrower (SASB) Commercial Mortgage Loan (CML) securitizations be assessed under the PBBD?	8-10	~~6~~7
8	Do synthetic or referenced pool structures within an ABS disqualify the ABS for reporting on Schedule D-2-1?	9	~~7~~8
9	Can expected but non-contractual cash flows (e.g. from future leases) be considered in determining the meaningful cash flow practical expedient for non-financial ABS?	9b	~~8~~9
10	How should hybrid securities be accounted and reported?	13	~~8~~9
11	When do non-bond debt securities need to be assessed for admittance based on underlying collateral?	SSAP No. 21, P 22	~~9~~10

Exhibit A – Principles-Based Bond Definition Implementation Questions & Answers

1. Q – When assessing whether a security has substantive credit enhancement, how should future cash flows be considered? Should future expected cash flows be incorporated into the overcollateralization disclosure? [SSAP No. 26, paragraph 6a & 10a]

1.1 A – There are two components to this question: 1) how to consider future cash flows in assessing substantive credit enhancement; and 2) how to disclose the overcollateralization percentage. For the first component, the purpose of the substantive credit enhancement concept is to determine whether the creditor is in a different economic position than owning the underlying collateral directly. This includes evaluating all forms of economic value that the creditor has recourse to, including "hard," saleable assets, contractual or expected future cash flows, operating entity guarantees or other sources, and determining whether there is another party that absorbs substantive losses in economic value before the creditor experiences any losses. Note however, **if** a reporting entity performs a quantitative assessment to support its conclusion, it should not double-count economic value. For example, in a lease-backed ABS, if the reporting entity incorporates future lease payments into its analysis, it should also consider the future, depreciated value of the "hard assets" rather than the current saleable value.

1.2 The second component of the question is how to complete the overcollateralization percentage disclosure on Schedule D, which is required for Non-Financial ABS that do not meet the practical expedient criteria and Financial ABS that are not self-liquidating. It was noted that including a quantification of all forms of economic value discussed in 1.1, which may include not only "hard," saleable assets but also future cash flows or operating entity guarantees, would be cumbersome to complete for each applicable investment, both at origination and an ongoing basis. It would also make the disclosure difficult to interpret, as it would not be apparent whether the overcollateralization is in the form of assets that could be liquidated upon default, or future cash flows which may be less readily able to be liquidated. Based on the discussion, it was determined that it would be most expedient, as well as most useful to annual statement users, for the overcollateralization percentage to only include "hard," saleable assets. For example, if a structure involved the leasing of railcars, and the structure had railcars and the associated lease cashflows pledged to the ABS Issuer as collateral, only the value of those railcars to the outstanding debt would be included in the disclosure. (This calculation is based on the value of the railcars, and not their future leasing potential.) Overcollateralization determined by the discounting of future cash flows is not permitted to be included in the disclosure.

1.3 Reporting entities shall report 'zero' when there is no "hard asset" overcollateralization in a structure on Schedule D. The column should not be left blank. A zero response is not standalone evidence that a structure does not qualify for bond reporting. A debt security can qualify for bond reporting without "hard asset" overcollateralization.

2. Q – Are securities issued by foreign governments or foreign government agencies considered Issuer Credit Obligations? [SSAP No. 26, paragraph 7a]

2.1 A – The examples of issuer credit obligations (ICO) in paragraph 7 are not all inclusive. Governmental entities are operating entities based on their substance, which does not change based on country. Securities issued as obligations of foreign governments or foreign government agencies are expected to be considered ICOs, unless the substance is more aligned with ABS. Schedule D-1-1 includes a reporting line for "Non-U.S. Sovereign Jurisdiction Securities." Foreign securities that reflect ABS, similar to US agency backed RMBS for example, are also expected to be considered ABS. Such ABS are anticipated to be reported on D-1-2 on the most appropriate reporting line that does not reflect a guarantee by the U.S. government.

3. Q – Are "Municipals" always Issuer Credit Obligations? [SSAP No. 26, paragraph 7c & 11]

3.1 A – The question received inquired on the classification of "municipals" noting the various structures and designs, and the explicit reporting lines on Schedule D-1-1 for general obligation and special revenue municipal structures. The answer to this question is that the naming convention of investment structures does not determine whether the investment qualifies for reporting as a bond or whether the investment is an issuer credit obligation (ICO) or asset-backed security (ABS). The first step in determining if an investment qualifies as a bond is whether it reflects a creditor-relationship in substance. The second step is determining whether the structure is an ICO or ABS, and that determination focuses on the primary source of cash flows that provides payment of interest and principal to the debtholder. Municipal securities are subject to the same assessment as other structures as to whether the cash flows are generated by the operations of an operating entity (the municipality) or whether the cash flows are generated from collateral outside of the operations of the municipality in determining whether the security shall be classified as ICO or ABS. However, this distinction is not always clear for several types of common municipal securities which warrants some additional interpretive guidance to promote consistency and streamline implementation efforts. The following summarizes preliminary assessments based on common designs of these structures. These assessments are contingent on the actual substance of the investment and shall not be inferred based on naming convention if the investment being reviewed does not conform to the traditional design.

a. General Obligation Municipal Bonds – These bonds are backed by the full faith and credit of the government issuer (municipality), which is an operating entity with the power to tax residents to pay bondholders. These securities, as general obligations of an operating entity (the municipality), would qualify as ICOs as explicitly stated in Paragraph 7c of SSAP 26, and shall be reported in the "Municipal Bonds – General Obligation" reporting line.

b. Special Revenue Municipal Bonds – These bonds are not backed by the government's general taxing power but by revenues from a specific municipality-owned project or source, such as highway tolls, water and sewer, electric utility, lease fees or usage charges. Payment of interest and principal depends on the adequacy of the revenues derived from the project. Although the operating asset and/or its associated cash flows are often walled off in a bankruptcy remote SPV in order to facilitate more efficient financing of such projects, the primary purpose is still to raise debt capital to fund a component of a municipality's operations. Both Paragraph 7c and 11 of SSAP 26 explicitly contemplate securities of this type qualifying as ICO, and shall be reported in the "Municipal Bonds – Special Revenue" reporting line.

c. Tax Revenue Bonds – These bonds are backed from certain dedicated tax revenues overseen by the municipality, such as sales taxes, gasoline or tobacco taxes, hotel or tourist taxes, special tax assessments or incremental property taxes. Payment of interest and principal depends on the adequacy of tax revenue. Although the obligation is secured only by a single revenue source, rather than the full faith and credit of the municipality, it is still backed by the municipality's taxing authority and is ultimately used to facilitate the raising of financing to be used in funding the needs and responsibilities of the municipality. Tax revenue bonds are determined to have the substance of an ICO and should be reported in the "Municipal Bonds – Special Revenue" reporting line.

d. Housing Bonds – These securities may be issued by a state or local government housing authority to facilitate construction or rehabilitation of multi-family apartments for low to moderate income residents. The bonds are secured by a pledge of rental or lease revenues and/or mortgage payments. These bonds generally only have recourse to the assets or mortgages pledged. These securities are not backed by the operations of the municipality, the financing is not being used to fund any

operations of the municipality and the primary source of repayment are non-municipal collateral assets. Based on these observations, their substance appears to more closely reflect that of an ABS and shall be assessed for bond qualification under the ABS requirements. If qualifying as ABS, these structures shall be reported on Schedule D-1-2, likely as a non-guaranteed, non-agency, mortgage-backed security.

e. Conduit Bonds – These debt securities are issued by a government entity as a conduit for the benefit of a business or non-governmental enterprise, such as a manufacturing company, developer, college, hospital or non-profit organization. Revenues pledged by the business or enterprise are used to pay interest and principal on the investments. The government issuer is not responsible for making payments on the bonds if the business or enterprise defaults. These debt securities will need to be assessed to determine whether the structure qualifies as an ICO or ABS. If the structure is backed by the creditworthiness of a single operating entity (such as a college), then the structure is expected to be an ICO. If qualifying as an ICO, the specific reporting line used should be the one that most closely reflects the nature of the investment. If historical reporting and/or market conventions would consider the ICO investment to be a municipal security, then it would be reasonable for the investment to be reported as a special-revenue municipal bond. However, this reporting is contingent on the ICO classification. If the structure represents an ABS (such as a conduit bond secured by housing assets or mortgages pledged), it should not be reported as a municipal on Schedule D-1-1 simply due to historical reporting or market convention as a municipal bond.

4. Q – Should common types of "Sports Deals" be classified as ICO or ABS? [SSAP No. 26, paragraphs 7-8]

4.1 A – There are two main types of leaguewide sports financing vehicles, with the key difference being whether or not noteholders have recourse to the individual sports teams.

4.2 Leaguewide Deals **with** Recourse to Teams - The League sets up an SPV or Trust that serves to aggregate debt issued by multiple teams within the League. The SPV (Trust) issues a Note, representing the aggregation of each underlying team's debt obligation. Through the SPV, Noteholders have recourse back to each individual team for its respective debt on a several (but not joint) basis. The Notes are also secured by Franchise rights for each team that participates in the financing and all revenues from current and future League media contracts and typically other ancillary revenue streams (e.g. online/streaming revenues, royalty fees from sports gear sold to fans, etc.). No cross-collateralization among teams or their respective revenue streams, but Noteholders have some protection from the League (which exercises considerable control over individual teams) and a pledge of team ownership rights as collateral. Should any individual team default, the League could (and in all practicality, would) step in to orchestrate a sale of the team, otherwise Noteholders could take ownership of the team.

4.3 The question raised was whether this type of deal would fall under the ICO or ABS criteria. Each team represents an operating entity, and each are individual obligors for their pro rata portion of the financing. Though the direct issuer is an SPV, it is being used to facilitate the efficient raising of debt capital by the individual teams/operating entities, as opposed to redistributing or transforming the underlying risk. In addition, the league itself is an operating entity, and though it is not a direct obligor on the financing, it has a significant role in the facilitation of the financing, its actions can significantly impact the paying ability of the individual teams and it has levers it can and would pull to ensure debtholders receive payment. Through discussion of this example, it was determined that the substance was more aligned with that of an ICO than an ABS. Under one perspective, the league could be viewed as a single-operating entity with all of its affiliated teams being part of that operating entity. This would allow the debt to be considered a

"single operating entity backed obligation" under Paragraph 7g of SSAP 26. Under another perspective, debtholders effectively hold debt obligations of each of the individual teams. If each team were to individually issue their debt to the noteholders, rather than through a coordinated offering, the noteholders would be in no different economic situation and each individual security would qualify as an ICO. As a result, this investment is effectively a series of "single operating entity backed obligations" under Paragraph 7g. Based on these observations, it was determined that this type of deal is an ICO in substance.

4.4 Leaguewide Deals **without** Recourse to Teams - Each participating team sells its share of all current and future contracted media revenues (and other ancillary revenues) to a newly created, bankruptcy remote subsidiary of the team in a true sale. The subsidiary then pledges the purchased assets to an SPV/Trust set up by the League. The SPV/Trust then issues Notes to investors. The structure has many features associated with ABS securities, including a bankruptcy-remote legal opinion, a true sale legal opinion, debt service reserves, and a payment waterfall (with Noteholders receiving priority of payment). The Notes are secured by revenues generated from the media contracts and other ancillary revenues (e.g. online/streaming revenues, royalty fees from sports gear sold to fans, etc.).

4.5 Unlike the previous example, these securities do not have recourse to an operating entity. They have all of the characteristics of a securitization of a revenue stream. Therefore, they must be evaluated under the ABS criteria. Also, there is a performance obligation for the cash flows to become collectible, as the product must be provided in order for the revenue to be generated (i.e. games must be played). As a result, the collateral are deemed to be non-financial assets, requiring the security to be assessed under the non-financial ABS criteria.

5. Q – Do cashflows produced by non-financial assets backing an ABS have to actually be used to make interest and principal payments throughout the life of the debt security for an investment to qualify as a non-financial backed ABS under the meaningful cash flow test? [SSAP No. 26, paragraph 8]

5.1 A – The principles-based bond definition is clear that the collateral supporting non-financial ABS must have a means of producing meaningful cash flows through other than sale or refinancing. However, it does not specify whether those cash flows must actually be used to pay the principal and interest in all scenarios. For example, it is not uncommon for an ABS to allow cash flows to be paid to equity holders prior to the debt tranches being repaid, so long as no covenants or triggering events have been breached. The example given was a continuation of the leaguewide sports deal **without** recourse to the individual teams as discussed in Question #4 in which the ABS was backed by current and future contracted media revenues (non-financial assets). The notes were issued as non-amortizing bullet maturities (e.g., 100% balloon payments). Therefore, the base case expectation is that the bonds will be refinanced at maturity. However, after full analysis, it was identified that the non-financial assets backing the structure generated substantially more cash flows over the life of the debt security than what would be needed to provide all interest and principal payments and would produce enough cash flows to "turbo" amortize and pay 100% of principal and interest in a short time frame if refinancing were not to occur. Additionally, there exist covenants (e.g. upon a significant decrease in media revenue) which, if triggered, would cause all cash flows to be diverted away from the equity holders and used to "turbo" amortize the debt. The question is, does the fact that the base case expectation is that the cash flows will not be used to pay down the debt result in the ABS lacking meaningful cash flows? Based on these discussions, it was determined that this situation would not preclude a conclusion that meaningful cash flows exist. Despite the meaningful cash flows not being used to pay the debt in the base case, the creditor still has rights to them and would collect them prior to experiencing any loss upon default. Therefore, all such cash flows available to creditors may be included in the assessment of meaningful cash flows.

6. Q – How should CMBS Interest Only (IO) strips be assessed under the PBBD? [SSAP No. 26, paragraphs 8-10]

6.1 A – The question pertains to the classification of CMBS IO strips that are paid from the excess spread of a CMBS structure. Excess spread is the excess of the interest collected on the underlying commercial mortgages over the contractual interest to be paid on the issued securitized tranches. In these instances, the IO strip is "linked" to either a specific tranche (such as a specific B-rated or AAA-rated tranche), or the IO strip could be linked to a combination of the issued tranches (from the residual tranche through the top AAA tranche). The tranche or tranches to which an IO is linked refers to the notional amount of principal from which the IO interest is calculated. Regardless of which tranche an IO is linked to, it is paid pari-passu with AAA rated tranche. The calculation of the IO strip interest to be paid is the product of the remaining principal of the linked debt tranche and the contractual rate of the IO strip and the contractual rate is equal to the difference between the weighted average coupon of the underlying loans, and the weighted average coupon of the issued securitization tranches. The contractual rate of the IO strip is recalculated each period based on the loan and debt tranche balances that remain outstanding. For example, if weighted average coupon on the underlying loans is 9.2% and the weighted average coupon on the securitization tranches is 8%, the contractual rate on the CMBS IO is 1.2%. If the IO strip is linked to the BBB tranche and the BBB tranche has a principal value of $1,000, there would be a monthly coupon payment of $1.00 [(1.2% / 12 months) * 1,000]. The CMBS IO holder would receive their contractual interest pari-passu with the AAA tranche, meaning they would receive all contractual interest prior to any of the subordinated securitization tranches being entitled to receive interest. When losses or principal payments are applied to the linked securitization tranche, the notional amount on which the CMBS IO interest is calculated is reduced until fully paid or written off.

6.2 In assessing these structures under the bond definition, IO strips should be considered in the same manner as a debt security that reflect both principal and interest components. That is, for a CMBS security (a financial asset-backed security), the structure would be required to have substantive credit enhancement to qualify for bond classification. For these CMBS structures, even if the IO tranches may always be paid pari-passu with the AAA tranche, an assessment must still occur on whether there is substantive credit enhancement. If the IO tranche is linked to a debt tranche, or a combination of debt tranches, that have substantive credit enhancement, then the IO is also considered to have substantive credit enhancement resulting in an ABS bond classification. If the IO tranche is linked to a tranche that does not have substantive credit enhancement, or a combination of debt tranches that includes a tranche that does not have substantive credit enhancement (such as the residual tranche), the IO strip would also not be considered to have substantive credit enhancement and shall be classified as a non-bond debt security. This is because it would lack substantive credit enhancement to absorb losses before the notional balance from which the IO interest is calculated is reduced. As a result, principal losses on the underlying loans would result in an economic loss to the IO if there is no credit enhancement to absorb them.

7. Q – How should debt securities that reflect Single Asset Single Borrower (SASB) Commercial Mortgage Loan (CML) securitizations be assessed under the PBBD? [SSAP No. 26, paragraphs 8-10]

7.1 A – The question pertains to SASB commercial mortgage-backed security (CMBS) structures which involve securitizing a single mortgage loan collateralized by one property owned by a single borrower. Although structures can vary, SASBs are usually associated with high-value properties with many long-term tenants where the mortgage loan is too large for a single lender to hold. By securitizing the loan into rated, tradeable securities, it facilitates access to a broader lender base than would exist for commercial mortgage loans. SASB CMBS structures can issue multiple tranches with different priorities of payment, or they can issue one single tranche (i.e., uni-tranche) that simply passes through the cash flows of the underlying mortgage. In either scenario, the principal and interest payments on the underlying loan provide the cash flows to service the principal and interest on the issued debt securities. Usually, the principal and

interest on the commercial mortgage loan and the issued securities are equal except for fees and expenses for servicing and structuring paid by the ABS Issuer.

7.2 Under the PBBD concepts, SASBs should be assessed as asset-backed securities (ABS), as the repayment of principal and interest is derived from the cash flows of the underlying collateral and not the general creditworthiness of an operating entity. SASB CMBS structures are not expected to qualify for reporting as issuer credit obligations reflecting a debt security fully supported by an underlying contractual obligation of a single operating entity pursuant to SSAP No. 26, paragraph 7g. Although the ultimate cash flows for repayment are expected to be derived from the leasing of the property, the lease cash flows are typically not pledged and there are typically multiple lessees, thus not qualifying under paragraph 7g. Under the ABS criteria, a SASB CMBS reflects a financial asset-backed structure (as a mortgage loan is a financial asset), therefore the debt security must qualify under the substantive credit enhancement concept to qualify for bond reporting. Determination of whether the debt issuance has substantive credit enhancement is contingent on the actual structure (multi-tranche or uni-tranche) and position of the security within the structure.

7.3. The senior tranches (those above the most junior tranche) in a multi-tranche SASB are expected to qualify under the substantive credit enhancement criteria, as the subordinated tranches will absorb losses first. Assuming the subordination is significant enough to be considered substantive, the subordination of the lowest tranche puts the reporting entity that holds a more senior tranche in a different economic position than if the mortgage loan was held directly.

7.4 The lowest tranche of a multi-tranche SASB, any tranche in which the subordinated tranches below it do not provide substantive credit enhancement, and uni-tranche SASBs are not expected to qualify for reporting as a bond as they do not meet the requirement for substantive credit enhancement. For these situations, the reporting entity is not in a different economic position than if they held the underlying mortgage loan directly. This is true regardless of the LTV or overcollateralization of the property compared to the underlying mortgage loan as the bond definition does not contemplate a broad look-through of the underlying collateral to indirect subordination. This is most clearly illustrated in Example 1 of Exhibit A of SSAP 26~~R~~ which does not contemplate looking through the mortgage loan collateral to overcollateralization of the mortgage loans themselves through recourse to the underlying properties. While this is a legitimate source of overcollateralization, it represents overcollateralization of the mortgage loans in relation to the underlying properties, not overcollateralization of the debt securities in relation to the mortgage loans. The investor is in the same economic position as holding the mortgage loans directly. Therefore, these structures fail the substantive credit enhancement requirement and do not qualify for reporting as a bond.

7.5 SASB structures that do not qualify for reporting as a bond shall be captured as non-bond debt securities on Schedule BA within the reporting line specific for “Debt Securities That Lack Substantive Credit Enhancement.” Life reporting entities can file these debt securities within the NAIC SVO to obtain an NAIC designation that can be used for RBC.

8. Q – Do synthetic or referenced pool structures within an ABS disqualify the ABS for reporting on Schedule D-1-2~~2-1~~? [SSAP No. 26, paragraph 9]

8.1 A – The principles-based bond definition refers to ABS as being repaid with cash flows produced by collateral “owned” by the issuer. The term “owned” as used for this purpose is not necessarily intended to align with a legal view of ownership, but rather, all economic value to which the creditor has recourse. This may include rights to assets or payments derived through assignment, or other provisions. An example that has become common due to evolving banking regulations was discussed whereby a bank has a portfolio of auto loans but wants to transfer their credit risk without transferring or selling their loans. The bank creates a special purpose trust (or vehicle) to which the bank issues a “credit linked note” (effectively equivalent to a “credit risk transfer”) which references the performance of the bank’s portfolio of auto loans.

The securities issued by the special purpose trust (e.g., debt tranche(s) and an equity tranche) are exposed to the reference pool of collateral and the payments received are linked to the credit and principal payment risk of the underlying borrowers captured in the reference pool. The specific underlying collateral, and whether it resides within the ABS, or if the ABS references a collateral item/pool that generates cash flows is not a determining factor as long as the ABS Issuer has contractual rights to the cash flows produced to repay the debt. An ABS Issuer that owns derivatives in the structures (such as a credit default swap or total return swap) that solely transfers the performance of the referenced pool into the ABS structure does not automatically disqualify ABS classification, but the assessment of derivatives within a structure must be closely considered. Structures with derivatives that influence payments based on variables unrelated to the ultimate collateral would not qualify as a creditor relationship in substance. Further, consideration should be given to *SSAP No. 86—Derivatives* in determining whether structures with derivatives are subject to specific guidance, such as that for structured notes.

9. Q – Can expected but non-contractual cash flows (e.g. from future leases) be considered in determining the meaningful cash flow practical expedient for non-financial ABS? [SSAP No. 26, paragraph 9b]

9.1 A – The example given was a single-family rental where the lease duration is shorter than the duration of the debt security, subjecting the investor to re-leasing risk. The insurer has a high degree of confidence based on its understanding of the market that the property will be able to be re-leased and that the leases (including consideration of unleased time) will produce sufficient cash flows to satisfy all of the interest and at least 50% of the original principal. The question is whether this example qualifies under the practical expedient. Paragraph 9b explicitly states that only contractual cash flows are to be considered in assessing qualification under the practical expedient. As such, evaluating qualification under the practical expedient should not include any future leases that are not yet in place and this example would therefore not qualify. However, this does not necessarily mean that the full analysis will require significantly more effort than using the practical expedient in this case. In fact, the analysis the insurer performed to determine that all of the interest and at least 50% of the principal would be satisfied through expected lease payments is likely sufficient to conclude that there are meaningful cashflows, even though the practical expedient is not met.

9.2 This question was brought forward because, although Paragraph 9b is explicit that only contractual cash flows are included, a paragraph in a prior draft of the issuer paper addressing this topic omitted the word “contractual”. This has since been corrected. This question highlights an important point. Issue papers intend to provide key context regarding the discussions leading to the development of new accounting standards. However, any unintended language that conflicts with statements in the SSAP should be disregarded.

9.3 As one more element of clarity coming from the discussions on this topic, the meaningful cash flow practical expedient is that less than 50% of the original principal relies on sale or refinancing risk. In some cases, this has been phrased in the inverse, that all interest and more than 50% of the original principal must be satisfied by the contractual cash flows at investment acquisition for the investment to qualify under the practical expedient. These two phrasings would be expected to have the same meaning, but for the avoidance of doubt, the standard should be interpreted that any outstanding amounts that rely on sale or refinancing at maturity, whether characterized as principal or accrued interest, must be less than 50% of the original principal in order to qualify under the practical expedient.

10. Q – How should hybrid securities be accounted and reported? [SSAP No. 26, paragraph 13]

10.1 A – SSAP No. 26 prior to the principles-based bond definition explicitly scoped in a class of assets referred to as “hybrid securities” which are defined as “securities whose proceeds are accorded some degree of equity treatment by one or more of the nationally recognized statistical rating organizations (NRSRO)

and/or which are recognized as regulatory capital by the issuer's primary regulatory authority. Hybrid securities are designed with characteristics of debt and equity and are intended to provide protection to the issuer's senior note holders. Hybrid securities are sometimes referred to as capital securities." During the development of the principles-based bond definition, it was decided to remove the explicit scope-in and instead rely on the new principles to determine whether bond classification is appropriate. As these securities come in several forms, additional clarity on where to report such securities is warranted.

10.2 Equity Securities: Investments that represent shares, units, or an ownership interest in a company or other entity but do not reflect common stock that were previously considered hybrids under SSAP No. 26 are equity investments and shall be captured as preferred stock in scope of *SSAP No. 32—Preferred Stock*. Investments in debt securities are not permitted to be reported in scope of *SSAP No. 30—Unaffiliated Common Stock* or SSAP No. 32.

10.3 Debt Securities: Investments in debt securities previously considered hybrids under SSAP No. 26 (including those debt securities with cumulative interest features) **that qualify** under the principles-based bond definition shall be reported as bonds on Schedule D. An example may include certain debt securities which NRSROs allow to be treated as equity but for which all the principles-based bond definition requirements are present. To be clear, a set maturity date for a debt security is not a requirement for bond classification if the bond otherwise qualifies under the definition. (Perpetual bonds that qualify under the bond definition are permitted as bonds.) ~~Debt securities that do not qualify under the bond definition shall be captured as follows:~~

10.4 Investments in debt securities treated as regulatory capital by the issuer's primary regulatory authority, and **that do not qualify** under the principles-based bond definition solely because interest can be cancelled in the event of financial stress in a non-resolution scenario without triggering an act of default are capital notes and shall be captured in *SSAP No. 41—Surplus Notes*. These capital notes are often issued by domestic or foreign banks, and the domestic or foreign bank regulator or the Issuer has the ability to cancel interest or dividends, without future interest accumulation or payment.

10.5 Debt securities other than capital notes (as defined in 10.4 above) that permit the issuing entity to cancel interest without future interest accumulation or payment and without triggering an act of default, or that incorporate other equity components that do not permit bond classification under the principles-based bond definition are non-bond debt securities and shall be captured in scope of *SSAP No. 21—Other Admitted Assets*.

10.6 Debt securities issued by regulated institutions where only the issuer's primary regulator may have regulatory power to cancel or convert to equity all or a portion of the debt and/or its related interest payments, solely **in a resolution scenario** were not previously considered hybrid securities and should continue to be reported as Schedule D bonds, as Issuer Credit Obligations under SSAP 26, so long as all principles-based bond definition requirements are met.

10.7 Exhibit A to this Q&A provides a summary of common types of securities and how they are to be treated under this Q&A.

11. Q – When do non-bond debt securities need to be assessed for admittance based on underlying collateral? [SSAP No. 21, paragraph 22]

11.1 A – All debt securities that do not qualify as bonds, regardless of the reason for which they do not qualify, shall be assessed as to the primary source of repayment. If the primary source of repayment is derived through underlying collateral, then the collateral must qualify as an admitted asset in order for the non-bond debt security to be admitted. For example, if the source of repayment is derived from mortgage loans, and the structure failed because it did not reflect a creditor relationship, have substantive credit

enhancement or meaningful cash flows, the debt security is permitted to be admitted if the mortgage loans would have qualified as admitted assets if held directly. If the source of repayment is derived from railcar leases, and the structure failed because it did not reflect a creditor relationship, have substantive credit enhancement or meaningful cash flows, the debt security shall be nonadmitted as directly held railcars would not qualify as admitted assets.

Exhibit A – Principles-Based Bond Definition Implementation Questions & Answers

Appendix A – Summary of Securities for Application under Question 10

Bank Debt/Capital & Hybrid Securities Matrix	Bank Issuers					All Issuers	
				Additional Tier 1 Capital			
	Sr. Unsecured OpCo Debt	Sr. Unsecured HoldCo Debt	Tier 2 Capital (Subordinated Debt)	Debt Form	Perpetual Preferred Form	Debt Issued for Partial Equity Treatment from NRSROs	Debt Issued for Partial Equity Treatment from NRSROs
In scope of "hybrid securities" definition in Q&A?	No	**Yes***	**Yes***	**Yes***	**Yes***	**Yes**	**Yes**
Issuer Can Cancel Interest (or Dividend) Non-Cumulatively w/out Default**	No	No	No	**Yes**	**Yes**	**Yes**	**No**
Regulator Can Force Cancellation of Interest (or Dividends) Non-Cumulatively w/out Default	No	No***	No***	**Yes**	**Yes**	No	No
Regulator Can Force Write-down or Equity Conversion of Debt	No	**Yes**	**Yes**	**Yes**	**Yes**	No	No
Proposed Accounting Treatment	SSAP 26 Bond Schedule D, Part 1	SSAP 26 Bond Schedule D, Part 1	SSAP 26 Bond Schedule D, Part 1	SSAP 41 Capital Notes Section of Schedule BA	SSAP 32 Preferred Stock Schedule D, Part 2	SSAP 21 Non-Bond Section of Schedule BA	SSAP 26 Bond Schedule D, Part 1

*Bank regulators require a specific amount of debt that is subject to "bail-in" during a resolution. Additional Tier 1 Captial, Tier 2 Capital and Total Loss Absorbing Capacity (the latter of which includes Sr. Unsecured HoldCo Debt) are all subject to bail-in requirements and count towards various solvency ratio tests.

**Older verions of bank capital exist where the Issuer can defer interest on a cumulative basis without triggering a default. These securities would be treated as SSAP 26 Schedule D, Bonds, as would any security with cumulative interest features.

***Interest amount can be cancelled or reduced following a write-down of debt in resolution scenario only.

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

Issue: Collateral Loan Reporting

Check (applicable entity):

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

Description of Issue: This agenda item has been developed to propose an expansion of reporting for collateral loans on Schedule BA to enable regulators the ability to quickly identify the type of collateral in support of admittance of collateral loans in scope of *SSAP No. 21R—Other Admitted Assets*. This agenda item has been drafted in response to comments that the current reporting detail on Schedule BA does not provide sufficient clarity on the type of collateral used in support of admittance of collateral loans. Furthermore, with the adoption of agenda item 2022-11, the statutory accounting guidance has been clarified that the collateral must reflect a qualifying investment, meaning that it would qualify for admittance if held directly by the insurer. This amendment further clarified that collateral that represents an investment in scope of *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* or *SSAP No. 97—Investments in Subsidiary, Controlled or Affiliated Entities* is required to be audited consistent with the admittance requirements of those SSAPs.

As detailed within, this agenda item proposes new disclosure requirements in SSAP No. 21R for collateral loans. The new disclosure requirement is proposed to be satisfied by an expansion of the reporting on Schedule BA, so that the collateral loans are separated by the type of collateral investment that secures the loan. Additionally, a new aggregated data-captured note is proposed to identify the admitted and nonadmitted collateral loans by the type of collateral that secures the loan.

Existing Authoritative Literature:

- **SSAP No. 21R—Other Admitted Assets - (Tracking shows the edits adopted on Oct. 23, 2023.)**

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

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

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

made available to the applicable domiciliary regulator and independent audit firm upon request.

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

Footnote 2: A qualifying Iinvestment defined as those assets listed in Section 3 of *Appendix A-001—Investments of Reporting Entities* which would, if held by the insurer, qualify for admittance. For example, if the collateral would not qualify for admittance under SSAP No. 4 due to encumbrances or other third-party interests, then it does not meet the definition of "qualifying" and the collateral loan, or any portion thereof which is not adequately collateralized, is not permitted to be admitted. In the cases where the collateral is an equity/unit investment in a joint venture, partnership, limited liability company, and or SCA is pledged as collateral in a collateral loan, audited financial statements on a consistent annual basis are always required in accordance with SSAP No. 48 and/or SSAP No. 97.

Effective Date and Transition

22. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors. The guidance for structured settlements when the reporting entity acquires the legal right to receive payments is effective December 31, 2018. The clarification regarding audits of qualifying collateral pledged for collateral loans in the footnote 2 to paragraph 4, requires applicable audits to be obtained for the 2023 reporting period in the subsequent year. In periods after year-end 2023, the audits of equity collateral pledged for collateral loans are required to be obtained for the reporting year in which it was pledged and annually thereafter. The annual audit lag shall be consistent from period to period.

- **A/S Blank and Instructions** *(This reflects what is proposed to be adopted in 2023-12BWG.)*

Collateral Loans

Unaffiliated..3199999
Affiliated..3299999

Collateral Loans

Include: Refer to SSAP No. 21R—Other Admitted Assets for a definition of collateral loans. Loans that are backed by any form of collateral, regardless of if the collateral is sufficient to fully cover the loan, shall be captured in this category. Guidance in SSAP No. 21R shall be followed to determine nonadmittance.

In the description column, the name of the actual borrower and state if the borrower is a parent, subsidiary, affiliate, officer or director. Also include the type of collateral held.

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 2022-11: Collateral for Loans clarified guidance on the criteria for collateral in order for a collateral loan to qualify as an admitted asset.

- Blanks Agenda Item 2023-12BWG incorporates revisions as part of the bond project to capture debt securities that do not qualify as bonds on Schedule BA. The revisions within this blanks item incorporate minor revisions to the instructions for collateral loans.

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

Recommendation:

NAIC staff recommend that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose this agenda item with proposed revisions to incorporate a new disclosure to SSAP No. 21R, for initial reporting as of year-end 2024, and to sponsor a blanks proposal for a new data-captured disclosure and to expand the reporting lines on Schedule BA to separate collateral loans by the type of collateral that secures the loan. NAIC staff recommends that the Working Group direct a corresponding blanks proposal to allow for concurrent exposure.

Proposed Revisions to SSAP No. 21R: *(Only new edits are tracked. Prior adopted revisions are shown clean.)*

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

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

b. Nonadmitted Asset—In accordance with *SSAP No. 20—Nonadmitted Assets*, collateral loans secured by assets that do not qualify as investments which would otherwise be admitted shall be nonadmitted. Further, any amount of the loan outstanding which is in excess of the permitted relationship of fair value of the pledged investment to the collateral loan shall be treated as a nonadmitted asset. To support the admissibility of collateral loans, reporting entities shall maintain documentation sufficient to support the reasonableness of the fair value measurement of the underlying collateral, which shall be made available to the applicable domiciliary regulator and independent audit firm upon request.

5. Collateral loans shall be reported based on the type of qualifying investment that secures the loan. An aggregate note disclosure shall identify the total amount of collateral loans and the collateral loans admitted and nonadmitted by qualifying investment type.

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

Footnote 2: A qualifying investment defined as those assets listed in Section 3 of *Appendix A-001—Investments of Reporting Entities* which would, if held by the insurer, qualify for admittance. For example, if the collateral would not qualify for admittance under SSAP No. 4 due to encumbrances or other third-party interests, then it does not meet the definition of "qualifying" and the collateral loan, or any portion thereof which is not adequately collateralized, is not permitted to be admitted. In the cases where the collateral is an equity/unit investment in a joint venture, partnership, limited liability company, and or SCA is

pledged as collateral in a collateral loan, audited financial statements on a consistent annual basis are always required in accordance with SSAP No. 48 and or SSAP No. 97.

Proposed Schedule BA Reporting Changes:

Collateral Loans – Reported by Qualifying Investment Collateral that Secures the Loan

Cash, Cash Equivalent & Short-Term Investments (SSAP No. 2R)
Unaffiliated..
Affiliated..

Bonds (SSAP No. 26R)
Unaffiliated..
Affiliated..

Asset-Backed Securities (SSAP No. 43R)
Unaffiliated..
Affiliated..

Preferred Stocks (SSAP No. 32R)
Unaffiliated..
Affiliated..

Common Stocks (SSAP No. 30R)
Unaffiliated..
Affiliated..

Mortgage Loans (SSAP No. 37R)
Unaffiliated..
Affiliated..

Real Estate (SSAP No. 40R)
Unaffiliated..
Affiliated..

Joint Venture, Partnerships or Limited Liability Companies (SSAP No. 48R)
Unaffiliated..
Affiliated..

Subsidiary, Controlled or Affiliated Investment (SSAP No. 97)
Unaffiliated..
Affiliated..

Other Qualifying Investment Category
Unaffiliated..
Affiliated..

Collateral Does Not Qualify as an Investment
Unaffiliated...
Affiliated...

Collateral Loans

Include: Refer to SSAP No. 21R—Other Admitted Assets for a definition of collateral loans. Loans that are backed by any form of collateral, regardless of if the collateral is sufficient to fully cover the loan, shall be captured in this category. Guidance in SSAP No. 21R shall be followed to determine nonadmittance.

In the description column, the name of the actual borrower and state if the borrower is a parent, subsidiary, affiliate, officer or director. Also include the type of collateral held.

Classify the collateral loan in accordance with the type of collateral held, such that if the loan was to default and the collateral was to be claimed by the reporting entity, where it would be captured (investment type by SSAP) as a directly-held investment. If more than one form of collateral secures the loan, classification should occur based on the primary collateral source. The other qualifying investment category shall only be used to capture collateral loans secured by collateral in the form of contract loans, derivatives, other invested assets not separately reported, receivables for securities, securities lending and any investments that would qualify as a write-in for invested assets.

Proposed Data-Captured Disclosure:

Aggregate Collateral Loans by Qualifying Investment Collateral:

Collateral Type	**Aggregate Collateral Loan**	**Admitted**	**Nonadmitted**
Cash, Cash Equivalents & ST Investments			
Bonds			
Asset-Backed Securities			
Preferred Stocks			
Common Stocks			
Real Estate			
Mortgage Loans			
Joint Ventures, Partnerships, LLC			
Subsidiary, Affiliated and Controlled Entities			
Other Qualifying Investments			
Collateral Does not Qualify as an Investment			
Total			

Pursuant to SSAP No. 21R, nonadmittance of a collateral loan is required when the fair value of the collateral is not sufficient to cover the collateral loan or if the collateral securing the loan is not a qualifying investment. This includes situations in which collateral in form of joint ventures, partnerships, LLCs or SCAs is not supported by an audit as required by SSAP No. 48 or SSAP No. 97.

The other qualifying investment category shall only be used to capture collateral loans secured by collateral in the form of contract loans, derivatives, other invested assets not separately reported, receivables for securities, securities

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lending and any investments that would qualify as a write-in for invested assets. All collateral loans secured by collateral that does not qualify as an investment areis required to be nonadmitted under SSAP No. 21R.

Staff Review Completed by: Julie Gann - NAIC Staff, September 2023

Status:
On December 1, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification and exposed revisions to incorporate a new disclosure to SSAP No. 21R for initial reporting as of year-end 2024, and to sponsor a blanks proposal for a new data-captured disclosure and to expand the reporting lines on Schedule BA to separate collateral loans by the type of collateral that secures the loan. Comments are requested on whether any of the proposed reporting lines should be combined.

On February 20, 2023, the Statutory Accounting Principles (E) Working Group took the following two actions:

1) The Working Group **adopted** the exposed revisions to SSAP No. 21R incorporating a collateral loan disclosure for year-end 2024. With this adoption, the Working Group sponsored a blanks proposal to data-capture the disclosure. Adopted revisions to SSAP No. 21R are shown below:

    5. Collateral loans shall be reported based on the type of qualifying investment that secures the loan. An aggregate note disclosure shall identify the total amount of collateral loans, and the collateral loans admitted and nonadmitted by qualifying investment type.

2) The Working Group exposed proposed reporting lines to Schedule BA for collateral loans with a comment deadline of April 19, 2024. Although the exposure does not contain AVR reporting revisions, the Working Group is specifically requesting feedback from regulators and industry on whether collateral loans backed by certain types of collateral should flow through AVR for RBC impact. Additionally, the Working Group directed a referral to the Life Risk-Based Capital (E) Working Group on the proposed reporting lines and the AVR mapping/RBC impact for collateral loans.

February 20, 2024, Exposed Schedule BA Reporting Changes*:*
(Tracking shows changes from the prior exposure.)

Collateral Loans – Reported by Qualifying Investment Collateral that Secures the Loan

Cash, Cash Equivalent & Short-Term Investments (SSAP No. 2R)
Unaffiliated...
Affiliated..

Bonds and Asset-Backed Securities (SSAP No. 26R & SSAP No. 43R)
Unaffiliated...
Affiliated..

Asset-Backed Securities (SSAP No. 43R)
Unaffiliated...
Affiliated..

Preferred Stocks (SSAP No. 32R)
Unaffiliated...
Affiliated..

Common Stocks (SSAP No. 30R)
Unaffiliated...

Affiliated...

Mortgage Loans (SSAP No. 37R)
Unaffiliated...
Affiliated...

Real Estate (SSAP No. 40R)
Unaffiliated...
Affiliated...

Joint Venture, Partnerships or Limited Liability Companies (SSAP No. 48)
Fixed Income Investments (Unaffiliated) ....
Fixed Income Investments (Affiliated) ....

Common Stocks (Unaffiliated) ....
Common Stocks (Affiliated) ....

Real Estate (Unaffiliated) ....
Real Estate (Affiliated) ....

Mortgage Loans (Unaffiliated) ....
Mortgage Loans (Affiliated) ....

Other (Unaffiliated) ....
Other (Affiliated) ....
~~Unaffiliated...~~
~~Affiliated...~~

~~Subsidiary, Controlled or Affiliated Investment (SSAP No. 97)~~
~~Unaffiliated...~~
~~Affiliated...~~

Other ~~Qualifying~~ Investment Category
Cash, Cash Equivalent and Short-Term Investments (Unaffiliated) ....
Cash, Cash Equivalent and Short-Term Investments (Affiliated) ....

Other Long-Term Invested Assets (Unaffiliated) ....
Other Long-Term Invested Assets (Affiliated) ....
~~Unaffiliated...~~
~~Affiliated...~~

~~Collateral Does Not Qualify as an Investment~~
~~Unaffiliated...~~
~~Affiliated...~~

Non-Collateral Loans

Related Party/Affiliated Loans
All Other Non-Collateral Loans
~~Unaffiliated...~~
~~Affiliated...~~

On May 15, 2024, the Statutory Accounting Principles (E) Working Group took the following two actions:

1) Directed NAIC staff to prepare a memo to the Blanks (E) Working Group to incorporate an instructional change to the AVR instructions that allows collateral loans backed by mortgages to flow through AVR as an "Other Invested Asset with Underlying Characteristics of Mortgage Loans" as an interim step while further consideration occurs on the reporting of collateral loans and how collateral loans should flow through AVR. The Working Group noted that this memo to blanks is contingent on the adoption of the exposed editorial change by the Life Risk-Based Capital (E) Working Group. This Life RBC editorial change adjusts the amount reported as collateral loans to be in "in part" so that the reduction for what is backed by mortgage loans could be removed from the collateral loan total, as they would be captured in a different category. If this Life RBC change does not get adopted, while the blanks memo moves forward, then collateral loans backed by mortgage loans would get captured in two places in the RBC formula.

2) Directed NAIC staff to proceed with sponsoring a blanks proposal for the reporting of collateral loans, using the reporting lines shown in the agenda item modified to reflect a majority of the interested parties' comments. NAIC staff notes that specific comments were not received on whether certain collateral loans should flow through AVR, so NAIC staff will be working in the interim with regulators and RBC staff to develop a proposal for initial consideration. (With this direction, this agenda item was not re-exposed. The agenda item will likely be exposed when the proposed blanks changes are drafted.)

2024 Summer National Meeting Updated Recommendation:

As detail of all collateral types will be collected in the data-captured disclosure, NAIC staff proposes only limited reporting lines on Schedule BA reporting lines focusing on categories for which look-through to underlying collateral for AVR and RBC purposes is warranted. The proposed categories shown below reflect where separate reporting and AVR/RBC consideration has been suggested. With the receipt of the 2024 data-captured disclosure, an assessment will occur to determine whether additional Schedule BA reporting lines should be considered based on the extent certain types of investments are backed by collateral loans. **NAIC staff recommend exposure of this agenda item with a request for comments on the following potential Schedule BA collateral loan reporting lines. With exposure, NAIC staff recommends sponsoring a blanks proposal to begin detailing the revisions to Schedule BA and AVR that would occur with these changes. As the resulting AVR and RBC factors would be contingent on the actions of the Capital Adequacy (E) Task Force (and its RBC Working Groups), NAIC staff recommend Working Group direction to notify those groups of this action.**

(Although the effective date of revisions is always contingent on the direction of the Working Group, it is currently anticipated that a Jan. 1, 2026, effective date would be considered. This would allow the revisions to begin at the start of a statutory filing year. Revisions would need to be adopted by August 2025 to meet that timeframe.)

Proposed Schedule BA Revisions:
(The existing collateral loan line will be deleted.)

Collateral Loans – Reported by Collateral that Secures the Loan

Backed by Mortgage Loans
Unaffiliated...
Affiliated...

(Collateral loans backed by mortgage loans that would be in scope of SSAP No. 37 if held directly.)

Backed by Investments in Joint Ventures, Partnerships or Limited Liability Companies
Unaffiliated...
Affiliated...

(Collateral loans backed by an investment that would be in scope of SSAP No. 48 if held directly.)

Backed by Residual Interests
Unaffiliated...
Affiliated...

(Collateral loans backed by an investment that would be in SSAP No. 21 as a residual if held directly.)

Backed by Debt Securities
Unaffiliated...
Affiliated...

(Collateral loans backed by an investment that would be assessed under SSAP No. 26 for bond reporting. This classification does not require confirmation that the debt security would qualify as a bond.)

Backed by Real Estate
Unaffiliated...
Affiliated...

(Collateral loans backed by an investment that would be captured in scope of SSAP No. 40 if held directly.)

Collateral Loans – All Other
Unaffiliated...
Affiliated...

(Collateral loans not captured in the specific reporting lines.)

With the inclusion of these new reporting lines, this recommendation also supports the inclusion of the following Schedule BA electronic-only columns for all collateral loan investments:

- Fair Value of Collateral Backing the Collateral Loan
- Percentage of Collateral to the Collateral Loan

Proposed AVR Revisions:
This exposure suggests a new category within the AVR Reporting Schedule to capture collateral loans. This is currently proposed to be a new category inserted after "residuals" (AVR lines 81-93) and before "All Other Investments" (AVR lines 94-99). The following illustrates the simple proposed addition to the schedule.

The following elements are requested for feedback during the exposure:

1) Should collateral loans backed by mortgage loans be included in the new collateral loan category, or should those continue to flow through the "Investments with the Underlying Characteristics of Mortgage Loans" permitted during the interim as the long-term resolution? If captured in the new collateral loan AVR category, to what extent should the underlying characteristic lines detailing quality / past due / foreclosure status (AVR lines 38-64) be duplicated?

2) What additional reporting lines (breakouts) of the proposed AVR categories are necessary to ensure appropriate look-through for RBC assessment purposes?

RESIDUAL TRANCHES OR INTERESTS

81	Fixed Income Instruments – Unaffiliated.....
82	Fixed Income Instruments – Affiliated ....
83	Common Stock – Unaffiliated.....................
84	Common Stock – Affiliated ....
85	Preferred Stock – Unaffiliated.....................
86	Preferred Stock – Affiliated ....
87	Real Estate – Unaffiliated ....
88	Real Estate – Affiliated ....
89	Mortgage Loans – Unaffiliated ....
90	Mortgage Loans – Affiliated ....
91	Other – Unaffiliated ....
92	Other – Affiliated ....
93	Total Residual Tranches or Interests (Sum of Lines 81 through 92)

COLLATERAL LOANS
Backed by Mortgage Loans – Unaffiliated
Backed by Mortgage Loans - Affiliated
Backed by SSAP No. 48 Investments – Unaffiliated
Backed by SSAP No. 48 Investments - Affiliated
Backed by Residuals – Unaffiliated
Backed by Residuals – Affiliated
Backed by Debt Securities – Unaffiliated
Backed by Debt Securities – Affiliated
Backed by Real Estate – Unaffiliated
Backed by Real Estate - Affiliated
All Other – Unaffiliated
All Other – Affiliated

(Renumbering will Occur Based on the Resulting Lines)

	ALL OTHER INVESTMENTS
94	NAIC 1 Working Capital Finance Investments
95	NAIC 2 Working Capital Finance Investments
96	Other Invested Assets - Schedule BA ....
97	Other Short-Term Invested Assets - Schedule DA
98	Total All Other (Sum of Lines 94, 95, 96 and 97)
99	Total Other Invested Assets - Schedules BA & DA (Sum of Lines 29, 37, 64, 70, 74, 80, 93 and 98)

On August 13, 2024, the Statutory Accounting Principles (E) Working Group exposed this agenda item with the proposed reporting lines for Schedule BA and AVR as shown above under the 2024 Summer National Meeting recommendation. Additionally, the Working Group directed NAIC staff to proceed with sponsoring a blanks proposal and to notify the Capital Adequacy (E) Task Force and related RBC Working Groups of this action. The RBC factors for the Schedule BA and AVR reporting lines will be contingent on the action of the Task Force. This item was exposed until September 27, 2024 to allow for consideration at the 2024 Fall National Meeting.

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

Issue: Repack and Derivative Investments

Check (applicable entity):

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

Description of Issue: This agenda item has been developed to address debt security investments with derivative components that do not qualify as structured notes. Although the original focus was on specific "credit repack" investments, the agenda item has been expanded to ensure that all debt security investments with derivative wrappers / components are captured.

As an overview of a special purpose vehicle (SPV) "repacking," the structure consists of an SPV acquiring a debt security and reprofiling the cash flows by entering a derivative transaction with a derivative counterparty (known as "credit repacks"). The redesigned debt instrument (reflecting the combined debt security and derivative) is then sold to an investor. NAIC staff has recently received calls on the classification of repacks under the bond definition, but the discussions of these transactions have identified that additional guidance may be warranted to ensure consistent reporting of these transactions within the statutory financial statements. From the discussions, there are initiatives for these combined investments to become more prevalent with U.S. insurance entities, but investment makers have noted that these investments are already common in other countries.

As a key element, repacking (and potentially other derivative wrapped debt structures) takes two separate items (debt security and derivative) and combines them into one instrument that resembles a debt security. This is done at an SPV, with the SPV issuing a new debt security to the reporting entity. From discussions, there are several variations of the derivative components that can be combined with the debt security. Some of them are very simple (such as a cross-currency swap), but others are complex, altering both the amount and timing of cash flows. The structures can be customized allowing for ongoing innovation, benefiting insurers with the ability of entering derivative transactions to appropriately reduce risk, but creating difficulty in the ability to group repacks structures into limited exception guidance.

For all of these structures, the derivative arrangements could be entered into separately and do not need to be entered into as a combined transaction, however, the noted benefits for entering into a combined structure include:

1) **Derivative Margin / Collateral Requirement:** There is no daily settling of a margin requirement at the derivative counterparty based on fair value changes in the derivative. **This is because the debt security in the structure serves as constant collateral, and any amount owed to the derivative counterparty would be taken first from debt instrument cash flows before payment is made to the investor. (The derivative counterparty is senior in priority.)** The repack structure limits the collateral obligation to the debt security in the structure, so there is no potential for the reporting entity to be obligated for more collateral beyond the linked debt security. This is a benefit of a repack in comparison to normal derivatives that do not have a collateral limit.

    - Although perceived as a benefit from the entity / investment maker as it reduces liquidity risk associated with margin calls, from a statutory accounting perspective, if the transactions were reported separately and the debt investment was pledged as collateral, the debt instrument would be identified as a restricted asset. If the repack is collectively reported as a debt instrument, there would be no identification that the debt instrument is restricted or encumbered as collateral to the derivative counterparty. This is

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because the restriction is at the SPV and not the reporting entity. Also, if separately engaging in derivative transactions, the derivative counterparty is known and reported. If a repack is collectively reported as a debt instrument, it is uncertain if the affiliation between the derivative counterparty and reporting entity would be known.

2) **Bond Reporting:** If these structures are accounted for as bonds, **reporting entities would determine measurement method and RBC impact based on the NAIC designation. Ultimately, this structure provides the reporting entity with a derivative arrangement, with no separate reporting or acknowledgement of the derivative instrument within the financial statements.**

   - From a statutory accounting perspective, if reporting is combined in a repack, derivatives would not be captured on Schedule DB and reporting entities would not be required to assess whether the derivative is effective under *SSAP No. 86—Derivatives*. (There is also a question on whether these arrangements would be captured in a reporting entity's derivative use plan filed with the domiciliary state.) Any obligation based on the performance of the derivative would not be reported in the investor's financials.

3) **RBC Impact:** By reporting as a bond investment, the reporting entity would incur a single RBC factor charge based on the NAIC designation on the debt security issued by the SPV.

   - From a statutory perspective, if the investment had been reported separately as a bond and a derivative, there would be RBC impacts for both components. The collateral pledged to the derivative counterparty (bond) would also be coded as a restricted asset. Whether the combined reporting results in a benefit to RBC depends on how the derivative would have been reported separately (at amortized cost or fair value) and whether the derivative is in a loss position. However, if reported separately, these components are captured in the RBC formula to reflect those dynamics.

The following identifies specific elements for discussion:

1) **Sale / Reacquisition:** A "credit repack" can be originated with a reporting entity's currently held debt security. In those situations, the insurer would sell the debt security to an SPV, that security would be combined with a derivative at the SPV, and the SPV would sell the restructured combined instrument back to the insurer.

   From the discussions held, inconsistent interpretations may exist on whether the initial debt security should be reflected as disposed, with the reporting entity acquiring a new investment for the "repack." The discussions have referred to "substantially similar" U.S. GAAP guidance and have noted that the base investment (original debt security) has not changed, therefore the action did not warrant disposal / new acquisition reporting. If this interpretation was applied, the original debt security would still be shown on the financial statements, but with the repack the issuer, yield and NAIC designation have been impacted. If it is concluded that the revised instrument is substantially similar to what was originally held and did not require a disposal / reacquisition, it is likely that there would be no indication in the financial statements that the entity has entered into a new arrangement that combines a debt security and derivative instrument. NAIC staff does not agree with interpretations that the repack is substantially similar based on existing guidance in SSAP No. 103, paragraph 52, but this has been noted as part of the discussions. Under SSAP No. 103, to be considered substantially the same, an investment needs to have the same primary obligor, identical contractual interest rates and identical form and type to provide the same risks and rights. Under a repack, the issuer, yield and designation are impacted as follows, disallowing consideration that the instrument is substantially the same:

   - The revised issuer is the SPV and the new instrument is a combined instrument of the debt instrument and the derivative.

   - The fees for engaging in this instrument are built into the investment yield, resulting in a lower yield than what would have been received if the original debt instrument was still held.

- The NAIC designation (CRP rating) could also be impacted, as the revised instrument reflects the credit quality of both the original issuer and the derivative counterparty. From discussions, this is often a 1-level decrease in rating.

Not all repacks involve a previously held debt instrument. An entity may acquire a repack directly from the SPV rather than sell a currently owned debt security to the SPV. From the discussions, if this was to occur, it is believed that entities would report the acquired investment as a bond (under existing SSAP guidance), unless the structure is considered to be a structured note under paragraph 5.g. of *SSAP No. 86—Derivatives:*

> 5.g. "Structured Notes" in scope of this statement are instruments defined in *SSAP No. 26R—Bonds* (often in the form of debt instruments), in which the amount of principal repayment or return of original investment is contingent on an underlying variable/interest[1]. Structured notes that are "mortgage-referenced securities" are captured in *SSAP No. 43R—Loan-Backed and Structured Securities.*

There is also a question on whether all repacks should be considered structured notes. In a repack structure, if the debt security is liquidated early and there is an amount owed from the derivative performance, the SPV must first satisfy that amount to the derivative counterparty. This could result in a payment less than the principal amount being remitted to the insurer holder. Although the repack designs differ based on the derivative instrument and intent, in some situations this is only driven by the early liquidation of the structure and not a component that comes into play if the structure is held to maturity. In those structures, the design would not be considered a structured note. However, in other designs, the repack may reflect a structured note regardless, and the structured note guidance should be followed.

2) **<u>Derivative Obligation</u>**: A credit repack investment ultimately could allow an insurer to enter into derivative arrangements that are not separately reported or assessed within the scope of SSAP No. 86, which is currently explicit that embedded derivatives shall not be separated from the host contract. If the derivative was to be separately reported, it would only qualify for amortized cost treatment if determined to be highly effective pursuant to SSAP No. 86, otherwise it would be reported at fair value.

   From discussions of these investment / derivative designs, NAIC staff has the impression that these derivative arrangements would be reported at fair value if held separately from the debt instrument. (Discussions have indicated that they would be separately reported at fair value under U.S. GAAP.) By combining with the debt security, and if permitted to follow bond accounting, reporting entities would utilize an amortized cost measurement for the combined credit repack based on the NAIC designation pursuant to current guidance within SSAP No. 26 / SSAP No. 43.

   Although it has been communicated that the derivative is designed to match the maturity duration of the debt instrument, if the investment was to be liquidated in advance of the maturity date, the obligation with the derivative counterparty must still be satisfied. If the derivative was in a liability position, upon liquidation of the debt instrument, the SPV would collect the proceeds from the debt instrument and first remit any amount owed to the derivative counterparty before providing the remaining balance to the reporting entity. Although it depends on the derivative arrangement, in some designs, the reporting entity could receive less than the stated

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

principal amount of the bond. For these designs, unless the derivative was reported separately (or the repack was reported at fair value), the amount to be received at any point in time for the repack investment may be overstated due to the derivative impact. *(The inverse is also true, whereas if the derivative was in an asset position, the SPV would collect funds from the derivative counterparty and the reporting entity would receive an amount that exceeds the principal amount of the bond.)*

3) **Principles-Based Bond Definition Application**: The discussion with NAIC staff on credit repacks initially occurred due to questions on whether the repack is an issuer credit obligation (ICO) or an asset-backed security (ABS) under the principles-based bond definition. Initially, it was noted that a repack with a derivative that simply converted cash flows (fixed to floating or foreign currency), but which did not impact the timing or extent of cash flows could still potentially reflect an ICO obligation under the single-entity payer provision, assuming that the investment did not reflect a structured note. However, any design that was to alter the timing or amount of cash flows would result in an ABS classification. For example, if the repack altered the timing of cash flows so instead of periodic interest in line with the debt security terms, all interest payments were accumulated at the SPV and provided at maturity, this would require an ABS classification. If classified as an ABS, it was noted that there would be no substantive credit enhancement (as the structure simply passes through cash flows) and the structure would fail to qualify as a bond. However, after further assessment of these structures, NAIC staff recommends explicit guidance for the accounting of these combined debt / derivative structures. From discussions on these investments, a key driver is getting the combined structure classified as a Schedule D investment. From information shared, a vast array of different derivative structures could be combined with the debt security to form a combined item, with many different cashflow desired outcomes.

Ultimately, NAIC staff believes the issue goes further than bond classification as ICO or ABS. As such, this agenda item proposes SSAP guidance / interpretation to address all situations in which a debt security may be wrapped or combined with a derivative structure to ensure consistent and transparent reporting as well as information to the regulators on these investment transactions. NAIC staff believes the potential for these structures originates from the existing SSAP No. 86 guidance that indicates that embedded derivatives shall not be separated from the host contract and accounted for separately as a derivative instrument. NAIC staff notes that this SSAP No. 86 guidance allows these investment structures to be reported in ways that were perhaps not intended when that embedded derivative guidance was originally established.

Existing Authoritative Literature:

- ***SSAP No. 26R—Bonds (Effective Jan. 1, 2025)***

SSAP No. 26R includes the adopted principles-based bond definition and the provisions for detailing an ICO or ABS. Key provisions from this SSAP are provided below. These excerpts focus on the definition of a bond, the creditor relationship review involving pre-determined interest and principal payments, and relevant provisions of the ICO and ABS terms.

Specific Excerpts:

5. A bond shall be defined as any security representing a creditor relationship, whereby there is a fixed schedule for one or more future payments, and which qualifies as either an issuer credit obligation or an asset-backed security as described in this statement.

6. Determining whether a security represents a creditor relationship should consider its substance, rather than solely the legal form of the instrument. The analysis of whether a security represents a creditor relationship should consider all other investments the reporting entity owns in the investee as well as any other contractual arrangements. A security that in substance possesses equity-like characteristics or represents an ownership interest in the issuer does not represent a creditor relationship.

6.d. In order for a debt instrument to represent a creditor relationship in accordance with Paragraph 6, it must have pre-determined principal and interest payments (whether fixed interest

or variable interest) with contractual amounts that do not vary based on the appreciation or depreciation (i.e., performance) of any underlying collateral value or other non-debt variable. For example, an issued security that has varying principal and interest payments based on the appreciation of referenced equity, real estate or other non-debt variable is precluded from bond treatment. This exclusion is not intended to restrict variables that are commonly related to debt instruments such as, but not limited to, plain-vanilla inflation or benchmark interest rate adjustments (such as with U.S. TIPs or SOFR-linked coupons, respectively), scheduled interest rate step-ups, or credit-quality related interest rate adjustments. This exclusion is also not intended to encompass nominal interest rate adjustments[2]. For clarification purposes, all returns from a debt instrument in excess of principal are required to be considered as interest. Therefore, investments with "stated" interest and then "additional returns" to which the holder of the debt instrument is entitled are collectively considered as interest and shall be assessed together in determining whether the investment has variable principal or interest due to underlying referenced non-debt variables. Examples of securities excluded from the bond definition under this guidance:

i. Structured Notes, which are securities that otherwise meet the definition of a bond, but for which the contractual amount of the instrument to be paid at maturity (or the original investment) is at risk for other than the failure of the borrower to pay the principal amount due, are excluded from the bond definition. These investments, although in the form of a debt instrument, incorporate the risk of an underlying variable in the terms of the agreement, and the issuer obligation to return the full principal is contingent on the performance of the underlying variable. These investments are addressed in *SSAP No. 86—Derivatives*. Mortgage-referenced securities issued by a government sponsored enterprise are explicit inclusions in scope of SSAP No. 43. Foreign-denominated bonds subject to variation as a result of foreign currency fluctuations are not structured notes.

ii. Principal-protected securities, as defined in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* are excluded from the bond definition as they have a performance component whose payments originate from, or are determined by, non-fixed income securities. These investments shall follow the guidance for non-bond securities in *SSAP No. 21—Other Admitted Assets.*

7. An issuer credit obligation is a bond, for which the general creditworthiness of an operating entity or entities through direct or indirect recourse, is the primary source of repayment. Operating entity or entities includes holding companies with operating entity subsidiaries where the holding company has the ability to access the operating subsidiaries' cash flows through its ownership rights. An operating entity may be any sort of business entity, not-for-profit organization, governmental unit, or other provider of goods or services, but not a natural person or "ABS Issuer" (as defined in paragraph 8). Examples of issuer credit obligations include, but are not limited to:

7.g. Investments in the form of securities for which repayment is fully supported by an underlying contractual obligation of a single operating entity (e.g., Credit Tenant Loans (CTLs), Equipment trust certificates (ETCs), other lease backed securities, Funding Agreement Backed Notes (FABNs), etc.). For purposes of applying this principal concept, repayment is fully-supported by the underlying operating entity obligation if it provides cash flows for the repayment of all interest and at least 95% of the principal of the security.

8. An asset-backed security is a bond issued by an entity (an "ABS Issuer") created for the primary

[2] Nominal interest rate adjustments are those that are too small to be taken into consideration when assessing the investment's substance as a bond. Nominal adjustments are not typically influential factors in an investors' evaluation of investment return and are often included to incentivize certain behavior of the issuer. An example would include sustainability-linked bonds where failure to achieve performance metrics could cause interest rate adjustments. In general, interest rate adjustments that adjust the total return from interest by more than 10% (e.g., >0.4% for a 4% yielding bond), would not be considered nominal. Further, any such adjustments that cause an investment to meet the definition of a structured note would not be considered nominal.

purpose of raising debt capital backed by financial assets or cash generating non-financial assets owned by the ABS Issuer, for which the primary source of repayment is derived from the cash flows associated with the underlying defined collateral rather than the cash flows of an operating entity. In most instances, the ABS Issuer is not expected to continue functioning beyond the final maturity of the debt initially raised by the ABS Issuer. Also, many ABS Issuers are in the form of a trust or special purpose vehicle ("SPV"), although the presence or lack of a trust or SPV is not a definitive criterion for determining that a security meets the definition of an asset-backed security. The provisions in paragraphs 9-10 detail the two defining characteristics that must be present for a security to meet the definition of an asset-backed security.

10. The holder of a debt instrument issued by an ABS Issuer is in a different economic position than if the holder owned the ABS Issuer's assets directly. The holder of the debt instrument is in a different economic position if such debt instrument benefits from substantive credit enhancement through guarantees (or other similar forms of recourse), subordination and/or overcollateralization.

10a. *Substantive Credit Enhancement*: The intent of the criteria requiring the holder to be in a different economic position is to distinguish qualifying bonds from instruments with equity-like characteristics or where the substance of the transaction is more closely aligned with that of the underlying collateral. To qualify as an ABS under this standard, there is a requirement that there are substantive credit enhancements within the structure that absorb losses before the debt instrument being evaluated would be expected to absorb losses. This is inherent in the context of an issuer credit obligation in scope of SSAP No. 26R as the owners of the equity in the operating entity are the first to absorb any variability in performance of the operating entity. The same concept applies to asset-backed securities. If substantive credit enhancement did not exist, the substance of the debt instrument being evaluated would be more closely aligned with that of the underlying collateral than that of a bond. Credit enhancement that is merely nominal or lacks economic substance does not put a holder in a different economic position. The substantive credit enhancement

- ***SSAP No. 86—Derivatives***

SSAP No. 86 provides guidance for derivatives. Paragraph 5g addresses structured notes, paragraph 16 addresses variation margin, paragraph 17 addresses embedded derivative investments, with paragraphs 20-21 providing recognition guidance.

5. Derivative instruments include, but are not limited to; options, warrants used in a hedging transaction and not attached to another financial instrument, caps, floors, collars, swaps, forwards, futures, structured notes with risk of principal/original investment loss based on the terms of the agreement (in addition to default risk), and any other agreements or instruments substantially similar thereto or any series or combination thereof.

5g. "Structured Notes" in scope of this statement are instruments defined in *SSAP No. 26R—Bonds* (often in the form of debt instruments), in which the amount of principal repayment or return of original investment is contingent on an underlying variable/interest3. Structured notes that are "mortgage-referenced securities" are captured in *SSAP No. 43R—Loan-Backed and Structured Securities.*

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

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

Embedded Derivative Instruments

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

Recognition of Derivatives

20. Derivative instruments represent rights or obligations that meet the definitions of assets (SSAP No. 4—Assets and Nonadmitted Assets) or liabilities (SSAP No. 5R) and shall be reported in financial statements. In addition, derivative instruments also meet the definition of financial instruments as defined in *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures*. 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 46-50 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.

21. Derivative instruments that are not used in hedging, income generation or replication (synthetic asset) transactions shall be considered “Other” derivatives. These derivatives shall be accounted for at fair value and the changes in fair value shall be recorded as unrealized gains or losses. These derivatives do not qualify as admitted assets.

- ***SSAP No. 103—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities***

SSAP No. 103 provides guidance for the transfers of assets and liabilities, including guidance for when a sale shall be considered to have occurred. Guidance is captured for when securities are sold/reacquired are considered to be substantially the same and how those transactions should be reflected. As detailed in paragraph 52, credit repack notes would not qualify as substantially the same as the credit repack generally has a different issuer, different yield and modified NAIC designation/CRP rating from the original underlying investment.

12. Repurchase agreements, reverse repurchase agreements, repurchase financing, collateral requirements and dollar repurchase agreements are described in paragraphs 102-118. When an asset is sold and the proceeds are reinvested within 30 days in the same or substantially the same security, such transfers shall be considered to be wash sales and shall be accounted for as sales as discussed in paragraphs 96-101 and disclosed as required by paragraph 28[4]. Unless there is a concurrent contract

[4] Paragraph 28.l. also details the items that are excluded from the wash sale disclosure.

to repurchase or redeem the transferred financial assets from the transferee, the transferor does not maintain effective control over the transferred financial assets.

Agreement to Repurchase or Redeem Transferred Financial Assets

51. An agreement that both entitles and obligates the transferor to repurchase or redeem transferred financial assets from the transferee maintains the transferor's effective control over those assets as described in paragraph 8.c.(1) when all of the following conditions are met:

a. The financial assets to be repurchased or redeemed are the same or substantially the same as those transferred (paragraph 52).

b. The agreement is to repurchase or redeem them before maturity, at a fixed or determinable price.

c. The agreement is entered into contemporaneously with, or in contemplation of, the transfer.

52. To be substantially the same, the financial asset that was transferred and the financial asset that is to be repurchased or redeemed need to have all of the following characteristics:

a. The same primary obligor (except for debt guaranteed by a sovereign government, central bank, government-sponsored enterprise or agency thereof, in which case the guarantor and the terms of the guarantee must be the same);

b. Identical form and type so as to provide the same risks and rights;

c. The same maturity (or in the case of mortgage-backed pass-through and pay-through securities similar remaining weighted-average maturities that result in approximately the same market yield);

d. Identical contractual interest rates;

e. Similar assets as collateral; and

f. The same aggregate unpaid principal amount or principal amounts within accepted "good delivery" standards for the type of security involved.

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 2023, the Working Group adopted the principles-based bond definition, which resulted in key revisions to *SSAP No. 26R—Bonds* and *SSAP No. 43R—Asset-Backed Securities*, and *SSAP No. 21R—Other Admitted Assets* for the review and classification of debt securities pursuant to the bond definition. This guidance is effective Jan. 1, 2025.

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 as a new SAP concept and expose proposed edits to *SSAP No. 86—Derivatives*, to establish guidance that requires separate accounting and reporting of derivatives that are captured in debt security structures. This is a change from existing guidance that explicitly precludes the separation of embedded derivatives. In addition to these changes, minor revisions are also proposed to *SSAP No. 26—Bonds* and to the annual statement instructions to clarify application guidance. NAIC staff will also draft an issue paper to document these revisions.

From initial discussions with banks / investment makers, guidance to separate the derivative from the debt security is believed to be preferred over a conclusion that would preclude bond treatment for the combined structure. With the proposal, debt security repack structures will be treated similarly to investments where the bond and derivative are not combined. (Ultimately, there would be no capital benefit or detriment due to the structure.) Additionally, this proposal will allow transparency as to the derivatives being used and ensure compliance with the reporting entity's derivative use plan. (If this proposed guidance is not supported, the combined repack, which represents a debt structure, would need to be assessed under the bond definition. This may require more detailed guidance to assess different types of derivative structures to determine whether the repack should qualify as a bond or as a non-bond debt security.)

NAIC staff has not proposed revisions to SSAP No. 103 as the existing guidance is clear that a sale of a debt security which is subsequently or simultaneously reacquired as a credit repack would not meet the criteria of substantially the same. This is because a credit repack generally has a revised issuer, yield and NAIC designation to reflect the additional derivative risk. As noted, minor revisions have been proposed to the annual statement instructions to clarify that the sale of a security that is reacquired with different terms shall be reported as a sale on Schedule D-Part 4 and a new acquisition on Schedule D-Part 3.

Proposed Revisions to *SSAP No. 86—Derivatives*:

Embedded Derivative Instruments

17. Contracts that do not in their entirety meet the definition of a derivative instrument, such as ~~bonds,~~ insurance policies, and leases, may contain "embedded" derivative instruments—implicit or explicit terms that affect some or all of the cash flows or the value of other exchanges required by the contract in a manner similar to a derivative instrument. The effect of embedding a derivative instrument in another type of contract ("the host contract") is that some or all of the cash flows or other exchanges that otherwise would be required by the contract, whether unconditional or contingent upon the occurrence of a specified event, will be modified based on one or more underlyings. For these contracts, excluding debt securities with derivative components/wrappers pursuant to paragraph 18, ~~A~~an embedded derivative instrument shall not be separated from the host contract and accounted for separately as a derivative instrument.

18. Debt securities that have derivative components or wrappers shall initially be assessed to determine if they are a structured note pursuant to paragraph 5g. Structured notes shall not be bifurcated and shall be collectively reported as a derivative investment and shall be measured and reported pursuant to the guidance within this statement. Debt securities that are not structured notes, but have been combined with a derivative instrument[FN1] shall be bifurcated with separate reporting as a debt security and a derivative instrument. Once the investment is bifurcated, the debt security shall be reviewed in accordance with the bond definition within *SSAP No. 26—Bonds* and captured as an issuer credit obligation, asset-backed security, or non-bond debt security, based on the characteristics of the debt security[FN2]. If the debt security serves as collateral to the derivative counterparty, the reported debt security shall be coded as a restricted asset under *SSAP No. 1—Accounting Policies, Risks & Uncertainties and Other Disclosures*. The derivative shall be captured in scope of this statement, measured and classified pursuant to the guidance within and reported on Schedule DB.

New Footnote 1: This guidance applies to all debt securities with derivative components or wrappers but was incorporated in response to credit repack notes. With a credit repack, a debt security is combined with a derivative instrument at an SPV, with the reporting entity acquiring a new debt security ("repack") from the SPV reflecting the combined components. This structure can be viewed as advantageous over the separate acquisition of a derivative instrument as the debt security held in the structure serves as the sole source of collateral to the derivative counterparty, reducing potential liquidity concerns based on future market fluctuations. However, if this repack structure was collectively reported as a debt security, information on the use of derivatives would not be identifiable within the statutory financial statements. A repack note often has a reduced interest yield from the stated yield of

the underlying debt security held in the structure to cover the fees of issuing the repack, as well as a revised NAIC designation/CRP rating that reflects the added risk of the SPV and derivative counterparty.

New Footnote 2: Assessment under the bond definition shall be based on the characteristics of the underlying debt security, but the issuer, investment yield, NAIC designation/CRP rating, as well as any other reported investment components, shall reflect the terms of the held (combined) investment and not the terms of the underlying security.

Proposed Revisions to SSAP No. 26—Bonds

4. This statement excludes:

e. Replication (synthetic asset) transactions and debt security structures that have been combined with derivative components or wrappers addressed in *SSAP No. 86—Derivatives*. The admissibility, classification and measurement of a replication (synthetic asset) transactions are not preemptively determined by the principles-based bond definition and should be evaluated in accordance with the guidance on replication (synthetic asset) transactions within SSAP No. 86. Debt security structures combined with a derivative, such as a credit repack note that does not reflect a structured note, shall follow the guidance in SSAP No. 86 for bifurcation. After bifurcation, the underlying debt security is subject to the guidance in this statement in determining whether it qualifies for bond reporting.

Proposed Revisions to Annual Statement Instructions:

Schedule D – Part 4: Long Term Bonds and Stocks Sold, Redeemed or Otherwise Disposed Of During Current Year

This schedule should include a detailed listing of all securities that were sold/disposed of during the current reporting year that were owned as of the beginning of the current reporting year (amounts purchased and sold during the current reporting year are reported in detail on Schedule D, Part 5 and only in subtotal in Schedule D, Part 4). This should include all transactions that adjust the cost basis of the securities (except other-than-temporary impairments that are not part of a disposal transaction). ~~Thus, it~~This schedule should not be used for allocations of TBAs to specific pools subsequent to initial recording in Schedule D, Part 3 or ~~other~~ situations ~~such as~~that only involve CUSIP number changes. The following list of items provides examples (not all inclusive) of the items that should be included:

Pay downs of securities still owned (including CMO prepayments);

Subsequent partial sales of investment issues still owned;

Sales of securities to an SPV or other entity for which a new instrument is reacquired from the SPV/entity reflecting a combined instrument containing the original security and derivative instruments or other components (such as a credit repack note). The sale shall be captured on this schedule (or Schedule D, Part 5 if the debt security was acquired in the current year), and the new security shall be reported on Schedule D, Part 3.

Reallocation of the cost basis of an already owned stock to the cost basis of a new stock received as a dividend (e.g., spin off); and

Any decreases in the investments in SCA companies that adjust the cost basis, not including other-than-temporary impairments alone (e.g., subsequent return of capital from investments in SCA companies valued using the equity method).

Schedule D – Part 5: Long-Term Bonds and Stocks Acquired During the Year and Fully Disposed Of During Current Year

As with Schedule D, Parts 3 and 4, this schedule should ~~not~~ be used for ~~a~~ transactions ~~unless it~~that affects the cost basis of the securities. ~~Thus, it~~This schedule should not be used for allocations of TBAs to specific pools subsequent to initial recording in Schedule D, Part 3 or ~~other~~ situations ~~such as~~ that only involve CUSIP number changes. Refer to the examples on Schedule D, Part 4 of transactions that should be captured.

Existing Guidance in SSAP No. 103, paragraph 52 – No Revisions Proposed:

With this existing guidance, debt securities sold and reacquired as a credit repack should not be considered to be substantially the same. This is because the credit repack is acquired from a new issuer, with a revised yield and with revised risks and rights (including revised NAIC designation/CRP rating) to reflect the derivative components / counterparty. Comments are requested on different interpretations and if edits are needed to ensure proper application of this guidance.

52. To be substantially the same, the financial asset that was transferred and the financial asset that is to be repurchased or redeemed need to have all of the following characteristics:

    a. The same primary obligor (except for debt guaranteed by a sovereign government, central bank, government-sponsored enterprise or agency thereof, in which case the guarantor and the terms of the guarantee must be the same);

    b. Identical form and type so as to provide the same risks and rights;

    c. The same maturity (or in the case of mortgage-backed pass-through and pay-through securities similar remaining weighted-average maturities that result in approximately the same market yield);

    d. Identical contractual interest rates;

    e. Similar assets as collateral; and

    f. The same aggregate unpaid principal amount or principal amounts within accepted “good delivery" standards for the type of security involved.

Staff Review Completed by: Julie Gann, NAIC Staff—June 2024

On August 13, 2024, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, classified as a new SAP concept, and exposed revisions to *SSAP No. 86--Derivatives,* as shown above, to require bifurcation of debt securities with derivative wrappers or components if the item does not reflect a structured note. The guidance details the accounting and reporting guidance for the bifurcated debt and derivative components. This item was exposed until September 27, 2024 to allow for discussion at the 2024 Fall National Meeting.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/11-17-24 Fall National Meeting/Hearing/11 - 24-16 - Repacks and Derivative Wrapper Investments.docx

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Statutory Accounting Principles (E) Working Group
Fall National Meeting
Comment Letters Received

TABLE OF CONTENTS

COMMENTER / DOCUMENT	PAGE REFERENCE
Comment Letters Received for Items Exposed for the Fall National Meeting	
Interested Parties – September 27, 2024 ○ Ref #2019-21: Bond Definition Q&A ○ Ref #2023-28: Collateral Loan Reporting ○ Ref #2024-11: *ASU 2023-09, Improvements to Income Tax Disclosures* ○ Ref #2024-16: Repack and Derivative Instruments ○ Ref #2024-17: Clearly Defined Heding Strategy ○ Ref #2024-18: Clarifications of Accounting Guidance for Recognition of Tax Credits ○ Ref #2024-19: *ASU 2024-02—Codification Improvements—Amendments to Remove References to the Concepts Statements*	2-7
Interested Parties – October 28, 2024 ○ Ref #2019-21: Bond Definition Q&A	8-9
Spectrum Asset Management, Inc. – October 28, 2024 ○ **Ref #2019-21: Bond Definition Q&A**	9-13
Industry Recommendations on 2025 Medicare Part D Prescription Payment Plan	
America's Health Insurance Plans (AHIP) / Blue Cross Blue Shield Association (BCBSA) November 1, 2024 on Medicare Part D Prescription Payment Plan	14-20

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September 27, 2024

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
hut Street, Suite 1500
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RE: Interested Parties Comments on the Items Exposed for Comment by the Statutory Accounting Principles Working Group with Comments due September 27th

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the following items that were exposed for comment by the Statutory Accounting Working Group (the Working Group) during the NAIC National Meeting in Chicago with comments due September 27th.

Ref #2019-21: Bond Definition Q&A

The Working Group exposed a Question-and-Answer Implementation Guide (Q&A) for comments. This Q&A provides interpretations on how the principles-based bond guidance should be applied to specific structures or investment characteristics.

Interested parties appreciate the exposure of the Q&A as it will help address meaningful interpretative issues and facilitate more consistent implementation by insurance companies. Interested parties also would like to highlight the following language in paragraph 7.2:

> *This question highlights an important point. Issue papers are not authoritative accounting guidance. It is intended to provide key context regarding discussions leading to the development of new accounting standards. However, neither the issue paper nor this Q&A document represents authoritative accounting guidance. Any unintended language that conflicts with statements in the SSAP should be disregarded.*

First, interested parties would like to suggest that Issue Papers be recognized as authoritative guidance and included in Level 2, or alternatively Level 4, in the statutory hierarchy of authoritative guidance. Level 2 would place issue papers higher in the hierarchy than the annual statement instructions (Level 3) which arguably is appropriate. Level 4 specifically includes the preamble as authoritative guidance and paragraph 45 of the preamble states, "While it is not intended that there be any significant differences between an underlying issue paper and the resultant SSAP, if differences exist, the SSAP prevails and shall be considered definitive." This part of the preamble implies if a difference exists, and is not addressed by the SSAP, it is authoritative. If this interpretation by interest parties is not consistent with the NAIC's interpretation, it is important that the issue papers be explicitly included in the statutory hierarchy as many are drafted to include interpretative guidance not included in the SSAPs (e.g., feeder funds related to the new principles-based bond definition (PBBD) and superseded US GAAP OTTI impairment guidance that is still applicable for statutory accounting but is not codified within the SSAPs). Further, other areas of the Accounting Practices & Procedures Manual that suggest issues papers are not authoritative (e.g., Appendix E) would need to be updated for consistency.

Interested parties also believe the Q&A should be included in the statutory hierarchy, perhaps by including them as an interpretation (Level 2) which still serves the purpose of the language in paragraph 7.2 that puts the Q&A in a position subordinate to SSAP Nos. 26 and 43.

Ref #2023-28: Collateral Loan Reporting

The Working Group exposed revisions to Schedule BA with reporting lines to identify the types of collateral used to support recognition of collateral loans as an admitted asset, as well as additions to the Asset Valuation Reserve ("AVR") Schedule. The Working Group also directed NAIC staff to proceed with sponsoring a blanks proposal and to notify the Capital Adequacy (E) Task Force and related RBC Working Groups of this action. The RBC factors for the Schedule BA and AVR reporting lines will be contingent on the action of the Task Force.

The Working Group also requested input from regulators and interested parties to certain AVR related elements. Having reviewed the exposure, interested parties recommend several editorial changes that relate to the exposure.

Schedule BA

- Remove the italicized items under the sub-categories and incorporate them into the Schedule BA instructions.
- Consider renaming the sub-category 'Backed by Residual Interests' to 'Backed by Residual Tranches or Interests' for consistency with the Schedule BA category for Residuals.
- For the sub-category 'Backed by Debt Securities', clarify in the instructions that Debt Securities could be reported on either Schedule D or Schedule BA because it fails the bond definition.
- For the electronic-only column 'Percentage of Collateral to the Collateral Loan', rename the column 'Current Overcollateralization Percentage' for consistency with the Schedule D column.

AVR

- Consider renaming 'Backed by SSAP No. 48 Investments' to 'Backed by Investments in Joint Ventures, Partnerships, or Limited Liability Companies' (as reported in Schedule BA) for consistency.
- Consider renaming 'Backed by Residuals…' to 'Backed by Residual Tranches or Interests…' for consistency with the Schedule BA category for Residuals.
- Clarify if this new Collateral Loan section should be ahead of or after the newly adopted Capital/Surplus Note section of the schedule.
- Consider modification to the instructions to clarify that amounts include only admitted collateral loans.

Interested parties also suggest clarification from the Working Group if there should be a crosscheck between the newly adopted Note 5S Collateral Loans to the revised Schedule BA category for Collateral Loans, as the sub-categories are different.

The Working Group seeks feedback on whether 'collateral loans backed by mortgage loans' should be part of the new collateral loan category or remain under 'investments with underlying characteristics of mortgage loans' for now. While aligning the AVR and Schedule BA would streamline crosschecks, interested parties prefer continuing the current interim solution until the Life Risk-Based Capital Working Group examines the collateral loan section. Interested parties concur that the mortgage section could need to match the lines referenced in LR009 of the Life Risk-Based Capital Report if that working group desires to continue having these items feed LR009 instead of LR008 within the Life Risk-Based Capital Report. The Life Risk-Based Capital Working Group's initial proposal will provide the necessary detailed AVR lines to support data pulls between filings. We look forward to collaborating with NAIC staff and other groups as we finalize categories within the AVR.

Ref #2024-11: ASU 2023-09, Improvements to Income Tax Disclosures

The Working Group exposed revisions to reject ASU 2023-09 Improvements to Income Tax Disclosures in *SSAP No. 101—Income Taxes* and delete the disclosure in SSAP No. 101 paragraph 23b as it is no longer considered relevant due to changes in federal tax law.

Interested parties support the conclusion on this item and note that since paragraph 23.b has been deleted, paragraph 23. a should be changed to paragraph 23.

Ref #2024-16: Repack and Derivative Investments

The Working Group moved this item to the active listing, classified as a new SAP concept, and exposed revisions to *SSAP No. 86--Derivatives,* as shown above, to require bifurcation of debt securities with derivative wrappers or components if the item does not reflect a structured note. The guidance details the accounting and reporting guidance for the bifurcated debt and derivative components.
This agenda item has been developed to address debt security investments with derivative components that do not qualify as structured notes. Although the original focus was on specific

"credit repack" investments, the scope of the agenda item has been expanded to include all debt security investments with derivative wrappers / components.

As an overview of a special purpose vehicle (SPV) "repacking," the structure consists of an SPV acquiring a debt security and reprofiling the cash flows by entering a derivative transaction with a derivative counterparty (known as "credit repacks"). The redesigned debt instrument (reflecting the combined debt security and derivative) is then sold to an investor. NAIC staff has recently received calls on the classification of repacks under the bond definition, but the discussions of these transactions have identified that additional guidance may be warranted to ensure consistent reporting of these transactions within the statutory financial statements. From the discussions, there are initiatives for these combined investments to become more prevalent with U.S. insurance entities, but investment firms have noted that these investments are already common in other countries.

As a key element, repacking (and potentially other derivative wrapped debt structures) takes two separate items (debt security and derivative) and combines them into one instrument that resembles a debt security. This is done at an SPV, with the SPV issuing a new debt security to the reporting entity. From discussions, there are several variations of the derivative components that can be combined with the debt security. Some of them are very simple (such as a cross-currency swap), but others are complex, altering both the amount and timing of cash flows. The structures can be customized allowing for ongoing innovation, benefiting insurers with the ability of entering derivative transactions to appropriately reduce risk, but creating difficulty in the ability to group repacks structures into limited exception guidance.

Interested parties note that U.S. insurance companies do not have significant holdings of credit repack securities and note the following challenges with the exposure:

An insurance company is not the counterparty to the derivative embedded within the SPV and therefore it would be inappropriate to report the derivative on schedule DB for the following reasons:

- The investor does not control or own the derivative directly and reporting the derivative in Schedule DB would be inconsistent with state law. Also, the investor would not have the requisite information to complete Schedule DB (e.g., when they are rolled into a new derivative, terms of the derivative, etc.),
- The insurer may not have the information to apply the requisite hedge accounting requirements including determining whether the derivative qualifies as hedging, income generation, or replication (synthetic asset) transactions and/or, and
- Companies would potentially need a new category within their derivative use plans.

These reasons would create unneeded complexity for companies when the "plain vanilla" derivatives (e.g., cross currency swaps or fixed for floating (or vice versa) swaps) could be used in replicating a bond through a replication strategy.

Lastly, bifurcating the derivative and the bond in such SPVs would presumably create a restricted asset (bond) as the derivative has no margin requirement. This could result in showing a liability for the insurance company which would be inconsistent with the overall approach used in statutory accounting and reporting and/or legal requirements.

Interested parties believe that insurers that own these types of instruments will need to evaluate the debt investment in its entirety to determine if the PBBD has been met. Therefore, we do not believe that further guidance is needed on this topic.

Ref #2024-17: Clearly Defined Hedging Strategy

The Working Group moved this item to the active listing as an SAP clarification, and exposed revisions to SSAP No. 108 to update the definition of a clearly defined hedging strategy to mirror guidance previously adopted by the Life Actuarial (A) Task Force.

Interested parties have no comments on this item.

Ref #2024-18: *Clarification of Accounting Guidance for Recognition of Tax Credits*

The Working Group exposed revisions to *SSAP No. 93—Investments in Tax Credit Structures*, *SSAP No. 94—State and Federal Tax Credit*, and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*.

Interested parties have no comments on this item.

Ref #2024-19: *ASU 2024-02—Codification Improvements—Amendments to Remove References to the Concepts Statements*

The Working Group exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2024-02, Codification Improvements—Amendments to Remove References to the Concepts Statements* as not applicable to statutory accounting.

Interested parties have no comments on this item.

* * * *

Please feel free to contact either one of us if you have any questions or would like to discuss further.

Sincerely,

D. Keith Bell Rose Albrizio

cc: Interested parties
NAIC staff

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October 28, 2024

Mr. Dale Bruggeman, Chairman
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National Association of Insurance Commissioners
hut Street, Suite 1500
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RE: Interested Parties Comments on the Bond Definition Q&A

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the following item that was exposed for comment by the Statutory Accounting Working Group (the Working Group) with comments due October 28th.

Ref #2019-21: Bond Definition Q&A

The Working Group exposed an updated Question-and-Answer Implementation Guide (Q&A) on how the bond definition should be applied to specific investment structures or characteristics. The Q&A has been revised from prior exposure to include three additional topics.

Interested parties appreciate the exposure of the three additional Q&A topics as they will help address meaningful interpretative issues and facilitate more consistent implementation by insurance companies. Interested parties would like to share five editorial comments:

1) In paragraph 7.4, change “SSAP No. 26R” to “SSAP No. 26” to be consistent with other references to SSAP No. 26 throughout the document.
2) In the “Q” in paragraph 8, change Schedule “D-2-1” to “D-1-2” to properly reflect the ABS schedule.
3) In paragraph 10.3, remove the last “sentence” that ends in a colon. This sentence does not appear needed and ends in a colon which implies everything after paragraph 10.3 does not qualify under the bond definition while paragraph 10.6 includes bonds that do qualify.

4) In paragraph 10.6, make the last sentence a separate paragraph (e.g., 10.7) so it is clear the summary in Exhibit A is applicable to all paragraphs of Q10.
5) As a result of Q10, SSAP No. 41 may need slight revisions to appropriately reflect these new distinctions in classifications. Interested parties are happy to work with NAIC staff and regulators on this as appropriate.

* * * *

Please feel free to contact either one of us if you have any questions or would like to discuss further.

Sincerely,

D. Keith Bell Rose Albrizio

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October 28, 2024

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RE: Comments on *Principles-Based Bond Definition Implementation Questions and Answers* (Last Updated: October 2, 2024)

Dear Mr. Bruggeman:

Thank you for the opportunity to provide comments on the *Principles-Based Bond Definition Implementation Questions and Answers* document dated October 2, 2024, during the NAIC National Meeting in Denver with comments due October 28th. Please note that our comments reflect our opinion only.

Regarding the "Implementation Questions and Answers" document, section 10.4:

"Investments in debt securities treated as regulatory capital by the issuer's primary regulatory authority, and ***that do not qualify*** *under the principles-based bond definition solely because interest can be cancelled in the event of financial stress in a non-resolution scenario without triggering an act of default are capital notes and shall be captured in SSAP No. 41—Surplus Notes. These capital notes are often issued by domestic or foreign banks, and the domestic or foreign bank regulator or the Issuer has the ability to cancel interest or dividends, without future interest accumulation or payment."*

We are specifically concerned about the RBC treatment of certain debt instruments moving to Schedule BA for P&C/Health filers. In particular, we are focused on securities classified as "capital notes" captured in SSAP No. 41 – Surplus Notes to be reported on Schedule BA as this rule change will have unintended and uneconomic consequences for the institutions holding these highly rated instruments.

For example, a highly rated security such as the Allianz 3.2% perpetual restricted Tier 1 notes (rated A3/A by Moody's/S&P) may classify under section 10.4 "capital notes" captured in SSAP 41 – Surplus Notes *(e.g.,* non-cumulative with optional coupon cancellation, albeit extremely remote based on issuer fundamentals and as indicated by the security ratings).

While Life insurers may be able to continue to use Filing Exempt (FE) designations or to file with the SVO to get a similar RBC factor as if it were held on Schedule D, Part 1, Bonds allowing an NAIC 1 bond factor for this instrument to be maintained on Schedule BA, P&C and Health cannot. As a result of this asset moving from Schedule D to Schedule BA, the RBC factor would increase to ~20% for P&C and Health from 1.5% and 1.9%, respectively today.

In our opinion, this reclassification imposes onerous capital requirements on a highly rated instrument (ratings which incorporate both credit and structure). We believe this deviates from the underlying fundamental risk as capital requirements would be higher than those for common equity holdings and could misallocate otherwise sound investments.

As such, we request that this matter be reviewed, and that P&C and Health insurers be able to file with the SVO/use Filing Exempt (FE) designations for RBC for capital notes reported on Schedule BA and suggest a change to P&C/Health RBC risk factors for capital notes, in line with that afforded to Life insurers. Thank you for your consideration as it relates to this matter.

Sincerely,

Jeffrey Gass and Chad Stogel
Spectrum Asset Management, Inc.
A member of the Principal Financial Group®

CC: Julie Gann, Robin Marcotte, Jake Stultz, Jason Farr and Wil Oden

Appendix: Structural ratings differentials between various credits and the prospective P&C RBC factors

						P&C		
			Moody's	S&P	Fitch	Current RBC Factor	New RBC Factor	Change in RBC Factor
Allianz	Restricted Tier 1		A3	A	N/A	1.50	20.00	18.50
	Senior Unsecured		Aa2	AA	AA-			
		Notching	4	3				
Barclays	Contingent Convertible Sec		Ba1	BB-	BBB-	5.50	20.00	14.50
	Senior Unsecured		Baa1	BBB+	A			
		Notching	3	5	4			
HSBC	Contingent Convertible Sec		Baa3	N/A	BBB	2.50	20.00	17.50
	Senior Unsecured		A3	A-	A+			
		Notching	3		4			
NatWest Group PLC	Contingent Convertible Sec		Baa3	BB-	BBB-	2.50	20.00	17.50
	Senior Unsecured		A3	BBB+	A			
		Notching	3	5	4			
Societe Generale	Contingent Convertible Sec		Ba2	BB	BB+	6.00	20.00	14.00
	Senior Non-Preferred		Baa2	BBB	A-			
		Notching	3	3	4			
Banco Santander	Contingent Convertible Sec		Ba1	BBB-	N/A	5.50	20.00	14.50
	Senior Non-Preferred		Baa1	A-	A-			
		Notching	3	3				
JP Morgan	Preferred		Baa2	BBB-	BBB+	1.00	1.00	0.00
	Senior Unsecured		A1	A-	AA-			
		Notching	4	3	4			
Bank of America	Preferred		Baa2	BBB-	BBB+	1.00	1.00	0.00
	Senior Unsecured		A1	A-	AA-			
		Notching	4	3	4			
Truist Financial	Preferred		Baa3	BBB-	BBB-	1.00	1.00	0.00
	Senior Unsecured		Baa1	A-	A-			
		Notching	2	3	3			
CMS Energy Corp	Preferred		Ba1	BBB-	BB+	2.00	2.00	0.00
	Senior Unsecured		Baa2	BBB	BBB			
		Notching	2	1	2			
Edison International	Preferred		Ba1	BB+	BB+	2.00	2.00	0.00
	Senior Unsecured		Baa2	BBB-	BBB			
		Notching	2	1	2			
Edison International	Junior Subordinated		Baa3	BB+	BB+	5.50	5.50	0.00
	Senior Unsecured		Baa2	BBB-	BBB			
		Notching	1	1	2			
NextEra	Junior Subordinated		Baa2	BBB	BBB	2.10	2.10	0.00
	Senior Unsecured		Baa1	BBB+	A-			
		Notching	1	1	2			
Prudential Fin	Junior Subordinated		Baa1	BBB+	BBB	1.80	1.80	0.00
	Senior Unsecured		A3	A	A-			
		Notching	1	2	2			

Observations:

- **NRSROs** (Nationally Recognized Statistical Rating Organizations) generally account for structural subordination in their security ratings. The greater the structural subordination, the greater the ratings notching which is reflected in the security ratings.
  - **Contingent Convertible Securities (CoCos)**: For UK banks, CoCos are typically notched 3, 5, and 4 ratings lower by Moody's, S&P, and Fitch, respectively, from their senior unsecured ratings. For EU banks, CoCos are usually notched 3, 3, and 4 lower from their senior non-preferred ratings.
  - **US G-SIB preferred securities**: These are generally notched 4, 3, and 4 ratings lower from their senior unsecured ratings, while non-G-SIB bank preferreds are notched 2, 3, and 3 (or 4) lower.
  - **Junior Subordinated Securities**: These are typically notched 1, 1, and 2 ratings lower from their respective senior ratings.
- RBC factors for most securities previously classified as "hybrids" are expected to remain unchanged, except for the securities captured by section 10.4 in the "Implementation Questions and Answers" document above. Using the securities above, on average, the securities captured by 10.4 move from a ~ 4% RBC factor to 20% for P&C Insurers ~ a move of 16%.

Recommendations to SAPWG Regarding Statutory Accounting for the Part D Medicare Prescription Payment Plan

Introduction and Purpose

The Inflation Reduction Act of 2022 introduced various changes to Medicare, including the addition of a new program intended to help members of Part D plans to manage their payments for prescription drugs. Known as the Medicare Prescription Payment Plan ("MP3"), the new program introduces some transactions that will be new for Part D plan sponsors, and with some new risks and costs. MP3 will go into effect January 1, 2025.

Of concern to Part D plan sponsors is how to account in their statutory financial statement filings to state insurance regulators for the ultimate cost resulting from uncollectible balances due from MP3 enrollees. A potential point of confusion in resolving that issue is the requirement imposed by the Centers for Medicare and Medicaid Services ("CMS") that Part D plan sponsors treat any unsettled balances from MP3 enrollees as part of the Part D plan sponsor's administrative costs for purposes of reporting their minimum medical loss ratio ("MLR") to CMS. Without taking exception to that CMS requirement for MLR purposes, the Trades' view is that for statutory financial statement filings with state insurance regulators, the ultimate costs resulting from such unsettled MP3 balances should be reported as a component of claims/benefit expense.

The purpose of this paper is to set forth the relevant details of MP3, current statutory accounting guidance that is applicable to reporting losses from unsettled MP3 balances, rationale and conclusions for the Trades' view on the appropriate statutory accounting treatment MP3, including whether and, if so, what, new guidance should be recommended to the NAIC's Statutory Accounting Principles Working Group ("SAPWG") in order to address any gaps in statutory accounting guidance and to assure uniformity in reporting across Part D plans in their statutory financial statement filings with state insurance regulators.

Relevant Features of MP3

MP3 is a new program that requires all Medicare prescription drug plans ("Part D plans") – including both standalone Medicare prescription drug plans and Medicare Advantage plans with prescription drug coverage – to provide their members with the option to pay their out-of-pocket ("OOP") prescription drug costs in the form of monthly payments over the remainder of the plan year instead of all at once to the pharmacy.

Part D plan members who so elect to participate in MP3 ("MP3 Enrollees") will pay $0 to the pharmacy for covered Part D drugs. Instead, the Part D plan sponsor is obligated to respond by fully paying the pharmacy the total of a participant's OOP amount and the Part D plan sponsor's portion of the payment in accordance with Part D prompt payment requirements, thereby making an MP3 Enrollee's OOP costs an extension of the original insurance claim. The Part D plan sponsor will then bill the MP3 Enrollee monthly for any cost sharing they incur while enrolled in MP3. The design of MP3 is such that MP3 Enrollees will not save money on prescription drug purchases (there are other Part D programs in place to help qualifying Part D plan members with affordability issues); rather, MP3 simply spreads payments over the remaining term of the plan year which may help many Part D plan members to better manage their monthly cash flow.

In an ideal situation where all parties pay their obligations timely and in full, the result would be a balance sheet-only impact to the Part D sponsor. The Part D plan sponsor would credit cash for the payment to the pharmacy and create a corresponding receivable; both amounts would then be reduced over the ensuing months as the MP3 Enrollee repays the Part D plan sponsor.

However, MP3 introduces new risks to the Part D plan sponsor: (1) the risk that the MP3 Enrollee will cease membership in the Part D plan resulting in some portion of the MP3 balance not being paid back to the Part D plan sponsor (i.e., uncollectible amounts); (2) the risk that, even if the MP3 Enrollee remains in the Part D plan that they will, for whatever reason, be unwilling or unable to fully pay their MP3 balance, and (3) the risk that the ultimate costs of uncollectible amounts and other aspects of implementing the payment plan will vary from amounts that had been factored into premium rates.

Whereas existing Part D programs involve funds that are due from the federal government (for which payment is effectively assured), MP3 funds are due from individuals – MP3 Enrollees. Part D Plan sponsors have a long history of billing and collecting premiums from members, but they have no prior experience akin to CMS's mandate that they pay OOP costs for MP3 enrollees. Consequently, MP3 is expected to result in Part D plans incurring (and paying to the pharmacy) MP3 Enrollees' OOP pharmacy claim costs for which some amounts billed back to the MP3 Enrollee may ultimately be uncollectible.

CMS Requirements that Apply When a MP3 Balance is Not Repaid

Unlike financing arrangements where the reporting entity has numerous options to mitigate the risk of loss from uncollectible balances, CMS imposes requirements on Part D plan sponsors to *insure* the risk of uncollectible balances. Other key differences include the following:

- Late fees, interest payments, or other fees, such as for different payment mechanisms, are not permitted under MP3.
- While Part D plan sponsors may create their own billing and payment procedures for MP3, they are required to prioritize payments towards Part D plan premiums to avoid a Part D enrollee losing their Part D coverage. This would apply in situations in which it is unclear whether a payment received from an MP3 Enrollee is intended by the participant to cover their outstanding Part D plan premium or their MP3 balance.
- CMS considers participation in MP3 as an arrangement between the Part D plan sponsor and the MP3 Enrollee; pharmacies cannot be held responsible for any unsettled balances of an MP3 Enrollee or for collecting unpaid balances from the MP3 Enrollee on the Part D plan sponsor's behalf.
- A Part D plan sponsor must terminate an individual's participation in MP3 if that individual fails to pay their monthly billed amount. However, the Part D plan sponsor is not permitted to terminate that individual's membership in the Part D plan because they failed to pay their MP3 billed amounts. An MP3 Enrollee will be considered to have failed to pay their monthly billed amount only after the conclusion of the required grace period of at least two months. Sponsors must continue to bill amounts owed under the program in monthly amounts not to exceed the maximum monthly cap according to the statutory formula for the duration of the plan year after an individual has been terminated.
- Part D plan sponsors must also reinstate an individual who has been terminated from MP3 if the individual demonstrates good cause for failure to pay the program billed amount within the grace period and pays all overdue amounts billed.
- A Part D plan sponsor may only preclude an individual from opting into MP3 in a subsequent year if the individual owes an overdue balance to that Part D plan sponsor. Preclusion is only permitted in Part D plans that are offered by the same parent organization. In other words, an individual who

owes an overdue balance under the program cannot be barred from MP3 in a subsequent year by a different Part D plan sponsor that does not have the same parent organization.

- Part D plan sponsors (and any third parties with whom Part D plan sponsors contract) that collect unpaid balances related to the program may be subject to other applicable federal and state laws and requirements, including those related to payment plans, credit reporting, and debt collection.

If facilitating the spreading of payments by an MP3 Enrollee for MP3 balances due was an administrative function at the discretion of a Plan D sponsor to offer, features akin to many of the above requirements imposed by CMS would not have been selected. But as explained further, below, MP3 is not a discretionary administrative function such as the financing of premiums; it is a program benefit imposed by federal law and CMS rules, with different implications as to its treatment for statutory accounting purposes. Provisions imposed by CMS such as those above are part of the design of MP3 as a benefit for Part D plan members, and thus are quite different than what would be in place by a company to manage credit risk for the discretionary offering of financing balances owed.

Statutory Accounting/Blanks Reporting for MP3 -- Considerations

In considering the reporting of statutory financial statements to state insurance regulators there are various considerations:

MP3 Balances Receivable: Considerations include:

- Admitted Assets. The Trades believe that MP3 balances are admitted assets. Repayment is the obligation of MP3 Enrollees, which represents a probable future economic benefit to the Part D plan sponsor resulting from past transactions or events (i.e., paying the MP3 Enrollee's OOP costs to the pharmacy). To cover potential uncollectible balances, CMS allows Part D plans to include an estimate in their premium bids; to the extent of the resulting incremental premium, MP3 balances are, in essence, secured. That said, SSAP No. 4 provides that a non-admitted asset is defined as an asset which is accorded limited or no value in statutory reporting and is one which is (a) Specifically identified within the Accounting Practices and Procedures Manual ("Manual") as a non-admitted asset; or (b) Not specifically identified as an admitted asset within the Manual. Since MP3 is new, it is not currently mentioned in the Manual at all. ***The Trades would thus encourage the NAIC's SAPWG to provide in the Manual explicit language that makes it clear that MP3 balances are admitted assets (subject to non-admission after billed amounts are 90 days past due).***

- Impairments. Current statutory accounting guidance for recognizing the impairment of assets is contained in Statement of Statutory Accounting Principles ("SSAP") No. 5 "*Liabilities, Contingencies, and Impairment of Assets"* of the Manual. It states that, "An estimated loss from a loss contingency or the impairment of an asset shall be recorded by charge to operations if both of the following conditions are met: (a) Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the statutory financial statements; it is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and (b) The amount of loss can be reasonably estimated."

  With one exception, the Trades' view is that the existing guidance in SSAP No. 5 is sufficient to address their members' needs in assessing and reporting impairments related to uncollectible MP3 balances. That exception pertains to the expense category to which impairments should be recorded.

The Trades' view is that such amounts are an integral component of overall claim /benefit expense of operating a Part D plan. Rationale and support for that conclusion is addressed in the following sections of this memo.

- Disclosures. Depending on the resolution of treatment of MP3-related losses in the quarterly and annual financial statement blanks, supplemental disclosures may be desirable to disaggregate MP3-related amounts that may be included in broader line-item categories. The Trades are open to the possibility of such supplemental disclosures, but the subject is beyond the scope of this memo and will be better addressed once the timing of planned discussions on the matter by SAPWG and/or the NAIC's Blanks Working Group is known.

Losses From Uncollectible MP3 Balances are an Inseparable Component of Part D Benefits

The risk of loss from uncollectible MP3 balances is a cost of being in the Part D business. The Inflation Reduction Act ("IRA") resulted in various provisions that are intended to make the cost of prescription drugs more affordable and manageable to seniors. In addition to MP3, these include authorizing the federal government to negotiate prices for certain drugs; requiring drug companies to pay rebates to Medicare if prices rise faster than inflation for drugs used by Medicare beneficiaries; limiting monthly cost sharing for insulin; eliminating cost sharing for adult vaccines covered under Medicare Part D; expanding eligibility for full benefits under the Medicare Part D Low-Income Subsidy Program, beginning in 2024; and capping OOP spending for Medicare Part D enrollees and make other Part D benefit design changes, beginning in 2024.

The bigger picture is relevant; combined with these other changes brought about by the IRA, MP3 is another means by which the federal government intends to make the cost of prescription drugs more manageable – and thus more likely to be used – to more Medicare participants. The Congressional Budget Office has reported that some of the resulting increased costs in Part D are expected, to some extent, to reduce government spending in Parts A and B of Medicare. While MP3 will likely raise costs to Part D plan sponsors, it is thus recognized that there are other benefits to the government that were also considered in developing the overall Part D program and in obtaining the necessary legislative and budgetary authority to proceed.

In essence, taking on the risk of MP3-related losses was not the decision of Part D plan sponsors; rather, it was the decision of the federal government resulting from negotiations over a broader legislative response to address the societal issue of the cost of prescription drugs. With respect to MP3, the Part D plan sponsor thus acts as an insurer, by regulation, of the federal government for any uncollectible balances due from MP3 Enrollees.

This is acknowledged in the final MP3 rules published by CMS which state, in part, that "Section 1860D-2(b)(2)(E)(v)(VI) of the Act specifies that any unsettled balances with respect to amounts owed under the Medicare Prescription Payment Plan "shall be treated as plan losses and the Secretary shall not be liable for any such balances outside of those assumed as losses estimated in plan bids."

Stated differently, the government is responsible for the amounts of estimated MP3 losses that are included in premium bids submitted by Part D plan sponsors. Part D plan sponsors receive incremental revenue to that extent, which helps to defray losses resulting from MP3 Enrollees' uncollectible balances. However, it is important to note that risk of loss to the Part D plan sponsor remains, nonetheless. There is pricing/underwriting risk relating to the needs for MP3 by the specific covered population of each Part D plan and the risk that the Part D plan sponsor will inaccurately estimate the amount of ultimate loss to include in the premium bid. For 2025 premium bids in particular, that risk is magnified because of the lack of prior experience upon which to base estimates with a high degree of confidence. In short, MP3 creates

additional insurance risk for Part D plan sponsors.

Other pertinent factors indicating that MP3 is about additional insurance risk and not credit risk include the following:

- Part D is offered on a guaranteed coverage basis, i.e., there is no underwriting. Enrollment in MP3 is effectively guaranteed as well; those who elect MP3 cannot be refused (until year 2 if they have been involuntarily terminated for non-payment and have not qualified for reinstatement pursuant to CMS rules).
- Part D plan sponsors thus have no ability to effectively manage (as a credit risk) potential losses from those enrolled in MP3 who do not pay their balances in full. For example, CMS does not permit use by a Part D plan sponsor of any credit risk techniques (credit risk assessment, credit history, collateral, etc.).
- Part D plan sponsors are not allowed to be compensated for taking on credit risk through MP3, e.g., through charging interest or fees of any kind. To offer Part D, plan sponsors must bear the resulting losses.

Risk management pertaining to MP3 is nonetheless achievable by Part D plan sponsors but is limited by CMS to the Part D plan sponsor's inclusion of estimated uncollectible balances in premium bids that are submitted to CMS. As a component of premium, additional funds received are fungible and cover or defray any and all claims and costs – they are not earmarked or appropriated solely for MP3 losses. The risk of uncollectible MP3 balances from enrollees is thus managed as a pricing /underwriting risk (not as a credit risk) that is not separable from other pricing/underwriting risks associated with offering Part D coverage.

The economic substance is that MP3-related costs have been foreseen by the government and the government has addressed that by requiring that Part D plan sponsors bear those costs but also be compensated to the extent of estimates of such losses included in premium bids. MP3-related costs are the result of governmental decisions to alter the design of Part D to provide additional benefits in the form of a technique to enable MP3 Enrollees to better manage their monthly cash flow when they have high OOP costs. MP3 is a benefit mandated by the government for Part D plan members just as much as other Part D-related provisions that resulted from the IRA. MP3 costs are not the result of discretionary administrative actions by Part D plans to manage benefits; they are the result of MP3 as an insured benefit itself for which the federal government pays a premium and for which the Part D plan sponsor bears pricing risk. Accordingly, MP3 costs should be reported for statutory accounting purposes as a benefit expense.

Related Existing Statutory Accounting Guidance

ASC 944, Accounting and Reporting by Insurance Enterprises, provides in part the following guidance for GAAP purposes (emphasis added):

> "The liability for unpaid claims shall be based on the estimated **ultimate cost** of settling the claims (including the effects of inflation and other societal and economic factors), using past experience adjusted for current trends, and any other factors that would modify past experience. Changes in estimates of claim costs resulting from the continuous review process and differences between estimates and payments for claims shall be recognized in income of the period in which the estimates are changed, or payments are made."

SSAP No. 55, *Unpaid Claims, Losses, and Adjustment Expenses,* is consistent with the cited guidance above from ASC 944. SSAP 55 supports that GAAP guidance by stating that the liability for claim reserves and

claim liabilities, unpaid losses, and loss/claim adjustment expenses shall be based upon the estimated **ultimate cost** of settling the claims (including the effects of inflation and other societal and economic factors), using past experience adjusted for current trends, and any other factors that would modify past experience.

The *AICPA Audit and Accounting Guide: Property & Casualty Insurance Companies* (*AICPA P&C Audit and Accounting Guide*) further echoes that guidance, stating that both SAP and GAAP require that insurance companies report a provision for all incurred losses that are unpaid as of the balance sheet date, including losses incurred but not reported. Further, the liability is based on management's estimate of the **ultimate cost** of settling each loss.

The focus on "ultimate cost" is a common theme in other sections of SAP and GAAP guidance as well. In applying that guidance to Part D plan sponsors, it is important to recognize the overall Part D program design and the ultimate costs relating to all of Part D's intended benefits that the government has offered to Part D beneficiaries. As stated above, MP3 is one such benefit that is mandated by the government. As such, costs related to MP3 should include estimated future losses resulting from events that have occurred prior to the balance sheet date and should be reported as a component of claims/benefit expense.

Based on the applicable guidance cited above, losses attributable to MP3 enrollees' unpaid balances are a component of the ultimate cost of Part D claims. However, and by way of comparison, costs associated with operating the MP3 program, such as staff support to handle MP3 billings, are administrative costs for SAP.

Basis for Conclusion:

Under MP3, Part D plan sponsors are required to reimburse a network pharmacy the total of a participant's OOP amount and the Part D plan sponsor portion of the payment for a covered Part D drug, and to do so within specified time frames as prescribed in the MP3 final rules. The obligation of the Part D plan sponsor is to pay those amounts to the pharmaceutical provider. The ultimate cost of the claim should be tied to the pharmacy payment, including additional costs from the MP3 Enrollee associated with the claim, as a benefit cost.

Further, MP3 is a benefit for members of Part D plans that is inseparable from other benefits provided to Part D beneficiaries through legislative mandates, such as lower costs for prescription drugs. MP3-related costs emanate from those government-mandated benefits, and from a risk management perspective are addressed by Part D plans as required by CMS as a pricing/underwriting risk. It follows that such costs should be reported as benefit/claim expense for statutory accounting purposes.

This position is also consistent with existing statutory and GAAP guidance discussed above that state the liability for unpaid claims shall be based on the estimated ultimate cost of settling the claims (including the effects of inflation and other societal and economic factors).

This Paper acknowledges that the Centers for Medicare and Medicaid Services ("CMS") requires Part D plan sponsors to treat any unsettled balances from MP3 Enrollees as part of the Part D plan sponsor's administrative costs for minimum MLR reporting purposes. This paper does not address that position. However, for reporting on a statutory reporting basis, CMS does not govern; rather, statutory reporting to state insurance regulators is the authority of those regulators, generally acting through NAIC's SAPWG to maintain its published Manual to encourage consistency in application across reporting entities and states.

The reporting of ultimate losses associated with uncollectible MP3 balances can therefore be treated differently from CMS guidance.

To enhance consistency in treatment across Part D plan sponsors as well as consistency in interpretation by regulatory examiners and analysts, it is recommended that SAPWG update the Part D guidance in INT 05-05 to address MP3. The update should briefly explain MP3 for the benefit of all users of the Manual and, more specifically, ***clarify by way of interpretation that losses incurred by a Part D plan sponsor that are attributed to uncollectible MP3 balances should be reported for statutory reporting purposes as a claim/benefit cost***.