Hearing Agenda

Statutory Accounting Principles (E) Working Group
Hearing Agenda
August 13, 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 August 8. This regulator session was pursuant to the NAIC Open Meetings Policy paragraph 3 (discussion of specific companies, entities or individuals) and paragraph 6 (consultations with NAIC staff related to NAIC technical guidance of the *Accounting Practices and Procedures Manual*). No actions were taken during these meetings as the discussion previewed 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. Spring National Meeting **(Attachment 1)**
2. May 15, 2024 **(Attachment 2)**

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 #2024-02: ASU 2023-01, Leases
2. Ref #2024-03: ASU 2023-08, Crypto Assets
3. Ref #2024-05: A-791 Paragraph 2c
4. Ref #2024-08: Consistency Revisions for Residuals
5. Ref #2024-09: SSAP No. 2R – Clarification
6. Ref #2024-14EP: Spring
7. Ref #2023-26: ASU 2023-06, Disclosure Improvements

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-02 (Jake)	**ASU 2023-01, Leases (Topic 842), Common Control Arrangements**	**3 – Agenda Item**	**Comments Received**	**IP – 11**

<u>*Summary:*</u>
On March 16, 2024, the Working Group exposed revisions to adopt, with modification, *Accounting Standard Update (ASU) 2023-01, Leases (Topic 842), Common Control Arrangements*. This ASU was issued as part of FASB's post-implementation review to address issues that have been found during the implementation of the new lease guidance from ASU 2016-02, Leases (Topic 842). As a reminder, ASU 2016-02 was rejected for statutory accounting and the operating lease treatment was retained.

ASU 2023-01 focuses on two issues that are 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.

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

<u>*Recommendation:*</u>
NAIC staff recommends 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 Heath Care Facilities*, as illustrated in the agenda item.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-03 (Jake)	**ASU 2023-08, Accounting for and Disclosure of Crypto Assets**	**4 – Agenda item**	**No Comments**	**IP – 11**

<u>*Summary:*</u>
On March 16, 2024, 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 Asset* and to also nullify *INT 21-01: Accounting for Cryptocurrencies*. This ASU establishes the accounting and reporting for crypto assets, which are defined in U.S. GAAP as assets that:

1. Meet the definition of intangible assets as defined in the Codification
2. Do not provide the asset holder with enforceable rights to or claims on underlying goods, services, or other assets
3. Are created or reside on a distributed ledger based on blockchain or similar technology
4. Are secured through cryptography
5. Are fungible
6. Are not created or issued by the reporting entity or its related parties.

ASU 2023-08 also clarified the disclosure of crypto assets in the financial statements, which note that crypto assets are to be reported at fair value, are reported separately from the other intangible assets, describe how they are to be disclosed in the income statement and statement of cash flows and includes a roll forward of activity and balances.

As background, on May 20, 2021, the Working Group adopted *INT 21-01: Accounting for Cryptocurrencies*, which established statutory accounting for crypto assets. At that time, NAIC staff had received several questions on the proper treatment of cryptocurrencies, and the Working Group adopted INT 21-01 to clearly establish that directly held cryptocurrencies do not meet the definition of an admitted asset. The INT established that directly held cryptocurrencies were not identified in the *Accounting Practices and Procedures Manual* (AP&P Manual) as an admitted asset, and do not meet the definition of any admitted asset that is defined in the AP&P Manual. Accordingly, by default they are a nonadmitted asset per *SSAP No. 4—Assets and Nonadmitted Assets*, paragraph 3, as they are not specifically identified in the AP&P Manual as an admitted asset. Additionally, a disclosure for crypto assets was added to the general interrogatories of the Annual Statement blanks and instructions.

This agenda item intends to incorporate the guidance that was adopted in INT 21-01 into SSAP No. 20.

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. 20—Nonadmitted Assets* which adopt with modification ASU 2023-08 to clarify that directly-held crypto assets are nonadmitted assets for statutory accounting and to define crypto assets using the definition from ASU 2023-08. NAIC staff also recommends that the Working Group nullify *INT 21-01, Accounting for Cryptocurrencies*, upon the adoption of this agenda item as the revisions to SSAP No. 20 also incorporate guidance and expand guidance which was previously in INT 21-01.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-05 (Robin)	**A-791 Paragraph 2c**	**5 – Agenda item**	**Comments Received**	**IP – 12**

Summary:
On March 16, 2024, the Working Group exposed revisions to Appendix-791, paragraph 2c's Question and Answer. This agenda item was developed in response to the Valuation Analysis (E) Working Group's (VAWG) referral to the Statutory Accounting Principles (E) Working Group which recommends making a clarifying edit to *Appendix A-791 Life and Health Reinsurance Agreements* (A-791), Section 2.c's 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." The referral notes that:

> First, this sentence is unnecessary, as it is an aside in a discussion about group term life. More importantly, this statement is being misinterpreted as supporting the use of Commissioner's Standard Ordinary (CSO) rates as a "safe harbor," at or below which YRT rates would be automatically considered not to be excessive.
>
> The 791 section 2c QA guidance does not provide a safe harbor based on CSO. It indicates that if the YRT reinsurance premium is higher than the proportionate underlying direct premium for the risk reinsured, then the reinsurance premium is excessive. VAWG observes that the prudent mortality under the *Valuation Manual*, Section 20: Requirements for Principle-Based Reserves for Life Products (VM-20), may appropriately be either higher or lower than the CSO rate depending on the facts and circumstances.

The Working Group also notified the Valuation Analysis (E) Working Group, the Life Actuarial (A) Task Force and the Reinsurance (E) Task Force of the exposure.

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

Recommendation:
NAIC staff recommends that the Working Group adopt this SAP clarification, which removes the first sentence of the A-791, paragraph 2c's Question and Answer as it is unnecessary.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-08 (Julie)	**Consistency Revisions for Residuals**	**6 – Agenda item**	**No Comments**	**IP – 17**

Summary:
On March 16, 2024, the Working Group exposed revisions to incorporate consistency revisions for residual tranches and residual security interests. Over the last couple of years, a variety of 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 discussion that accompanied these revisions have noted that conforming revisions would be needed coinciding with the effective date of the principles-based bond definition guidance to have consistency of guidance location, terminology and definitions.

With the revisions to *SSAP No. 21R—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. 21R and be reported on Schedule BA.

To ensure consistency in definitions and guidance, this agenda item proposes to centralize residual guidance within SSAP No. 21R and use a consistent approach in the other investment SSAPs to exclude residuals from their scope and direct companies to SSAP No. 21R.

Interested Parties' Comments:
Interested parties support the proposed changes.

Recommendation:
NAIC staff recommend that the Working Group adopt the exposed revisions, to be effective January 1, 2025. These changes incorporate consistency revisions for residuals so that all SSAPs refer to SSAP No. 21R for the formal definition and accounting and reporting guidance. This adoption also includes revisions to *SSAP No. 26R—Bonds* (Effective 2025), *SSAP No. 30R—Unaffiliated Common Stock*, *SSAP No. 32R—Preferred Stock*, *SSAP No. 43R—Asset-Backed Securities* (Effective 2025), and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*. The effective date of January 1, 2025, is necessary to mirror the effective date of the SSAP No. 21 guidance.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-09 (Julie)	**SSAP No. 2R – Clarification**	**7 – Agenda item**	**No Comments**	**IP – 17**

<u>*Summary:*</u>
On March 16, 2024, the Working Group exposed revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments*. This agenda item has been developed to update the guidance in SSAP No. 2R to remove a lingering reference to items that have been removed from scope pursuant to the bond project (asset-backed securities) 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. 43R—Asset-Backed Securities* investments and 'other Invested assets.' This guidance has been revised to only reflect items in scope of SSAP No. 2R.

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

<u>*Recommendation:*</u>
NAIC staff recommend that the Working Group adopt the exposed revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to eliminate lingering references that imply that asset-backed securities, mortgage loans, or other Schedule BA items are permitted to be reported as cash equivalents or short-term investments.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-14EP (Jason/Jake)	**Accounting Practices and Procedures Manual Editorial**	**8 – Agenda item**	**No Comments**	**IP – 19**

<u>*Summary:*</u>
On March 16, 2024, the Working Group exposed agenda item 2024-14EP. The editorial revisions remove the "Revised" and "R" previously intended to identify a substantively revised SSAP, from SSAP titles and SSAP references within the Manual. NAIC staff consider the "Revised" and "R" identifiers to no longer be useful.

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

<u>*Recommendation:*</u>
NAIC staff recommend that the Statutory Accounting Principles (E) Working Group adopt the exposed editorial revisions as illustrated within the agenda item.

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Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2023-26 (Wil)	**ASU 2023-06, Disclosure Improvements**	**9 – Agenda item**	**No Comments**	**IP – 10**

Summary:
On March 16, 2024, 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*. Prior to this on Dec. 1, 2023, the Working Group deferred action on ASU 2023-06 to allow staff further time to consider whether certain aspects of ASU 2023-06 were applicable to statutory accounting. In October 2023, FASB issued ASU 2023-06 in response to a referral from SEC Release No. 33-10532, Disclosure Update and Simplification, issued August 17, 2018. The changes detailed in the ASU seek to clarify or improve disclosure and presentation requirements of a variety of topics. Many of the amendments allow users to more easily compare entities subject to the SEC's existing disclosures with those entities that were 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 is the requirement for companies to disclose their the weighted-average interest rate of debt and provide repurchase agreement (repo) counterparty risk disclosures. 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.

The ASU requires repo counterparty risk disclosures on the accrued interest incurred in securities borrowing or repurchase or resale transactions, separate presentation of the aggregate carrying amount of reverse repurchase agreements on the face of the balance sheet if that amount exceeds 10% of total assets, disclosure of amounts at risk with an individual counterparty if that amount exceeds more than 10% of stockholder's equity, and disclosure for reverse repurchase agreements that exceed 10% of total assets on whether there are any provisions in a reverse repurchase agreement to ensure that the market value of the underlying assets remains sufficient to protect against counterparty default and, if so, the nature of those provisions.

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

Recommendation:
NAIC staff recommends that the Working Group adopt, with modification, certain disclosures from *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative,* for statutory accounting within *SSAP No. 15—Debt and Holding Company Obligations* and *SSAP No. 86—Derivatives*. The disclosure revisions recommended by NAIC staff for adoption, as detailed within the Form A, are:

- Disclosures for unused commitments and lines of credit, disaggregated by short-term and long-term.
- Disclosure of the derivative cash flow accounting policy

In addition, NAIC staff recommend that the previously exposed revisions to adopt, with modification, certain disclosures from ASU 2023-06 within *No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* be removed from this agenda item and combined with agenda item 2024-04: Conforming Repurchase Agreements. Agenda item 2024-04 is intended to review and revise current statutory guidance for repos and secured lending, as such adoption of additional repo disclosures should be considered as a part of that project. These disclosure revisions, as detailed within the Form A, include:

- Disclosure of accrued interest from repos and securities borrowing, separate disclosure of significant (10% of admitted assets) reverse repos, and counterparty disclosures for significant (10% of adjusted capital and surplus) repos and reverse repos.

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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: Principles-Based Bond Project - Issue Paper
2. Ref #2024-01: Bond Definition – Debt Securities Issued by Funds
3. Ref #2024-04: Conforming Repurchase Agreements
4. Ref #2024-06: Risk Transfer Analysis on Combination Reinsurance Contracts
5. Ref #2024-07: Reporting of Funds Withheld and Modified Co-Insurance Assets
6. Ref #2024-10: SSAP No. 56 – Book Value Separate Accounts
7. Ref #2024-11: ASU 2023-09, Improvements to Income Tax Disclosures
8. Ref #2024-12: Updates to SSAP No. 27
9. Ref #2022-12: Review of INT 03-02: *Modification to an Existing Intercompany Pooling Arrangement*

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-21 (Julie)	**Principles-Based Bond Project**	**10 – Issue Paper 11 – Q&A (Pending)**	**Comments Received**	**IP – 21**

Summary:
On May 15, 2024, the Working Group exposed updates to the draft issue paper for the principles-based bond project for a comment period ending 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 has been reflected as the authoritative SAP revisions have been adopted. (As a reminder, issue papers are not authoritative, and simply provide background and discussion elements for historical reference.) Changes from the prior exposed version are shown as tracked within the document.

Interested Parties' Comments:
Interested parties have the following three comments:

- Paragraph 32c – Editorial edits are needed to remove the following language which is included twice, "In contrast, an ABS Issuer has a primary purpose of raising debt capital………..These features support the entity's primary purpose of raising debt capital."

- Paragraphs 107, 110, 111, 113, & 115 – The example number cadence is off such that each needs to be reduced by 1 (e.g., in paragraph 107, Example 5 Rationale needs to be shown as Example 4 Rationale, etc.

- Paragraph 59 – SSAP No. 26 discusses that the practical expedient could only be used if less than 50% of the principal relies on sale or refinancing. The Issue Paper (paragraph 59) discusses that the practical expedient could only be used if contractual cash flows at origination are sufficient to cover all interest and at least 50% of the original principal. To avoid confusion, we suggest the following sentence be added to the Issue Paper, paragraph 59 as a last sentence: "That means, as discussed in SSAP 26, paragraph 9b, that the practical expedient can only be used if less than 50% of the principal relies upon sale or refinancing."

Recommendation:
NAIC staff recommends that the Working Group adopt the issue paper with modifications to reflect the interested parties' comments. Revisions to reflect the comments are shaded in yellow and captured on pages 11 (P32c), 21 (P59b), and 34-35 (P107-P115). 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 was intended by the issuer at the time of origination.

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The other tracked changes are not new and just reflect the edits that were exposed in May. Upon adoption, the issue paper will be publicly posted on the SAPWG website along with the other documents (SSAP adoptions and Blanks changes) related to the bond project.

(Note: The adopted issue paper will be impacted by the next topic, agenda item 2024-01. With adoption of the issue paper, it will not reflect the edits from agenda item 2024-01 but will be updated if the revisions from 2024-01 are subsequently adopted.)

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 / AICPA small group. This Q&A details interpretations on how the SAP guidance should be applied to specific investment structures or investment characteristics.

The Q&A is planned for exposure until September 27 to allow for consideration at the Fall National Meeting.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-01 SSAP No. 26R (Julie)	**Bond Definition – Debt Securities Issued by Funds**	**12 – Agenda item**	**Comments Received**	**IP – 10**

<u>*Summary:*</u>
On March 16, 2024, the Working Group re-exposed revisions to both *SSAP No. 26R—Bonds* 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 asset-backed securities to determine if they qualify for bond reporting.

<u>*Interested Parties' Comments:*</u>
The Working Group re-exposed this item with a request for regulators and industry to provide comment on the proposed language that assists with clarifying the scope of guidance and to 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.

This agenda item was developed to clarify guidance in the principles-based bond definition on the treatment on debt securities issued by funds, particularly to eliminate inconsistent application between similar funds and to better align with the recently adopted definition of residual tranches. In the adopted bond definition, bonds issued by business development corporations (BDCs), closed-end funds (CEFs), or similar operating entities are provided as examples of issuer credit obligations (ICOs) when they are registered under the Investment Company Act of 1940 (1940 Act). It has been noted that this guidance is inconsistent with the stated intent of having the bond definition be principles-based as the registration of the fund appears to be the basis of classification as an ICO vs ABS, rather than based on principles. It has been noted that with the current guidance, two funds with issued debt that are virtually identical can have separate SSAP classification of the debt securities (resulting with different accounting/reporting) simply based on whether the fund is registered. Additionally, it would lead to debt securities being classified inconsistently with their equity counterparts. In concept, there should be consistency between the classification of a debt security as an asset-backed security, and the equity of that structure being classified as a residual interest. Using SEC-registration as currently adopted would result in misalignment of these concepts.

The changes captured within this agenda item propose to revise the principles-based bond definition guidance to clarify that debt securities issued by funds representing operating entities qualify as ICOs. This would allow consistent treatment of similar funds regardless of SEC registration status. Guidance is also proposed to assist with distinguishing whether a fund represents an operating entity or a securitization vehicle.

The original guidance, and the reference to the SEC registration, was an easy approach to determine whether a debt security from a fund qualified as an ICO. This is because SEC registered funds have leverage limits on how much debt can be issued. Although debt securities issued from SEC registered CEFs and BDCs are still permitted as ICOs, the proposed edits permit debt securities from non-registered funds to qualify as ICO if the funds are functioning as operating entities and are not issuing securities for the primary purpose of raising debt capital.

Interested parties reviewed the NAIC Staff proposal and support with the revised language and believe it will achieve the stated objective of greater consistency for debt issued by like funds.

Recommendation:

NAIC staff recommend that the Working Group expose language to clarify guidance for debt securities issued by funds for a shortened timeframe ending Friday, September 6, 2024. Based on the comments received, this agenda item could be considered for adoption via an evote. 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 working with industry and was not formally exposed. This exposure is considered appropriate to ensure regulators and all industry representatives have time to review the revised language.

The proposed language is shown below. The revisions from the exposure are shaded. These revisions predominantly clarify that the SEC registration is a practical safe-harbor and should not be utilized as a proxy for other debt securities issued by funds. Other debt securities issued by funds must be classified in accordance with the issuer's primary purpose. If the primary purpose is for raising debt capital, then it must be assessed as an ABS regardless of the amount of debt issued.

(Note – Non-revised subparagraphs have not been included for brevity.)

Proposed Revisions to *SSAP No. 26—Bonds*

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:

i. Bonds issued by funds representing operating entities as described in paragraph 12.~~Bonds issued by business development corporations, closed-end funds, or similar operating entities, in each case registered under the 1940 Act.~~

12. Likewise, distinguishing between a fund that represents an operating entity and a securitization vehicle that represents an ABS Issuer can involve similar ambiguity. Both types of entities may hold only passive investments and issue debt securities for which ultimate recourse upon default is to those investments. However, a clear distinction can generally be made by evaluating the substance of the entity and its primary purpose:

a. A fund representing an operating entity has a primary purpose of raising equity capital and generating returns to its equity investors. ~~Marginal amounts of~~Ancillary debt may be issued to fund operations or produce levered returns to equity holders. However, this is in service to meeting the fund's primary equity-investor objective. As a practical safe harbor,~~For~~ 1940-Act registered closed-end funds (CEFs) and business development corporations (BDCs), debt securities issued from the fund in accordance with permitted leverage ratios represent debt issued by operating entities and qualify as issuer credit obligations. This safe harbor for SEC-registered funds should not be viewed to extend to funds that are not SEC-registered by analogy, through comparison of leverage levels for example. All other funds should be classified in accordance with the determination of the issuer's primary purpose.

b. In contrast, an ABS Issuer has a primary purpose of raising debt capital and its structural terms and features serve to support this purpose. Perhaps most distinctively, in addition to the characteristics detailed in paragraph 8, the contractual terms of the structure generally define how each cash flow generated by the collateral is to be applied. There is generally little discretion afforded to the manager/servicer of the vehicle and any discretion that is allowed is narrowly defined in the contractual agreements. This hardwiring of debtholder protections allows for the issuance of higher amounts of leverage than would be possible for a fund representing an operating entity, further supporting the entity's primary purpose of raising debt capital.

Proposed Revisions to Draft Issue Paper:

32. Whether an issuer of debt represents an operating entity or ABS Issuer is expected to be clear in most instances, but certain instances may be less clear. Ultimately, for an issuer credit obligation, it comes down to whether support for repayment consists of direct or indirect recourse to an operating entity or entities. In addition to "traditional bond" structures previously included in SSAP No. 26R, examples of issuer credit obligations include:

c. Bonds issued by funds representing operating entities. Determining whether a fund represents an operating entity can generally be made by evaluating the substance of the entity and its primary purpose. A fund representing an operating entity has the primary purpose of raising equity capital and generating returns to its equity investors. ~~Marginal amounts of~~Ancillary debt may be issued to fund operations or produce levered returns to equity holders. These debt issuances occur in accordance with the fund's primary equity-investor objective. Debt securities issued by closed-end funds and business development corps registered under the 1940 Act are permitted automatic qualification as issuer credit obligations as those funds are subject to strict limits or reporting components on the leverage (debt issuance) within the fund. This safe harbor for SEC-registered funds should not be viewed to extend to funds that are not SEC-registered by analogy, through comparison of leverage levels for example. All other funds should be classified in accordance with the determination of the issuer's primary purpose. (For example, although some registered funds allow a large percentage of debt, non-registered funds with comparable amounts of issued debt may reflect debt securities from feeder funds or equity-backed ABS, and those debt securities are required to be assessed as ABS. As such the percentage of debt permitted for a registered funds should not be utilized as a proxy in determining whether debt issued from a fund is permitted to be captured within the guidance.) ~~Bonds issued by business development corporations, closed-end funds or similar operating entities, in each case registered under the 1940 Act. With this inclusion, it is important to highlight that the intent is specific to bonds issued from SEC-registered entities. The reference to "similar entities" is not intended to capture items issued from collateralized fund obligations (CFOs) or other such structures.~~ In contrast, an ABS Issuer has a primary purpose of raising debt capital and its structural terms and features serve to support this purpose. More distinctively, the contractual terms of the structure generally define how each cash flow generated by the collateral is to be applied. For these structures, there is little or no discretion afforded to the manager/servicer of the vehicle and any discretion that is allowed is narrowly defined in the

contractual agreements. The hardwiring of debtholder protections allows for the issuance of higher amounts of debt securities to be issued than what would be possible for a fund representing an operating entity. These features support the entity's primary purpose of raising debt capital. Although some may consider CFOs or feeder funds to be similar to closed-end funds, that assessment is not supported for classification as an ICO. Instruments considered to reflect CFOs (and other like structures) are required to be assessed as ABS for inclusion as a bond reported on Schedule D-1. Paragraphs 27-28 also detail the assessment expected in classifying feeder funds, and the requirement to determine the source of the underlying cash flows in determining classification and if the structure qualifies for reporting as a bond on Schedule D-1.

(Note: If the above revisions are subsequently adopted, the adopted issue paper will be revised.)

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-04 (Julie)	**Conforming Repurchase Agreements**	**13 – Agenda item 14 – Sec. Lending & Repo Memo**	**No Comments**	**ACLI – 2 IP – 11**

<u>*Summary:*</u>
On March 16, 2024, 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 (LRBCWG). The LRBCWG 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.

Per the Statutory Accounting Principles (E) Working Group (SAPWG) referral response dated Feb. 8, 2024, it was identified that the statutory accounting and reporting for securities lending and repurchase agreements are currently different. As a result, the SAPWG requested that the LRBCWG defer consideration of the proposal until the SAPWG has time to assess the differences and consider converging revisions (if deemed appropriate) before modifying the RBC formula.

This agenda item identifies initial statutory differences between securities lending and repurchase agreements as well as other items that should be reviewed for potential clarification on the "conforming agreement" securities lending concept currently captured in the general interrogatories. These items are summarized as follows:

- <u>Documentation of Securities Lending Collateral:</u> Securities lending collateral is detailed in Schedule DL: Securities Lending Collateral Asset for 1) collateral that an entity has received and reinvested, and 2) collateral received that the entity has not reinvested but for which the entity has the ability to sell or repledge. This schedule currently does not include repurchase agreement collateral. As detailed within the ACLI proposal, the ACLI identifies that repurchase agreements and securities lending transactions are similar forms of short-term collateralized funding for life insurers, with counterparties reflecting the key difference between the two funding structures. With these similarities, consistent reporting of the collateral may be appropriate to ensure financial regulators receive comparable information regardless of the legal form of the agreement. Furthermore, a review of year-end 2022 data identified that securities associated with securities lending transactions are declining, whereas securities associated with repurchase agreements are increasing.

- <u>Blanks Reporting Revisions:</u> Blanks reporting revisions will be required to incorporate a new general interrogatory to capture repurchase collateral from conforming programs and for that data to be pulled directly into the RBC formula. Additionally, the current guidance on what reflects a "conforming program" for securities lending is captured in the RBC instructions. To ensure consistency in reporting, consideration should occur on incorporating the guidance into the annual statement instructions. This would ensure that financial statement preparers, who may not have the RBC instructions, have the guidelines to properly assess whether a program should be classified as conforming or nonconforming.

<u>Assessment of Conforming Provisions:</u> From a review of year-end 2022 financial statements, very few reporting entities reported any securities lending collateral as part of a nonconforming program. Although the instructions identify what is permitted as "acceptable collateral," from a review of the collateral reported on Schedule DL, reporting entities are classifying programs as conforming even though the reported Schedule DL collateral is outside the parameters of acceptable collateral. From initial assessments, it appears that there may be interpretation differences on whether the "acceptable collateral" requirement encompasses only the collateral received from the counterparty and not what the reporting entity currently holds due to reinvestment of the original collateral. From this information, clarification of the intent of the guidelines and what is conforming or nonconforming is proposed to be considered. It is also noted that the provisions to separate conforming and nonconforming programs in the RBC formula was incorporated before the great financial crisis, and significant changes to the accounting and reporting (Schedule DL) were incorporated because of how securities lending transactions impacted certain reporting entities during the crisis. For example, prior to Schedule DL, most of the security lending collateral was off-balance sheet, and now only collateral that an entity cannot sell or repledge is off-balance sheet. From a review of the detail, reporting entities are combining any off-balance sheet (which is limited) with what is captured on Schedule DL for inclusion in the "conforming program" securities lending general interrogatory.

<u>*ACLI Comments – April 17, 2024:*</u>
Interim Activity Note: The ACLI comments were received April 17, 2024, in advance of the Life RBC Working Group call to consider an RBC revision to incorporate a concept of conforming repos in the RBC instructions. During the April 19, 2024, Life RBC WG call, the accounting and reporting differences between securities lending and repo agreements were noted along with the SAPWG request to assess these differences and overall guidance for potential clarification and convergence prior to RBC revisions. The Life RBC WG agreed with this action and deferred consideration of the RBC changes. The NAIC has met with industry since then and the ACLI is working to provide additional responses to NAIC staff questions. Continued discussion in the interim is expected. The ACLI comments received April 17 are included below to ensure proper reflection for documentation purposes.

The American Council of Life Insurers (ACLI) appreciates the opportunity to respond to SAPWG's March 16th exposure of its report on conforming repurchase agreements (repo). The exposure requests that industry address three issues:

1. Inconsistent reporting of reinvested asset detail between conforming securities lending and conforming repo
2. While the RBC Instructions provide guidance on the criteria to establish conforming securities lending and repo programs, similar guidance should be provided in the Annual Instructions
3. Regulators are unsure about whether the limitations on "acceptable collateral" apply to:
    a. Securities being lent by the insurer
    b. Cash or cash equivalents received by the insurer
    c. Assets within the reinvestment pool
    d. Some combination of the 3 categories above

Below are ACLI's responses to each of these three issues.

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Reinvested Asset Detail

NAIC staff are correct in pointing out that, while reinvested assets for conforming securities lending programs are listed CUSIP-by-CUSIP in Schedule DL, ACLI is not proposing a similarly detailed asset listing for conforming repo programs. Instead, ACLI believes that the following disclosures should provide regulators sufficient comfort in the integrity of the reinvested assets:

1. Reinvested assets must conform to the Investment Guidelines established within the conforming repo program
2. Reinvestment assets must be dedicated and sufficient to satisfy a potential run-off of the repo liability. As a demonstration, both the book value and fair (market) value of the reinvested assets for conforming repo programs are reported in Footnote 5F(10) of Quarterly/Annual Statements. A full listing of the nine Footnotes related to conforming repo programs is listed as Appendix 1.

ACLI believes that these disclosures provide regulators with a more fulsome overview of the integrity of reinvested assets than a simple CUSIP-by-CUSIP asset listing.

Annual Statement Instructions

In the 2024-04 exposure, NAIC staff proposes that guidelines for conforming securities lending and conforming repo programs should appear in the Annual Statement Instructions as well as the RBC Instructions. In Appendix 2, ACLI proposes expanded Annual Statement Instructions incorporating guidelines for conforming securities lending and conforming repurchase agreement programs.

Scope of "Acceptable Collateral"

It can often be difficult to define the scope of the word "collateral." ACLI would like to clarify that the restrictive limitations on "acceptable collateral" apply *only* to the collateral received by an insurer when the insurer posts securities to the counterparty. "Acceptable collateral" limitations should *not* be applied to either securities lent or to assets in the reinvestment pool:

1. Securities lent are subject to restrictions in the binding written legal agreement between borrower and insurer
2. Assets in the reinvestment pool or portfolio are subject to restrictions in the Investment Guidelines

Securities lent, as well as assets in the reinvest pool, typically have a broader range of asset types than cash within "acceptable collateral." It should not be surprising, therefore, that assets in conforming securities lending reinvestment portfolios can fall outside the restrictive asset classes within "acceptable collateral."

Thank you once again for the consideration of our comments and we look forward to further discussion on this topic at a future meeting of SAPWG.

Interested Parties' Comments:

Interested parties support the ACLI comment letter submitted on April 17, 2024. We look forward to continuing to work with the statutory accounting staff on this topic.

Recommendation:

NAIC staff has developed a memo that walks through the accounting and reporting for securities lending and repo agreements with noted questions. NAIC staff has noted inconsistencies in application of these transactions across companies, particularly when the components are identified as restricted and how they flow through RBC and recommends clarification to the guidance to mitigate inconsistencies. **NAIC staff recommend exposure of this memo with a request for feedback on the documented processes and the noted questions. NAIC staff has met**

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

In addition, NAIC staff recommend that the previously exposed revisions to in agenda item 2023-06: ASU 2023-06 to adopt, with modification, certain disclosures from ASU 2023-06 within *No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* be combined with agenda item 2024-04: Conforming Repurchase Agreements for future review.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-06 (Robin)	**Risk Transfer Analysis on Combination Reinsurance Contracts**	**15 – Agenda item**	**Comments Received**	**CT – 6 IP – 12**

Summary:
On March 16, 2024, the Working Group exposed agenda item 2024-06 to address the risk transfer aspect of a December 2023 referral by the Valuation Analysis (E) Working Group (VAWG). The exposed *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* revisions 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 U.S. GAAP and in *SSAP No. 62R—Property and Casualty Reinsurance Exhibit A – Implementation Questions and Answers,* question 10 **which provides guidance on interdependent contract features noting that contracts with interdependent features must be analyzed in the aggregate for risk transfer.** In addition, a reference to A-791, paragraph 6 which requires 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 was proposed to be added to existing YRT guidance.

The referral, excerpted below, included risk transfer concerns regarding interdependent contract features which had been analyzed separately instead of in the aggregate for risk transfer. It also raised several concerns regarding the classification of reinsurance contracts and the size of the reinsurance credit taken. The referral noted that **(bolding added for emphasis)**:

> VAWG has identified that issues arise when evaluating reinsurance for risk transfer in accordance with *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*, when treaties involve more than one type of reinsurance, and there is **interdependence of the types of reinsurance, including but not limited to an experience refund that is based on the aggregate experience**. In such cases, VAWG regulators find that these types of reinsurance must be evaluated together and cannot be evaluated separately for the purpose of risk transfer. For example, where a treaty includes coinsurance and YRT with an **aggregate experience refund and the inability to independently recapture the separate types of reinsurance**, **it is not adequate to separately review the coinsurance and YRT pieces of the transaction for risk transfer**. The treaty as a whole is non-proportional. **This complexity is not immediately apparent to the regulatory reviewer, and it is important that this issue be raised broadly, so that individual state regulators are aware. In**dividual regulators are encouraged to contact VAWG if they would like additional perspective when reviewing such treaties.
>
> Generally, VAWG regulators observe that **some companies are reporting an overstated reserve credit due to a bifurcated risk transfer analysis.** Specifically, some companies reported a proportional reserve credit for a coinsurance component, despite in aggregate the reinsurer only being exposed to loss in tail scenarios. From an actuarial perspective, there is consensus among VAWG members that it is not

appropriate for a ceding company to take a proportional reserve credit that reflects the transfer of all actuarial risks when not all actuarial risks are transferred.

VAWG recommends that SAPWG discuss this issue, to 1**) increase familiarity with the issue and 2) consider whether any clarifications to risk transfer requirements is appropriate**

As noted in the referral above, regulators have observed reinsurance transactions that combine both coinsurance and YRT, with interdependent features including an aggregate experience refund and recapture provisions that allow for recapture by the cedant, but only if both components are recaptured simultaneously.

VAWG observed that some insurers have assessed these components under A-791 as if they were separate agreements, concluding that the requirements for risk transfer are met for each. Reserve credit was then taken on each component; a proportional credit for the quota share on the coinsured policies, and a YRT credit for the YRT component. Note that YRT contracts ordinarily cover a percentage of the one-year mortality risk for the net amount at risk on a policy. A simple way to describe net amount at risk is the difference between the policy reserve held and the face value of the policy.

Claire Thinking, Inc. Comments:
Thank you for the opportunity to provide comments to the NAIC's Statutory Accounting Practices Working Group regarding Exposure 2024-06. Please note that my comments only reflect my own opinion and not necessarily those of my past or present employer or of any professional organization.

Regarding Exposure 2024-06, I agree that a reinsurance agreement that is comprised of interdependent reinsurance arrangements (such as coinsurance and YRT) needs to be evaluated as a single agreement to determine risk transfer compliance. One of the primary intentions of Appendix A-791 of the *Accounting Practices and Procedures Manual* is to require, in order to qualify for reinsurance credit, that there generally not be a possibility that a ceding company's surplus could be adversely impacted by the performance of the ceded business. If a coinsurance agreement on its own would comply with Appendix A-791, but the reinsurance agreement it is part of obligates the ceding company to cede business under a YRT reinsurance arrangement, then that obligation needs to be considered in evaluating compliance with Appendix A-791.

In the drafting of the Life and Health Reinsurance Agreements Model Regulation and Appendix A-791, insurance regulators were primarily concerned about reinsurance agreements that provided surplus relief to the ceding company. These teams of insurance regulators believed that surplus relief should not be recognized if it was not permanent, thus the idea that the ceding company's surplus should not be adversely impacted at any future time by the ceded business. This includes the payment of any risk charge, which can only be paid from the income of the ceded policies and not from the surplus of the ceding company.

The Summary of Exposure 2024-06 frequently mentions experience refunds. The existence of an experience refund (which actually should benefit the ceding company) is generally not the concern. Rather, an experience refund may be typical of the types of reinsurance agreements that combine coinsurance with YRT reinsurance and charge YRT reinsurance premiums that are higher than what they would be otherwise, with the "excess" expected to be returned to the ceding company as part of an experience refund but which would provide a buffer to the reinsurer for at least some of the losses in the case that actual experience is sufficiently adverse. Such a reinsurance agreement should be evaluated in its entirety to determine if this buffer can result in a reduction of the ceding company's surplus. It should not matter whether a potential reduction of the ceding company's surplus is due to the coinsurance premiums exceeding policy premiums or due to YRT reinsurance premiums exceeding policy charges for the mortality risk, since the two reinsurance arrangements are connected.

In summary, the determination of a reinsurance agreement's compliance with Appendix A-791 of the NAIC Accounting Practices and Procedures Manual should include consideration of all obligations of the ceding company under the reinsurance agreement.

<u>*Interested Parties' Comments:*</u>
Overview
While the exposed language is characterized as a clarification, it is unclear that the proposed changes are strictly clarifications as there is confusion regarding the potential interpretation and resulting implications of these changes. Specifically, interested parties are concerned that the exposed language could lead to broader interpretive changes by regulators, auditors, and companies than is currently intended, which could cause confusion and inconsistency in approach across the industry. Interested parties suggest that further discussion between industry participants, the NAIC, and regulators on this important topic would ensure mutual understanding of intent.

Comments
Reinsurance agreements that combine coinsurance and yearly renewable term (YRT) coverage are not uncommon in the industry and have been historically interpreted (at least by some regulators and audit firms) as appropriately providing quota share credit on the coinsured policies and a YRT credit for the YRT component. We believe it would be in the interest of both regulators and the industry to fully understand the impact that the adoption of the exposed changes would have at the industry level before proceeding further with these changes.

The exposure states that "the substance of this interdependent agreement design is more akin to the risk transferred under a nonproportional reinsurance agreement. This is because in aggregate, proportionate amounts of the risk are not transferred." We believe that the determination of a contract being proportional or non-proportional should continue to be based on a careful consideration of the specific contractual terms of the reinsurance agreement(s) in question and the resulting reinsurance coverage provided to the ceding entity rather than the adoption of any automatic and universal conclusion for all combination coinsurance / YRT arrangements. Such belief is supported by the currently codified statutory guidance. SSAP 61R separately defines coinsurance, modified coinsurance, YRT and non-proportional reinsurance arrangements and provides applicable risk transfer guidance for each. Specifically, a non-proportional reinsurance arrangement is defined as follows:

> These arrangements provide for financial protection to the ceding entity for aggregate losses rather than providing indemnification for an individual policy basis as described in the preceding three reinsurance arrangements [i.e., coinsurance, modified coinsurance and YRT]. Catastrophic and stop loss reinsurance are written on an annual basis to protect the ceding entity from excessive aggregate losses. Usually, the coverage does not extend over the life of the underlying policy nor is there any requirement on the ceding entity to renew the arrangement.

The combination of coinsurance and YRT arrangements should not be automatically deemed non-proportional as many of these arrangements provide indemnification for losses on an individual policy basis, consistent with the current definition of proportional reinsurance under SSAP 61R. For many such arrangements, each component individually and in combination provides coverage over the life of the underlying policies and offers indemnification on an individual policy basis; and neither the coinsurance nor the YRT component, whether considered independently or in combination, constitutes a non-proportional arrangement.

In addition, the exposure states that "taking a full proportional reserve credit on the coinsured component is not reflective of the actual risk being transferred." While interested parties agree that combination arrangements can be structured in ways that do not meet statutory risk transfer requirements, we believe that combination arrangements can also be structured to meet these requirements and taking a full proportional reserve credit on the coinsured component would be considered appropriate.

Any risk transfer assessment of combination coinsurance / YRT arrangements should be conducted in the context of applicable SAP guidance and based on the facts and circumstances of the relevant reinsurance agreement(s). SAP guidance should be applied both individually to each of the coinsurance and YRT components of the agreement(s) and, in addition, an overall assessment of the combined agreement should be performed consistent with the requirement that "the agreement shall constitute the entire agreement between the parties with respect to the business

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being reinsured thereunder[.]" Interested parties agree that if any individual component of a combination coinsurance / YRT arrangement does not pass statutory risk transfer, then the aggregate transaction would not pass statutory risk transfer regardless of how it is structured. This overall assessment should include, among other things, an evaluation of (i) the coinsured business to ensure that all significant risks inherent in the reinsured business are transferred, and (ii) the YRT arrangement to ensure that the agreement does not violate any of the conditions described in Appendix A-791, paragraphs 2.b., 2.c., 2.d., 2.h., 2.i., 2.j. or 2.k.

Interested parties agree that transactions that inappropriately preclude any possibility of reinsurance losses being incurred as a result of excessive YRT premiums would be of concern from a statutory risk transfer perspective. In evaluating whether this is the case, YRT premium levels should be assessed using statutory principles as any resulting reserve credit will also have been established using statutory principles. In applying statutory principles, statutory valuation assumptions can serve as an acceptable benchmark. More specifically:

- YRT reinsurance results in the assumption of mortality risk for the lifetime of the underlying business. In such a context, the statutory valuation framework already defines a reasonably prudent valuation mortality basis for direct writers when reserving for such risks. As such, this same valuation mortality basis should also serve as a reasonable and prudent benchmark for reinsurers to consider when committing to the assumption of mortality risk for the lifetime of the underlying business.

- The determination of reserve credit relates to the underlying statutory reserves that are held by the ceding entity and determined based on statutory principles and assumptions. It would be inconsistent to determine a reserve credit using GAAP principles and assumptions in relation to underlying reserves that are computed using statutory principles and assumptions.

The exposure also states that SSAP 61R, paragraph 36, notes that the reinsurance credit is only for the risk reinsured. The exposure references this as a reason that it is not appropriate for a ceding company to take a proportional reserve credit that reflects the transfer of all actuarial risks when not all actuarial risks are transferred. This is a misinterpretation of paragraph 36. That section of the paragraph refers to coinsurance and states "It [the credit] is, of course, only for the percentage of the risk that was reinsured." As such, paragraph 36 refers to the quota share of risk and does not imply that coinsurance agreements satisfying risk transfer requirements could be subject to "partial risk transfer". Historically, risk transfer testing for life insurance, accident and health insurance, and annuity contracts has been performed on a pass/fail basis where companies evaluate the contractual terms of their reinsurance agreements and assess the substance of the transaction based upon SAP risk transfer guidance. Once the risk transfer assessment has been completed, full reserve credit is established for contracts deemed to have successfully satisfied risk transfer. For agreements not successfully demonstrating risk transfer, deposit accounting is utilized. No framework currently exists for assessing an appropriate level of partial reserve credit.

Summary Conclusion
There are established differences in the approach to evaluating risk transfer under SAP and GAAP. It is recognized that there are life reinsurance contracts that satisfy SAP risk transfer rules for life reinsurance but are not considered to have transferred the reasonable possibility of a significant loss to the reinsurer, as required under GAAP. Different types of reinsurance (i.e., coinsurance, YRT, and non-proportional) follow different risk transfer rules under SAP. Applying GAAP standards when evaluating risk transfer / reserve credit for life reinsurance is not appropriate as statutory life reserves are based on prudent assumptions, correspondingly reserve credit should be established on a consistent basis.

A substantive change from pass/fail risk transfer assessment and full reserve credit recognition to a separate assessment of partial reserve credit requires significant changes to SAP, is inconsistent with the current risk transfer assessment framework and would need to be tested further to understand resulting consequences (i.e., intended and unintended).

Interested parties do not believe that the SAPWG exposure pertaining to risk transfer represents a clarification but instead is a significant departure from the currently accepted practices for evaluating risk transfer for life reinsurance

contracts under SAP guidance. Therefore, if the exposure remains unchanged, the resulting consequences could be material, and insurers may not be able to unilaterally renegotiate existing agreements even if they desired to do so. Thus, in addition to the broader concerns with the proposal, retroactively changing the historical accounting treatment for existing reinsurance agreements would be inappropriate.

Additional discussion between interested parties, the NAIC, and regulators on this important topic would be greatly beneficial.

We note there are several concurrent efforts at the NAIC related to reinsurance. We suggest the NAIC take a broader view to address these concerns, and ensure coordination of the efforts at LATF, SAPWG, and other NAIC groups working on these issues. Such an approach avoids duplication of work, promotes consistency, and ensures concerns are addressed and understood broadly.

<u>Recommendation:</u>
NAIC staff recommends that the Working Group discuss the comments received which are summarized below. After discussion, NAIC staff recommends re-exposing the agenda item until September 27 to allow for discussion at the Fall National Meeting with a request for 1) more detail on the extent existing contracts would be impacted and 2) specific language regarding the concept that interdependent contract features should be analyzed in aggregate. It is also recommended that the Working Group direct NAIC staff to forward the comments received to the Valuation Analysis (E) Working Group, Life Actuarial (A) Task Force and the Reinsurance (E) Task Force.

NAIC staff notes that the exposed revisions to *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*, are narrowly focused on noting that interdependent contract features need to be analyzed in aggregate in determining risk transfer.

a. **The exposed guidance is consistent with existing guidance in SSAP No. 61R / A-791 which requires the entirety of a contract to be evaluated for risk transfer. The exposed revisions are also consistent with the guidance currently in SSAP No. 62R, Exhibit A Implementation Questions and Answers, question 10 and guidance that is existing in U.S. GAAP.**

b. **As the exposed revisions are already consistent with current risk transfer requirements, the Working Group could direct a different action such as the development of an implementation guide, etc.**

c. **The revisions also add reference to A-791, paragraph 6 guidance in the YRT guidance paragraph. Note that combination contracts continue to be allowed, the edits simply stress that contract features cannot be ignored when evaluating risk transfer.**

d. **Staff also notes that the Valuation Manual treatment of reinsurance is more akin to modelling in that the reserve is calculated before and after the effects of reinsurance. The work of VAWG continues to identify reinsurance concerns.**

<u>Comment Letter Discussion Points:</u>
The Working Group received two comment letters, with key points summarized below:

1. **Sheldon Summers, Claire Thinking, is a former CA regulatory actuary who worked on the development of Model 791, noting that his comments were his own. Key points were:**

- Agreement with the exposure that a reinsurance agreement which is comprised of interdependent reinsurance arrangements (such as coinsurance and YRT) needs to be evaluated as a single agreement to determine risk transfer compliance with Appendix A-791 of the NAIC *Accounting Practices and Procedures Manual.*

- Intent of Appendix A-791 was that reinsurance credits should not include a possibility of negative surplus impact to the ceding entity from the ceded business. Surplus relief should not be recognized if it is not permanent.

- If a coinsurance agreement on its own would comply with Appendix A-791, but the reinsurance agreement it is part of obligates the ceding company to cede business under a YRT reinsurance arrangement, then that obligation needs to be considered in evaluating compliance with Appendix A-791. The determination of a reinsurance agreement's compliance with Appendix A-791 of the NAIC Accounting Practices and Procedures Manual should include consideration of all obligations of the ceding company under the reinsurance agreement.

- The existence of an experience refund is generally not the concern. Rather, an experience refund may be typical of the types of reinsurance agreements that combine coinsurance with YRT reinsurance and charge YRT reinsurance premiums that are higher than what they would be otherwise, with the "excess" expected to be returned to the ceding company as part of an experience refund but would provide a buffer to the reinsurer for at least some of the losses in the case that actual experience is sufficiently adverse. **<u>Such a reinsurance agreement should be evaluated in its entirety to determine if this buffer can result in a reduction of the ceding company's surplus.</u> Since the two reinsurance arrangements are connected,** it should not matter whether a potential reduction of the ceding company's surplus is due to the coinsurance premiums exceeding policy premiums or due to YRT reinsurance premiums exceeding policy charges for the mortality risk**.**

2. Interested Parties' Comments Key Points:

- Opposed to adoption and request further study and discussion to better understand the impact. They also suggest coordination of the efforts at LATF, SAPWG, and other NAIC groups working on these issues.

- Agree that transactions that inappropriately preclude any possibility of reinsurance losses being incurred as a result of excessive YRT premiums would be of concern for statutory risk transfer.

- Agree that if any individual component of a combination coinsurance / YRT arrangement does not pass statutory risk transfer, then the aggregate transaction would not pass statutory risk transfer regardless of how it is structured.

- Reinsurance agreements that combine coinsurance and yearly renewable term (YRT) coverage are not uncommon and have been historically interpreted (at least by some regulators and audit firms) as providing quota share credit on the coinsured policies and a YRT credit for the YRT component.

The following interested parties' comments were focused on other aspects of the referral and the agenda item discussion, <u>and not on the exposed language</u> which is regarding risk transfer analysis.

- Classification a combination reinsurance contract for purposes of determining credit.

The VAWG referral also raised questions regarding the resulting reinsurance credit and contract classification when there is combination coverage (YRT and Coinsurance) in the same agreement, that is whether the resulting coverage is proportional or non-proportional. **<u>No language on this topic was exposed for comment.</u>**

- While interested parties agree that combination arrangements can be structured in ways that do not meet statutory risk transfer requirements, combination arrangements can also be structured to meet these requirements and therefore allowing full proportional reserve credit on the coinsured component.

- The interested partes commented that combination of coinsurance and YRT arrangements should not be automatically deemed non-proportional.

- The determination of reserve credit relates to the underlying statutory reserves that are held by the ceding entity and determined based on statutory principles and assumptions. It would be inconsistent to determine a reserve credit using GAAP principles and assumptions.

- A substantive change from pass/fail risk transfer assessment and full reserve credit recognition to a separate assessment of partial reserve credit requires significant changes to SAP, is inconsistent with the current risk transfer assessment framework and would need to be tested further (i.e., intended and unintended).

- The agenda item in discussing the VAWG referral notes that it is not appropriate for a ceding company to take a proportional reserve credit that reflects the transfer of all actuarial risks when not all actuarial risks are transferred. The interested parties note that paragraph 36 refers to the quota share of risk and does not imply that coinsurance agreements satisfying risk transfer requirements could be subject to "partial risk transfer". Historically, risk transfer testing for life insurance, accident and health insurance, and annuity contracts has been performed on a pass/fail basis based upon SAP risk transfer guidance. Risk transfer analysis can result in full reserve credit for pass contracts and depositing accounting for failed contracts. No framework currently exists for assessing an appropriate level of partial reserve credit.

- Experience Refund / YRT issues:

The VAWG referral and the agenda item discussed differences in risk transfer requirements under SSAP No. 61R/ A-791 regarding YRT which is not subject to all aspects of A-791 and coinsurance which is subject to all aspects of A-791. **No language on this topic was exposed for comment.**

- Interested parties agree that transactions that inappropriately preclude any possibility of reinsurance losses being incurred as a result of excessive YRT premiums would be of concern from a statutory risk transfer perspective. In evaluating whether this is the case, YRT premium levels should be assessed using statutory principles as any resulting reserve credit will also have been established using statutory principles. Statutory valuation assumptions can serve as an acceptable benchmark.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-07 (Jake)	**Reporting of Funds Withheld and Modco Assets**	**16 – Agenda item**	**Comments Received**	**IP – 15**

Summary:
On March 16, 2024, the Working Group exposed a concept agenda item with the intent to develop future revisions to annual statement Schedules S and 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 and Title annual statement blanks. The new part would be similar in structure to Schedule DL and would include all assets held under a funds withheld arrangement and would include a separate signifier for modco assets.

As background, during 2023, as a result of rising interest rates, the Statutory Accounting Principles (E) Working Group addressed the issue of net negative (disallowed) interest maintenance reserve for statutory accounting with *Interpretation (INT) 23-01 Net Negative (Disallowed) Interest Maintenance Reserve,* as a short-term solution. Later in 2023, the IMR Ad Hoc Group was formed to find a more permanent solution to address IMR for statutory accounting. During the IMR Ad Hoc Group's review process and discussions, it was noted that there were issues

with identifying assets that are subject to funds withheld or modified coinsurance (modco) arrangements within the financial statements and reporting schedules. The intent of this agenda item is to make it easier to identify assets that are subject to a funds withheld or modco arrangement through updated reporting in the financials. This agenda item does not intend to change statutory accounting for these arrangements.

Although this issue of clarity of reporting of funds withheld and modco assets came from the IMR project, which is focused on life insurance, funds withheld and modco also exist for property/casualty insurance, so this agenda item proposes to add this updated reporting to all the annual statement blanks.

Interested Parties' Comments:
Interested parties acknowledge the importance of transparency in financial reporting with respect to assets backing funds withheld and modco reinsurance transactions and regulators' preference to be able to understand the assets supporting these contracts. We look forward to working with the Working Group as it further refines its proposal.

Having reviewed the exposure, interested parties have several comments that relate to the effort. These include: a) sensitivities concerning the potential exposure of competitive information, b) the impracticability of providing such information in commonplace cases where specifically identifiable assets require are not ring-fenced as part of a funds held arrangement, and c) any new asset schedule would considerable resources, which are currently constrained by the bond definition project.

Granularity of reporting may expose proprietary competitive information
While we support giving regulators the information they need to regulate properly, there are issues of commercial sensitivity with having funds withheld and modco assets made public. Concerns have been expressed about the level of granularity that will be required. Investment strategy is a critical component of reinsurance pricing, which is considered proprietary, and the level of reporting could force companies to share this information publicly. Requiring public disclosure of such proprietary information may reduce the availability of funds withheld collateralized deals in the marketplace. Interested parties urge the Working Group to consider other non-public alternatives which would provide regulators with the information they require while maintaining the confidentiality of proprietary competitive information.

Identifying specific assets under Funds Withheld arrangements without trust accounts is not truly possible
The proposal to report assets held under funds withheld arrangements is also problematic for funds that are not held in trust accounts. Interested parties note that for property casualty companies in particular, many funds withheld arrangements do not require funds to be held in trust accounts. Rather, the funds are maintained by the insurer in their own cash or short-term investment accounts and are allowed to be co-mingled with other cash or invested assets of the insurer. The agreements that govern such funds withheld may specify an interest rate that is applied to the funds withheld for purposes of crediting the funds with interest, but there is no specific invested asset associated with the funds held. Therefore, it would not be possible to identify and report specific assets deemed to be the "funds withheld" under these arrangements.

In addition, interested parties note that for property casualty insurers, the amounts of funds held under reinsurance treaties are already reported in Schedule F Part 3 Column 20 of the annual statement by individual reinsurance treaty. We believe the current reporting in Column 20 was designed to accommodate both funds held agreements with and without trust accounts. For those arrangement where a trust account is used, regulators can easily confirm the invested assets held in the trust accounting during a financial examination.

A new asset schedule will require significant time, effort, and cost to build
A new schedule will increase the complexity of asset reporting requirements. To facilitate the required reporting, commercial annual statement reporting vendors will need to build the new schedule into their software. Beyond that, many companies note additional work may be required to modify their investment and/or accounting systems to populate the proposed new schedules with the assets associated with funds withheld or modco agreements. Others may not have the ability to make changes to their investment and/or accounting systems and would need to create manual processes including appropriate controls to meet the reporting obligations. Allocation processes may need

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to be established for situations where an asset is backing more than one agreement. This will all require significant time, effort, and cost. Additionally, in a significant part of the industry, the staff and vendor resources that would be involved in implementing the necessary changes for the funds withheld and modco asset schedule are currently heavily involved in the new Bond Definition project that is set to be effective reporting year 2025. Having both issues active at the same time would cause significant resource strain across the industry.

Finally, we note there are several concurrent efforts at the NAIC related to reinsurance. We suggest the NAIC take a broader view to address these concerns and ensure coordination of the efforts at LATF, the Working Group, and other NAIC groups working on these issues. Such an approach avoids duplication of work, promotes consistency, and ensures concerns are addressed and understood broadly.

We recognize the importance of this issue and want to be helpful and work collaboratively to address the Working Group's objectives of having full visibility of investments, specifically in funds withheld and modco agreements.

Recommendation:
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 Property/Casualty and Title annual statement blanks and direct NAIC staff to continue working with interest parties on this proposal.

The Life RBC formula reflects a reduction in RBC charges for modco and funds withheld assets. This reduction is by asset type and often by asset designation. The fair value of the assets withheld is also reported in the reinsurance Schedules S and F as collateral. Accordingly, to accomplish both things, asset-by-asset identification is necessary. Therefore, some of the submitted comments regarding not being able to identify assets withheld which are not held in trust would indicate a disconnect. <u>Comments are requested regarding if the assets cannot be identified, then how are the numbers determined for the life risk-based capital charge reductions reported and the collateral fair value.</u>

This item is planned for exposure until September 27 to allow for consideration at the Fall National Meeting.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-10 (Julie)	**SSAP No. 56 – Book Value Separate Accounts**	**17 – Agenda item**	**No Comments**	**IP – 18**

Summary:
On March 16, 2024, 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 (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 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. 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

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similar general-account type products that have been approved by the state of domicile for reporting in the separate account.

The guidance in SSAP No. 56 focuses on the accounting and reporting for both the separate account and general account, with specific focus on what is captured within each account as well as transfers between the two accounts. As the focus is on fair value separate account assets, there is not guidance that details how transfers should occur between the general and separate accounts when the assets will be retained and reported at "book value." Particularly, the guidance does not address whether assets should be disposed / recognized at fair value when transferring between accounts, with subsequent reporting at the general account measurement guidance or whether the assets should be transferred at the "book value" that is reported in the existing account. The process has the potential to impact recognition of gains / losses and IMR, so it should be clearly detailed to ensure consistent reporting.

Interested Parties' Comments:
Interested parties is currently working with NAIC staff and the IMR Ad Hoc Group on this agenda item.

Recommendation:
NAIC staff recommends that the Working Group expose draft revisions to *SSAP No. 56—Separate Accounts* 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, there are NAIC staff questions shaded in the document requesting additional information from regulators and industry. These questions focus predominantly on seed money and other asset transfers not captured in the proposed guidance.

This item is proposed for exposure until November 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.

As detailed in the updated recommendation within the agenda item, the IMR Ad Hoc group considered asset transfers between the general and separate account, as those transfers could generate IMR. With these discussions, it was noted that there are inconsistencies in practice as to how those transfers occur. ACLI representatives participating in the IMR Ad Hoc group presented three methods that are used, referred to as the market value offsetting method, the market value SSAP No. 25 method, and the book value method. With this discussion, the ACLI informed that if consistency in the process for transfers is desired, they would prefer the market value offsetting method. This method has the following three broad concepts:

1) The selling account transfers the asset at fair value, with a realized gain or loss and allocation to IMR.

2) The purchasing account records the asset at book value, with an adjustment to IMR for the difference between the fair value and book value.

3) This method has offsetting IMR impacts between the general account and the book value separate account, with a zero net impact to surplus.

Per the discussion at the IMR Ad Hoc Group, it was recommended that this discussion move to the full Working Group to consider the ACLI suggested methods as well as edits to SSAP No. 56.

The revisions to SSAP No. 56 incorporate a new section to SSAP No. 56 to specifically detail the measurement of separate account assets and a new section to provide guidance for asset transfers between the general and separate account. With these changes, a variety of revisions have been proposed to clarify the guidance, predominantly focused on the areas in which IMR is addressed in the standard.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-11 (Wil)	**ASU 2023-09, Improvements to Income Tax Disclosures**	**18 – Agenda item**	**No Comments**	**IP – 18**

<u>Summary:</u>
On March 16, 2024, the Working Group exposed revisions to adopt, with modification, *Accounting Standards Update (ASU) 2023-09, Improvements to Income Tax Disclosures*.

<u>*Interested Parties' Comments:*</u>
Interested parties appreciate the Working Group's partnership on the proposal, including various meetings to discuss potential changes to the proposed language. Through these meetings we have provided detailed responses so have only included here a summary of our concerns:

- One of the main changes in ASU 2023-09 is an expanded rate reconciliation, applicable to only public filers. Requiring expanded rate reconciliation disclosures to all insurance companies expands the scope of ASU 2023-09 and will create an additional burden for non-public insurance companies.

- Under paragraph 4 of SSAP No. 101, state income taxes are not accounted for under SSAP No. 101. They are instead accounted for under SSAP 5R and included in taxes, licenses, and fees above the line. During the drafting process of SSAP No. 101 state taxes were intentionally not recorded as part of income tax expense in the statutory financial statements because of the immateriality of this type of tax to insurance companies. Given that insurance companies primarily pay premium taxes in lieu of state income taxes (all but nine states have exempted insurance companies from state income tax), state tax income tax disclosures will have limited value from a statutory reporting perspective. Of the states that charge income tax, several have provisions that significantly reduce the net tax impact, including premium tax credits. State tax disclosures will therefore likely require additional guidance regarding what to report (e.g., before or after any credits for premium tax paid, consideration for mixed group and combined reporting).

- ASU 2023-09 was in part adopted to provide additional foreign tax information to investors to enable them to "understand an entity's exposure to potential changes in jurisdictional tax legislation" over worldwide income. These additional disclosures were also intended to help investors identify where companies operate in low-tax or no-tax jurisdictions. Foreign subsidiaries and affiliates are not consolidated into statutory statements, so tax jurisdiction information would not be as applicable as it would in consolidated GAAP group reporting. Moreover, Schedule Y already provides regulators with subsidiary information, including the jurisdiction such subsidiaries operate. Material foreign tax amounts will be limited to few insurers who have branches, which are fully taxable in the jurisdictions where they operate as well as in the U.S., with foreign tax credits offsetting the U.S. tax due. This dual taxation results in branches generally having tax rates of at least 21% even if the branch operates in a low or no tax jurisdiction.

Overall, ASU 2023-09 was driven by the investor community, whose disclosure wants and needs are not the same as the regulator focusing on solvency. The current statutory tax footnote provides extensive disclosures, some redundant to those in ASU 2023-09, with a goal of enabling regulators to assess the financial stability of the entity (as it relates to tax). Interested parties thus believe the additional disclosures and requirements under the new ASU 2023-09 would provide limited benefits to the regulators.

Interested parties suggest rejecting adoption of ASU 2023-09 and all modifications to SSAP No. 101, except for the deletion of SSAP No. 101, paragraph 23b. Interested parties agree the disclosure is no longer necessary given revisions to the Internal Revenue Code.

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<u>Recommendation:</u>
NAIC staff recommends that the Working Group expose revisions to reject *ASU 2023-09, Improvements to Income Tax Disclosures* in *SSAP No. 101—Income Taxes*, and revisions to remove the disclosure detailed in SSAP No. 101, paragraph 23b. This item is planned for exposure until September 27 to allow for consideration at the Fall National Meeting.

This item is planned for exposure until September 27 to allow for consideration at the Fall National Meeting.

Based on the comments from interested parties, shown above, NAIC staffs' recommendation has been changed from adopt with modification to reject for statutory accounting purposes. NAIC staff agreed with interested parties' comments that the additions from the ASU are duplicative of existing statutory income tax disclosures. NAIC staff still recommends the adoption of one change from the ASU, the deletion of SSAP No. 101, paragraph 23b, as both staff and interested parties agree this disclosure is no longer relevant.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2024-12 (Wil)	**Updates to SSAP No. 27**	**19 – Agenda item**	**No Comments**	**IP – 19**

<u>Summary:</u>
On March 16, 2024, the Working Group exposed revisions to remove references to FAS 105 from SSAP No. 27 and amend the annual statement instructions to clarify its scope and requirements.

During February 2024, it came to NAIC staffs' attention that *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures Risk and Financial Instruments with Concentrations of Credit Risk* references *FASB Statement No. 105, Disclosure of Information about Financial Instruments with Off-Balance-Sheet* (FAS 105) which was superseded by *FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities* (FAS 133). 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 in FAS 105 paragraphs 14 and 15.

NAIC staff suggest amending SSAP No. 27 to specifically list the financial instruments excluded from the SSAP rather than referencing FAS 105, which is significantly out of date as it was superseded by FAS 133 prior to the creation of the Accounting Standards Codification which in turn superseded FAS 133. Staff also suggests updating the annual statement instructions to add an "Other" derivatives category and disclosure examples and instructions for non-derivative financial instruments with off-balance sheet credit risks.

<u>Interested Parties' Comments:</u>
Interested parties note that Note 14 of the annual statement already requires disclosures regarding an insurer's commitments to provide any type of future funding as well as an insurer's guarantees of the performance of other parties. These disclosures are already very lengthy and detailed. It would seem repetitive to have to include most of the information in Note 16 again.

We recommend that the Working Group evaluate the current disclosure requirements under Note 14 to determine if there is information that should be provided in addition to what is already disclosed instead of having insurers duplicate the information in two different notes.

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<u>Recommendation:</u>
NAIC staff recommends that the Working Group defer this agenda item while staff continues to work with industry on this agenda item.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-12 (Robin)	**Review of INT 03-02: Modification to an Existing Intercompany Pooling Arrangement**	**20 – Agenda item 21 – INT 03-02**	**No Comments**	**IP – 8**

<u>Summary:</u>
On March 16, 2024, the Working Group deferred action of this agenda item, which was originally introduced in 2022 and proposed to nullify *INT 03-02: Modification to an Existing Intercompany Pooling Arrangement.* The INT was proposed to be nullified as it is inconsistent with *SSAP No. 25—Affiliates and Other Related Parties* guidance regarding economic and non-economic transactions between related parties. The guidance in INT 03-02 can result with, in essence, unrecognized gains (dividends) or losses by allowing 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. Treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance pooling transactions. At the 2023 Fall National Meeting the item was deferred to allow time for more illustrations and discussions with interested parties.

Among the concerns about INT 03-02 noted by NAIC staff was that it was not an interpretation of SSAP No. 25 but included guidance that was not consistent with SSAP No. 25. NAIC staff also received concerns that the guidance was being misapplied to other intercompany reinsurance transactions which were not pools.

<u>Interested Parties' Comments:</u>
The Working Group exposed its intent to nullify INT 03-02, and exposed revisions to *SSAP No. 25—Affiliates and Other Related Parties* and *SSAP No. 63—Underwriting Pools* to address transfers of assets when modifying intercompany pooling agreements. The exposed revisions were based on interested parties' comments with minor edits proposed by NAIC staff.

The exposed Revisions to SSAP No. 25 and SSAP No. 63 are illustrated below.

> *SSAP No. 25—Affiliates and Other Related Parties*
>
> <u>4. If a company transfers assets or liabilities to effectuate a modification to an existing intercompany pooling arrangement, the transaction, including the transfer of assets, shall be accounted for and valued in accordance with the guidance in *SSAP No. 63—Underwriting Pools.* The guidance in SSAP No. 63 regarding the transfers of assets or liabilities to effectuate a modification of an intercompany pooling arrangements shall not be applied or analogized to other transactions involving transfers of assets and liabilities.</u>
>
> *SSAP No. 63—Underwriting Pools (only impacted paragraph are reflected.)*
>
> 1. This statement establishes statutory accounting principles for underwriting pools and associations, <u>including intercompany pooling arrangements</u>.
>
> <u>8. Insurance groups that utilize intercompany pooling arrangements often modify these arrangements from time to time for various business reasons. These business reasons commonly include mergers,</u>

acquisitions, dispositions, or a restructuring of the group's legal entity structure. In order to effectuate a relatively simple modification, such as changing pooling participation percentages without changing the pool participants, companies often simply amend the existing pooling agreement. Alternatively, in order to effectuate a more complex modification, such as changing (by adding or removing) the number of pool participants, a company may commute the existing pooling agreement and execute a new pooling agreement(s). In conjunction with executing the appropriate intercompany pooling agreements, a transfer of assets and liabilities amongst the impacted affiliates may also be required in order to implement the new pooling agreement(s). The following subparagraphs provide guidance specific to modifications of intercompany pooling arrangements and shall not be applied to an analogous transaction or event.

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

b. The net amount of the assets and liabilities being moved among entities as a result of a modification to an intercompany pooling shall be used to settle the intercompany payable/receivable (i.e., the assets that are transferred in conjunction with the modification) to minimize the amount of assets transferred in the modification.

12. Note that other applicable reinsurance guidance from *SSAP No. 61R—Life, Deposit Type and Accident and Health Reinsurance* or *SSAP No. 62R—Property and Casualty Reinsurance*, depending on the type of business, applies to intercompany pooling arrangements and voluntary and involuntary pools. This includes the SSAP No. 62R guidance in paragraphs 33 through 39 regarding retroactive reinsurance.

New disclosure in paragraph 13

13.i For modifications to an existing intercompany pooling arrangement that involve the transfer of assets with fair values that differ from cost or amortized cost, the statement value and fair value of assets received or transferred by the reporting entity.

Interested parties agree with and support adoption of the proposed changes. For purposes of clarity, we recommend that the wording following the comma in the new disclosure in paragraph 13 of SSAP No. 63 be moved to the beginning of the sentence to read as follows: The statement value and fair value of assets received or transferred by the reporting entity for modifications to an existing intercompany pooling arrangement that involved the transfer of assets with fair value that differ from costs or amortized cost.

Recommendation:

NAIC staff recommends that the Working Group adopt the exposed revisions to SSAP No. 63 with a modification to paragraph 13i, which is similar to the edit suggested by interested parties modified to note disclosure should reflect the fair values that differ from statement value, as illustrated below. With this adoption, INT 03-02 would also be nullified.

SSAP No. 63 modified disclosure in paragraph 13i for adoption consideration

13.i The statement value and fair value of assets received or transferred by the reporting entity for modifications to an existing intercompany pooling arrangement that involved the transfer of assets with fair value that differ from statement value.

The comment letters are included in Attachment 22 (22 pages).

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Hearing/00 - 08-13-2024 - SAPWG Hearing Agenda.docx

Draft: 4/1/24

Statutory Accounting Principles (E) Working Group
Phoenix, Arizona
March 16, 2024

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met in Phoenix, AZ, March 16, 2024. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Todrick Burks (AL); Kim Hudson, Michelle Lo, and Laura Clements (CA); William Arfanis and Jack Broccoli (CT); Rylynn Brown (DE); Cindy Andersen (IL); Stewart Guerin (LA); Judy Weaver and Steve Mayhew (MI); Doug Bartlett and Pat Gosselin (NH); Bob Kasinow (NY); Diana Sherman (PA); Jamie Walker and Rachel Hemphill (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI).

1. Adopted its Feb. 20, 2024; Jan. 29, 2024; Jan. 10, 2024; and 2023 Fall National Meeting Minutes

The Working Group met March 7, 2024, 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 Spring National Meeting agendas.

During its Feb. 20, 2024, meeting, the Working Group took the following action: 1) exposed revisions to *Statement of Statutory Accounting Principles (SSAP) No. 21R—Other Admitted Assets* to incorporate a new measurement method for residual interests; 2) exposed revisions to provide detailed definitions for the annual statement reporting categories of *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* and residual interests on Schedule BA (Ref #2023-16); 3) adopted revisions to SSAP No. 21R to incorporate a collateral loan disclosure for year-end 2024; and 4) exposed additional changes that propose collateral loan reporting lines for Schedule BA (Ref #2023-28).

The Working Group conducted an e-vote that concluded Jan. 29, 2024, to expose additional revisions made to the drafts of *SSAP No. 93R—Low-Income Housing Tax Credit Property Investments* and *SSAP No. 94R—Transferable and Non-Transferable State Tax Credits* as part of Agenda Item 2022-14 New Market Tax Credits.

During its Jan. 10, 2024, meeting, the Working Group took the following action: 1) adopted *Interpretation (INT) 23-04 Scottish Re Life Reinsurance Liquidation Questions*; 2) adopted revisions to reject *Accounting Standards Update (ASU) 2016-13, Measurement of Credit Losses on Financial Instruments* (CECL) and related subsequent ASUs; and 3) exposed revisions to expand the transparency of reporting for collateral loans.

Malm made a motion, seconded by Sherman, to adopt the Working Group's Feb. 20, 2024 (Attachment One-A); Jan. 29, 2024 (Attachment One-B); Jan. 10, 2024 (Attachment One-C); and Dec. 1, 2023 (*see NAIC Proceedings – Fall 2023, Accounting Practices and Procedures (E) Task Force, Attachment One*) minutes. The motion passed unanimously.

2. Reviewed Comments on Exposed Items

The Working Group reviewed comments received (Attachment One-D) on its exposed items.

   A. Agenda Item 2022-14

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Bruggeman directed the Working Group to agenda item 2022-14: New Market Tax Credits. Wil Oden (NAIC) stated the agenda item was drafted in response to the Inflation Reduction Act and the subsequent issuance of *ASU 2023-02, Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method*, which permitted the application of the proportional amortization method for income tax equity investments. He stated that this agenda item updates the title and broadens the scope of *SSAP No. 93—Investments in Tax Credit Structures*, to include any qualifying tax credit investment, regardless of structure or the type of state or federal tax credit program. Additionally, the title and scope of *SSAP No. 94R—State and Federal Tax Credits* was expanded to include both state and federal purchase tax credits. Oden stated that interested parties submitted comments for the Jan. 29 exposure. He stated that most of the comments provided by interested parties were regarding updates to the risk-based capital (RBC) reporting lines for tax credit investments, though one comment noted an error in the examples, which NAIC staff have since corrected. Oden recommended the Working Group adopt the exposed revisions, which have been updated to reflect suggested example edits from interested parties. He recommended the Working Group sponsor a blanks proposal in the annual statement reporting categories for tax credit investment RBC, using suggestions from the interested parties' comment letter. Oden recommended the Working Group direct staff to send a referral to the Life Risk-Based Capital (E) Working Group to inform it of planned reporting line changes. He recommended the Working Group direct NAIC staff to prepare an issue paper to document the discussions.

Weaver made a motion, seconded by Sherman, to adopt the exposed revisions to *SSAP No. 34—Investment Income Due and Accrued* and SSAP No. 48 (Attachment One-E), SSAP No. 93R (Attachment One-F), and SSAP No. 94R (Attachment One-G), and to direct NAIC staff to complete the recommended actions. The motion passed unanimously.

B. Agenda Item 2023-25

Bruggeman directed the Working Group to agenda item 2023-25: ASU 2023-03 – SEC Updates. Oden stated that agenda item 2023-25 was drafted in response to *ASU 2023-03 – SEC Updates*, which amended various aspects of U.S. Securities and Exchange Commission (SEC) guidance on stock compensation equity-based payments. Oden stated that interested parties had no comments on this item and that NAIC staff recommend the Working Group adopt the exposed revisions to *Appendix D–Nonapplicable GAAP Pronouncements,* to reject ASU 2023-03 as not applicable to statutory accounting.

Walker made a motion, seconded by Bartlett, to adopt revisions to Appendix D to reject ASU 2023-03 (Attachment One-H) as not applicable to statutory accounting. The motion passed unanimously.

C. Agenda Item 2023-27

Bruggeman directed the Working Group to agenda item 2023-27: ASU 2023-04 – SEC Updates – Crypto. Jake Stultz (NAIC) stated this agenda item is specific to ASU 2023-04 paragraphs specifically regarding crypto currency. Stultz stated that the original exposure recommended this be rejected in *Appendix D–Non-Applicable GAAP Pronouncements*. He stated that interested parties did not have any comments and that NAIC staff recommend the Working Group adopt this agenda item.

Walker made a motion, seconded by Malm, to adopt revisions to Appendix D to reject ASU 2023-04 (Attachment One-I) as not applicable to statutory accounting. The motion passed unanimously.

D. Agenda Item 2023-29

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Bruggeman directed the Working Group to agenda item 2023-29: IMR/AVR Preferred Stock. Julie Gann (NAIC) stated that this agenda item addresses interest maintenance reserve (IMR) and asset valuation reserve (AVR) preferred stock. She stated that this is an annual statement instruction revision only, and it was identified that the guidance and the annual statement instructions still directed that perpetual preferred stock be allocated between IMR/AVR based on NAIC designation. Gann stated that, previously, guidance was revised so that those are always at fair value, so there was a disconnect between the annual statement instructions and the statutory accounting measurement guidance. She stated that the exposed revisions clarified that only redeemable preferred stock with NAIC designations would go through IMR and that perpetual preferred stock would always go through AVR. Gann stated that interested parties agreed, but they also identified that mandatorily redeemable preferred stock should also be included because since it is mandatorily redeemable, it should also be at fair value. She stated that NAIC staff are recommending f adoption of the exposed revisions with slight revisions to refer to the mandatory redeemable convertible preferred stocks, regardless of whether they are redeemable or perpetual. Gann stated that interested parties approve of the revisions.

Sherman made a motion, seconded by Clark, to adopt the revisions, which will be forwarded as a proposal to the Blanks (E) Working Group, to clarify that realized gains and losses on perpetual preferred stock and mandatory convertible preferred stock shall not be added to IMR, regardless of NAIC designation, and shall follow the same concepts that exist for common stock in reporting realized gains/losses to AVR (Attachment One-J). The motion passed unanimously.

E. Agenda Item 2023-30

Bruggeman directed the Working Group to agenda item 2023-30: Admissibility Requirements of Investments in Downstream Holding Companies. Robin Marcotte (NAIC) stated that the Working Group exposed consistency revisions to the existing guidance in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to update language in paragraph 24 on audits and admissibility to better align with guidance in paragraphs 26 and 27 on the look-through methodology. Marcotte stated that interested parties provided comments suggesting the removal of one extra exposed phrase. She stated that NAIC staff recommend the Working Group adopt the exposed revisions with the deletion of the extra exposed phrase.

Clark made a motion, seconded by Bartlett, to adopt the exposed revision with the minor modification proposed by interested parties. The revisions update the language in SSAP No. 97, paragraph 24, on audits and admissibility to better align with guidance in paragraphs 26 and 27 on the look-through methodology (Attachment One-K). The motion passed unanimously.

F. Agenda Item 2023-31

Bruggeman directed the Working Group to agenda item 2023-31: Model 630 Mortgage Guaranty Insurance. Marcotte stated that the Working Group exposed a project to address the updates to the *Mortgage Guaranty Insurance Model Act* (#630). She stated that this model is excerpted in *Appendix A-630 Mortgage Guaranty Insurance,* which is referenced in *SSAP No. 58—Mortgage Guaranty Insurance*. She stated that this agenda item was intended to announce the project and ask for comments on a proposed effective date. Marcotte stated that interested parties had no comments and that NAIC staff recommend the Working Group direct staff to develop updates to SSAP No. 58 and *Appendix A-630—Mortgage Guaranty Insurance* for future discussion. She stated that because there are approximately 10 mortgage guaranty insurers, and they are concentrated in a small number of states, NAIC staff will work with the effected states to establish a proposed effective date.

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Bruggeman noted agreement with directing NAIC staff as outlined and noted a motion was not required for the Working Group to direct NAIC staff.

G. Agenda Item 2024-01

Bruggeman directed the Working Group to agenda item 2024-01: Bond Definition – Debt Securities Issued by Funds. Gann stated that this agenda item was a revision to the adopted guidance for the principles-based bond definition in *SSAP No. 26R—Bonds*. She stated that the goal was to clarify the guidance for debt securities issued by funds and that, currently, the guidance adopted allows debt securities issued by SEC registered funds to be classified as issuer credit obligations. She stated that the SEC registration is a key component of that guidance and is a rule component. Gann stated that since the Working Group is trying to make the bond definition principles-based, revisions have been exposed to eliminate that specific rule and instead incorporate a principles-based concept that could be used in determining whether debt security issued by funds meets the criteria of an operating entity and should be recognized as issuer credit obligations.

Gann stated that interested parties requested a small change regarding the description of the amount of debt, proposing a change from marginal to prudent. She stated that a support letter was also received from PineBridge Investments. Gann stated that during the interim with the exposure, the Working Group received several informal comments from both regulators and industry, identifying some interpretations of this guidance that were going beyond the intent. She stated that some companies were interpreting this guidance to allow debt securities from feeder funds or rated notes to automatically be classified as issuer credit obligations, even though equity-type interests backed them. She stated that due to this, NAIC staff are not recommending the adoption of this guidance at this time. Instead, NAIC staff recommend re-exposure with direction to regulators and the industry to work together to develop guidance that accurately identifies what should be permitted as debt securities issued by funds that cannot be extrapolated to also include feeder funds or other collateralized fund obligation (CFO) type investments that are intended to be assessed as asset-back securities. Gann stated that the current guidance has the SEC registration component and that until and unless something else is adopted that replaces that guidance, only debt securities issued by SEC-registered funds would be permitted to be classified as issuer credit obligations under the principles-based bond definition.

Bruggeman stated that the feeder funds were a discussion topic at some point during the bond definition discussion, and there was a lot of back and forth to make sure the Working Group understood how they worked. He stated that the Working Group does not want to start making changes to the project's original intent and that the point of the revisions was to make the guidance better aligned with the residual's definition.

Clark stated that the principle is that an asset-backed security (ABS) issuer is an entity that exists with the primary purpose of raising debt capital. He stated that the exposed guidance was trying to better clarify how to evaluate a fund under those criteria. He stated that given a feeder fund's sole purpose is to raise capital through investors that have to invest in debt instruments but cannot directly invest in a master fund, he is confused how there could be any kind of interpretation that would allow all feeder fund issuances to be issuer credit obligations. He stated that it seems like that would be completely contradictory to what it says, so through this re-exposure period, he will look for some clarification on how the Working Group can avoid that interpretation or help the Working Group understand how that interpretation came to be in the first place.

Mike Reis (Northwestern Mutual), representing interested parties, stated that interested parties support the goal the exposure is trying to achieve. He stated that interested parties had several calls and believed they understood what it meant and thought they had the same conclusion that Clark did on feeder funds. He stated that interested parties look forward to working with the Working Group to achieve the objective without misinterpretation.

Clark made a motion, seconded by Weaver, to re-expose the agenda item for debt securities issued by funds with a request for regulators and industry to provide comment on the proposed language that assists with clarifying the scope of guidance and to 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, which is not intended under the guidance. The motion passed unanimously.

H. Agenda Item 2019-21

Bruggeman directed the Working Group to agenda item 2019-21: SSAP No. 21R - Principles-Based Bond Project. Gann stated that in February, the Working Group exposed an updated SSAP No. 21R for a shortened comment period to allow a final look at proposed revisions to encompass the guidance for non-bond debt securities, the accounting and reporting guidance in the classification of those in scope of SSAP No. 21R, and then to prescribe the measurement method for residual interests. She stated that the component of the non-bond debt securities has been exposed a couple of times now with no comments received. Gann stated that the last couple of exposures were focused on the measurement method for the residual interests. She stated that the way the guidance is currently written is that there is a new amortized cost calculation for residual interests in which a company would calculate the effective yield based on expected cash flows at the time of acquisition, and then as cash flows are received, anything received in accordance with that effective yield would be recognized as interest income. She stated that the amounts received in excess would reduce the book/adjusted carrying value (BACV). Gann stated there is also a practical expedient included where a company could elect to take all cash flows received from residual as a reduction to BACV. She stated that if electing the practical expedient, no interest income would be recognized until the BACV ends at zero. She stated that also under the new SSAP No. 21R measurement method, the recognition of residual interest would be capped at cost. Gann stated that some companies have recorded increases in cost historically, so the current BACV is significantly higher than the cost. She stated that the guidance in SSAP No. 21R is intended to be prospective, so NAIC staff do not necessarily anticipate those to be an elimination, but going forward, recognition of residuals would be kept at cost.

Gann stated that two comments were received from interested parties. One was a minor editorial change on sub-paragraph numbering, and the other had to do with a disclosure component related to *SSAP No. 43R—Loan-Backed and Structured Securities*. She stated that the way the guidance is worded in SSAP No. 21R is that in the non-bond debt security guidance, they would follow SSAP No. 43R for the recognition of other than temporary impairment (OTTI) allocation between IMR and AVR. Gann stated that interested parties provided a comment on the bifurcated impairment disclosure that exists in SSAP No. 43R, and the edit would have expanded the disclosure requirement for SSAP No. 21R to be an individual security reporting if they had bifurcated impairment. She stated that is not what was intended in that disclosure, so NAIC staff are recommending that the Working Group not adopt the interested parties' change since there already is an aggregate disclosure, and the individual one is only for those with bifurcated impairment. Gann stated that NAIC staff recommend the Working Group adopt SSAP No. 21R, with minor sub-paragraph edits as identified by interested parties. She stated that this will be the last SSAP revised as part of the principles-based bond definition. She stated that, upon adoption, the project should be complete minus the issue paper, which is being drafted for historical documentation purposes. Gann stated that Schedule D was already adopted by the Blanks (E) Working Group, and the only remaining piece on the reporting side is Schedule BA, which is currently exposed, and the adoption consideration should occur in May. She stated that NAIC staff are also working on a comprehensive training program for the bond project and are hoping to have it completed in 2024.

Bruggeman stated that this is planned to be effective Jan. 1, 2025, with early adoption allowed for residuals only. He stated that those companies that are increasing BACV from the original cost should be very conservative and follow the company's accounting policy.

Kasinow made a motion, seconded by Walker, to re-expose revisions to SSAP No. 21R to incorporate a new measurement method for residual interests. The current revisions incorporate industry's proposal of an "effective yield with a cap" method, as well as a practical expedient to allow the "cost recovery" method. The motion passed unanimously.

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 this agenda item was originally introduced in 2022 and proposed to nullify *INT 03-02: Modification to an Existing Intercompany Pooling Arrangement*, as it is inconsistent with guidance in *SSAP No. 25—Affiliates and Other Related Parti*es on affiliated related party transactions regarding economic and non-economic transactions between related parties. Marcotte stated that interested parties recommend replacing the guidance in INT 03-02 with additional guidance in SSAP No. 25 to add a paragraph which would continue to allow the use of book value for the transfer of assets, only related to existing intercompany pooling arrangements and those modifications. She stated that for *SSAP No. 63—Underwriting Pools*, on intercompany pooling, interested parties also proposed additional changes that would continue to allow intercompany pooling arrangements to be held at book value. Marcotte stated that this will be narrow, specific, and only apply to intercompany pooling, and it should not be analogized to other situations. She stated that NAIC staff recommend the Working Group decide between two options. The first option is to nullify and no longer allow an exception for intercompany pooling. The second option, if the Working Group decides to maintain an exception that allows the transfer of assets at book value for these intercompany pooling agreements, NAIC staff suggest that it be narrow and specific. She stated that NAIC staff recommend nullifying INT 03-02 with both options. Marcotte also stated that some states require a Form D filing to review assets being transferred in addition to the reinsurance agreement, but that NAIC staff did not add extra language related to that.

Bruggeman stated that perhaps, in completing the reviews of Form D for reinsurance, the regulator needs to make a comment on the book value or confirm that any assets instead of cash were reported at book value and or market value. He stated that the Working Group should not override what the state requires from a company. He stated that in honing it down to just intercompany pooling adjustments, or especially adding a new company, it makes sense to do it at book value because otherwise the liabilities coming across are different than what the assets are.

Arfanis, Clark, and Hudson expressed support for the exposure with the additional wording suggested by interested parties. Malm suggested that the Working Group refer this issue to the Risk-Focused Surveillance (E) Working Group to provide notification of the changes.

Arfanis made a motion, seconded by Clark, to expose revisions to SSAP No. 63 and SSAP No. 25 to address transfers of assets when modifying intercompany pooling agreements. In addition, the Working Group exposed its intent to nullify INT 03-02. The motion passed unanimously.

J. Agenda Item 2024-06

Bruggeman directed the Working Group to agenda item 2024-06: Risk Transfer Analysis on Combination Reinsurance Contracts. Marcotte stated that this agenda item resulted from a referral from the Valuation Analysis

(E) Working Group regarding reinsurance risk transfer and reserve credit for a particular form of reinsurance observed by regulators in the life insurance industry. She stated that the referral identified issues on evaluating reinsurance for risk transfer when there is more than one type of reinsurance, and there is an interdependence of the types of reinsurance, including but not limited to an experienced refund based on the aggregate experience. Marcotte stated the Valuation Analysis (E) Working Group noted that these types of reinsurance contracts should be evaluated together and not have separate risk transfer evaluations. She stated that the Working Group also noted concerns with overstated reserve credit due to bifurcated risk transfer analysis and provided an example treaty with coinsurance and a yearly renewable term that had an aggregate experience refund and the inability to independently recapture the separate types of reinsurance. Marcotte stated that the Valuation Analysis (E) Working Group expressed concern that some companies were taking too large of a reserve credit and noted concerns on risk transfer. She stated that NAIC staff recommend exposing new guidance that is derived from *SSAP No. 62R—Property and Casualty Reinsurance, Implementation Guide*. She noted that the source of the guidance in SSAP No. 62R was U.S. generally accepted accounting principles (GAAP), and under GAAP, the proposed guidance is also relevant to long-term contracts.

Bruggeman stated that the Working Group previously made SSAP changes related to reinsurance with the goal of being as consistent as possible across all business types. He stated that in a Form D filing, there cannot be a series of separate transactions and that regulators must look at them together. Bruggeman stated that is what the Valuation Analysis (E) Working Group is attempting to convey.

Clark made a motion, seconded by Walker, to expose revisions to incorporate guidance to *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*, which is consistent with the guidance currently in SSAP No. 62R, Exhibit A Implementation Questions and Answers, question 10. This guidance requires risk transfer to be evaluated in aggregate for contracts with interrelated contracts features, such as experience rating refunds. The exposure also recommends adding a reference in *Appendix A-791—Life and Health Reinsurance Agreements*, paragraph 6, clarifying the yearly renewable term guidance regarding the entirety of the contract. The motion passed unanimously. The Working Group also directed notification of the exposure to VAWG, the Life Actuarial (A) Task Force, and the Reinsurance (E) Task Force.

3. Considered Maintenance Agenda—Pending Listing

Stolte made a motion, seconded by Walker, to expose the following statutory accounting principle (SAP) concepts and clarifications to statutory accounting guidance until May 31, except for agenda item 2024-13, which has a comment deadline of April 19. The motion passed unanimously.

A. Agenda Item 2024-02

Bruggeman directed the Working Group to agenda item 2024-02: ASU 2023-01, Leases (Topic 842), Common Control Arrangements. Stultz stated that this agenda item is a clean-up item to Financial Accounting Standards Board (FASB) Topic 842 which covers two separate issues. He stated that the first issue is an optional practical expedient, specifically for private companies and not for profit companies, that NAIC staff are recommending the Working Group reject. The second issue provides updated guidance for leasehold improvements associated with a lease between entities under common control or within the same holding company group. Stultz stated since assets are going to be held in the same holding company group, it allows companies to factor that in when establishing the life of leasehold improvements. He stated that this issue could impact some companies that have these arrangements and so, in order to keep the statutory accounting guidance for leases as close as possible to U.S. GAAP while also maintaining the operating lease treatment for statutory accounting, NAIC staff recommend the Working Group incorporate this guidance for the leasehold improvements into *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. Agenda Item 2024-03

Bruggeman directed the Working Group to agenda item 2024-03: ASU 2023-08, Accounting for and Disclosure of Crypto Assets. Stultz stated that this agenda item is for accounting guidance and disclosure guidance for crypto assets. He stated that ASU 2023-08 establishes that crypto assets are intangible assets and provides several updates for disclosures. He stated that NAIC staff recommend the Working Group expose the FASB definition of crypto currency into *SSAP No. 20—Nonadmitted Assets* with minor modification to align with statutory accounting language, which would permanently clarify that crypto assets do not meet the definition of an admitted asset for statutory accounting. He also stated that NAIC staff recommend the Working Group maintain existing general interrogatories for crypto assets as that will allow regulators to obtain the cryptocurrency information in situations when companies do hold these assets and, upon adoption of the recommended guidance, nullify *INT 21-01: Accounting for Cryptocurrencies*.

C. Agenda Item 2024-04

Bruggeman directed the Working Group to agenda item *2024-04: Conforming Repurchase Agreements*. Gann stated that this agenda item was drafted in response to a referral from the Life Risk-Based Capital (E) Working Group received in January, which addressed conforming repurchase agreements. She stated that the referral was received pursuant to an American Council of Life Insurers (ACLI) request to modify the treatment of repurchase agreements in the life RBC formula, to converge with the treatment of conforming securities lending programs. Gann stated that NAIC staff reviewed the referral and provided an immediate response. She said in that response, it was identified that accounting and reporting are currently different for securities lending and repurchase agreements. As such, before an RBC factor change is considered, further investigation is needed to assess and determine whether convergence of accounting and reporting guidance for securities lending and repurchase agreements is appropriate for statutory accounting. Gann stated that, also in the referral response, it was identified that this topic would be addressed as an agenda item as soon as possible. She stated that NAIC staff have identified several other areas to recommend for Working Group review, including:

- Schedule DL currently only encompasses securities lending and expanding that to repurchase agreements would be part of the agenda item.
- Blanks reporting revisions would be needed to incorporate the RBC factor change for a new line for conforming repurchase agreements.
- An assessment of conforming provisions on Schedule DL.

Gann stated that NAIC staff are recommending exposure of the agenda item and for the Working Group to direct NAIC staff to work with industry and regulators to review these items during the exposure period.

D. Agenda Item 2024-05

Bruggeman directed the Working Group to agenda item 2024-05: Appendix A-791 Life and Health Reinsurance Agreements. Marcotte stated that the agenda item is a response to the other Valuation Analysis (E) Working Group exposure sent to the Working Group. She stated that the Valuation Analysis (E) Working Group recommended a clarifying edit to Appendix A-791, Section 2.c's question and answer (Q&A) section. Marcotte stated that the Valuation Analysis (E) Working Group recommends deleting one sentence within the Q&A section because the sentence was unnecessary and may create confusion and misinterpretation. She stated that NAIC

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staff recommend exposing the agenda item to remove the sentence and notify the Valuation Analysis (E) Working Group, the Life Actuarial (A) Task Force, and the Reinsurance (E) Task Force of the exposure.

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 this agenda item stemmed from the larger IMR project where NAIC staff identified a need to identify assets that are subject to a funds withheld or a modified coinsurance (modco) arrangement. He stated that the goal of this agenda item is to work towards establishing new reporting for funds withheld assets, and then further including a signifier for modco assets. Stultz stated that NAIC staff are recommending the Working Group add a new part to Schedule S for the Life and Fraternal and Health Annual Statements and Schedule F for Property/Casualty and Title, similar to in structure to the current Schedule DL. He stated that this reporting will allow for the reporting of assets that are subject to funds withheld arrangements as well as a signifier for assets subject to a modco arrangement, with the goal of having it flow cleanly into RBC.

F. Agenda Item 2024-08

Bruggeman directed the Working Group to agenda item 2024-08: Consistency Revisions for Residuals. Gann stated that this agenda item will eliminate all the edits that were done previously and will incorporate the guidance into one location. Gann stated that, with the adoption of SSAP No. 21R which includes the definition of residuals, and all of the accounting and reporting guidance, this agenda item will eliminate the definitions that were included in SSAP No. 26R, *SSAP No. 30R—Unaffiliated Common Stock*, *SSAP No. 32R—Preferred Stock*, SSAP No. 43R, and SSAP No. 48, so that there is a single source for the definition of residuals and all of those SSAPs point to the guidance in SSAP No. 21R. She stated that this will be consistent and will eliminate situations where the guidance may be different in one SSAP versus the other. Gann stated that NAIC staff are recommending exposure of all the edits within the agenda item.

G. Agenda Item 2024-09

Bruggeman directed the Working Group to agenda item 2024-09: SSAP No. 2R – Clarification. Gann stated that this agenda proposes an editorial change to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments*. She stated that NAIC staff were made aware of lingering references that imply that ABS, mortgage loans, or other Schedule BA: Other Long-Term Invested Assets items are permitted to be reported in the scope of SSAP No. 2R. She stated that those items are no longer allowed to be reported as cash equivalents or short-term investments under revisions already adopted. Gann stated that this agenda item has minor edits to remove those lingering references so there is no confusion that everything that goes within the scope as an asset-backed security, mortgage loan, or a Schedule BA item will no longer be included on Schedule DA or Schedule E, Part 2.

H. Agenda Item 2024-10

Bruggeman directed the Working Group to agenda item 2024-10: SSAP No. 56R – Book Value Separate Accounts. Gann stated that this agenda item was drafted 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. Gann stated that SSAP No. 56 anticipates a fair value measurement method, although there is guidance included within supporting fund accumulation contracts (GICs) that allows a book value measurement method. She stated that there is no direct guidance in SSAP No. 56 to identify how transfers should occur from the general account to the separate account. This agenda item is a concept to

recommend the Working Group to direct NAIC staff to work with the industry to develop consistent guidance so that all parties are operating with the same approach for SSAP No 56.

I. 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 this agenda item was drafted in response to ASU 2023-09, which was issued to enhance the transparency and decision usefulness of income tax disclosures. Oden stated that the most significant change made by this is a new tax rate reconciliation disclosure, which would require companies to disclose certain information and the difference between its effective tax rate, and the stated federal, state, and foreign income tax rates. He stated that under ASU 2023-09, public companies would be required to disclose detailed quantitative and qualitative disclosures for the tax rate reconciliation while private companies only must provide certain qualitative disclosures. Additionally, ASU 2023-09 also requires all entities to provide additional disclosures on income tax expense and income taxes paid and removes two existing income tax disclosures from the codification. Oden stated NAIC staff recommend that the Working Group expose revisions to adopt ASU 2023-09 with modification to *SSAP No. 101—Income Taxes*. He stated that NAIC staff specifically recommend the adoption of the private company tax rate reconciliation requirement (qualitative disclosures only), both additional disclosures and income tax expense and income taxes paid, and to remove only one of the two income tax disclosures eliminated by ASU 2023-09.

J. Agenda Item 2024-12

Bruggeman directed the Working Group to agenda item 2024-12: Updates to SSAP No. 27. Oden stated that this agenda item was developed in response to a question received on the annual statement Note 16 table for reporting off balance sheet risk for derivative contracts. He stated that the current table only allows for three types of derivative contracts to be reported and does not have the equivalent of an "other" category for contracts that do not fit within the three existing categories. Oden stated that it was also noted that *SSAP No. 27—Off-Balance Sheet and Credit Risk Disclosures* references *FAS 105—Disclosure of Information about Financial Instruments with Off-Balance-Sheet*, which was superseded prior to the establishment of the FASB codification. Oden stated that NAIC staff recommend that the Working Group expose this agenda item with revisions to SSAP No. 27 to remove reference to FAS 105 as well as to revise the annual statement instructions.

K. Agenda Item 2024-13

Bruggeman directed the Working Group to agenda item 2024-13: Update SSAP No. 107 Disclosures. Marcotte stated that this agenda item was initiated by UnitedHealth Group and recommends updates to the disclosure requirements in *SSAP No. 107—Risk-Sharing Provisions of the Affordable Care Act* to remove disclosures related to transitional reinsurance and the risk corridors programs, which have both expired. She stated that NAIC staff also added additional revisions to remove related parts of the roll forward illustration in Exhibit B of SSAP No. 107 for the expired programs. Marcotte stated that NAIC staff have coordinated with the Blanks (E) Working Group to develop a proposal to have the disclosures removed for the year-end 2024 financial statements.

L. Agenda Item 2024-14EP

Bruggeman directed the Working Group to agenda item 2024-14EP: Accounting Practices and Procedures Manual Editorial. Stultz stated that this agenda item recommends editorial revisions to remove the "Revised" and "R" previously intended to identify a substantively revised SSAP from SSAP titles and SSAP references within the manual. NAIC staff consider the "Revised" and "R" identifiers as no longer useful.

4. Considered Maintenance Agenda – Active Listing

   A. Agenda Item 2023-26

Bruggeman directed the Working Group to agenda item 2023-26: ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative. Oden stated that this ASU is intended to update certain disclosure requirements so that readers can more easily compare entities subject to existing SEC disclosures with entities that were not previously subject to these disclosures. He stated that the revisions consist of changes that would broaden the scope of disclosures to both private and public entities, as well as miscellaneous clarifications or technical corrections to other disclosures. Oden stated NAIC staff recommend the Working Group expose revisions to adopt with modification certain disclosures from ASU 2023-06 within *SSAP No. 15—Debt and Holding Company Obligations* and *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. He stated that NAIC staff recommend rejection of the weighted average interest rate disclosure due to concerns about the complexity of the calculation. Oden stated that the Working Group is also requesting input on whether the accounting policy disclosure for cash flows associated with derivatives, Accounting Standards Codification (ASC) 230-10-50-9, would provide useful information to regulators.

Sherman made a motion, seconded by Weaver, to expose revisions to adopt, with modification, certain disclosures from ASU 2023-06 for statutory accounting within SSAP No. 15 and SSAP No. 103. The Working Group also requested input from regulators and interested parties on whether the derivative cash flow accounting policy disclosure, described in ASC 230-10-50-9, would provide useful information to regulators. The motion passed unanimously.

5. Discussed Other Matters

   A. Discussion of Collateral Loan Reporting

Clark addressed questions received on the reporting of collateral loans for year-end 2024, noting that all collateral loans shall be reported in the collateral loan reporting line on Schedule BA. He noted that it has been identified that some entities have been reporting collateral loans within the non-registered private equity fund reporting lines to allow RBC to be determined based on the type of underlying collateral. Although that reporting line will not be deleted until 2025, he noted that it would be erroneous for companies to continue reporting collateral loans within that line for 2024 unless they have a permitted practice, as it is now explicit that reporting line should not be used for those investments.

   B. Review of U.S. GAAP Exposures

Stultz identified two GAAP items currently exposed by the FASB. He stated that comments are not recommended at this time and that NAIC staff recommend review of the final issued ASUs under the SAP Maintenance Process as detailed in *Appendix F—Policy Statements*.

   C. Update on the IMR Ad Hoc Subgroup

Gann stated that the IMR Ad Hoc Subgroup has met regularly since its first meeting in October 2023. She stated that discussions have focused on how IMR affects actuarial calculations, the definition and purpose of IMR, the impact of derivatives on IMR, and how reinsurance impacts IMR. Gann stated that the IMR Ad Hoc Subgroup has

meetings scheduled through the 2024 Summer National Meeting. She stated that key elements expected as part of the future discussions will be to provide more detail on the derivatives impacting IMR. These discussions are expected to include concepts for how companies determine effectiveness for these "economically effective" derivatives that do not qualify as "accounting effective" under *SSAP No. 86—Derivatives* as well as the concepts reporting entities have used in determining the amortization timeframe for IMR generated from derivative gains/losses.

Gann stated that NAIC staff will be compiling information on the reported 2023 year-end IMR in the statutory financial statements, including the extent that insurance reporting entities have moved to a net negative (disallowed) IMR position, and the extent (if any) companies have exceeded the 10% admittance threshold. She stated that NAIC staff will share information on the reported financial statement info with regulators as soon as possible.

D. <u>IAIS Audit and Accounting Working Group (AAWG Update)</u>

Gann stated that she and Maggie Chang (NAIC) have been recently involved in monitoring International Association of Insurance Supervisors (IAIS) discussions, including the Climate Risk Disclosure Subgroup. Gann stated that there have been many meetings and discussions towards the development of an IAIS paper to provide guidance for supervision of climate-related risks and disclosure. She stated that recent discussions have focused on linking the paper to disclosure requirements in Insurance Core Principle (ICP) 9 (Supervisory Review and Reporting) and ICP 20 (Public Disclosure). She stated that topics including issues with data quality, data validation, metrics, and U.S. stakeholder concerns in public reporting have been highlighted as part of the discussions. Gann stated that discussions have also included the Accounting and Auditing Working Group (AAWG), which has met recently to discuss items including the International Accounting Standards Board (IASB) exposure on proposed amendments to Financial Instruments with Characteristics of Equity, information on the Climate Risk Disclosure Subgroup, and discussions on the International Auditing and Assurance Standards Board (IAASB) exposure draft ISA 240, as well as the Auditor's Responsibilities Related to Fraud in an Audit of Financial Statements.

Gann stated that this update is intended to inform the Statutory Accounting Principles (E) Working Group regulators and interested parties of these ongoing NAIC staff actions to monitor and participate in the IAIS AAWG. Any questions on discussions or if additional information is requested, please contact NAIC staff.

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

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Hearing/01 - SAPWG Minutes 3-16-2024 TPR.docx

Draft: 5/22/24

Statutory Accounting Principles (E) Working Group
Virtual Meeting
May 15, 2024

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met May 15, 2024. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Sheila Travis and Richard Russell (AL); Kim Hudson (CA); Michael Estabrook (CT); Rylynn Brown (DE); Cindy Andersen (IL); Melissa Gibson and Stewart Guerin (LA); Judy Weaver and Steve Mayhew (MI); Doug Bartlett (NH); Bob Kasinow (NY); Jamie Walker (TX); Jennifer Blizzard and Doug Stolte (VA); and Amy Malm (WI).

1. Discussed Comments on Exposed Items

The Working Group met to review comments received (Attachment 1) on items exposed during its Feb. 20 meeting and the Spring National Meeting.

A. Agenda Item 2023-16

Bruggeman directed the Working Group to agenda item 2023-16: Schedule BA Reporting Categories. Julie Gann (NAIC) stated that after considering comments on the exposed blanks proposal 2023-12BWG, the Working Group exposed this agenda item at its Feb. 20 meeting and directed a modified Working Group sponsored blanks proposal to be shared with the Blanks (E) Working Group for consideration. The modified proposal was exposed for a public comment period that ended April 23, with a follow-up meeting scheduled for May 23 to consider adoption. She stated that this agenda item does not result in statutory accounting revisions.

Gann stated that interested parties have submitted comments to the Blanks (E) Working Group on the exposure, including proposing to remove the maturity date column from Schedule BA. She stated that NAIC staff oppose this change and instead propose to clarify what should be captured in that column. Gann stated that NAIC staff recommend the Working Group adopt this agenda item and sponsor modifications to the Blanks (E) Working Group to be considered part of the package for adoption on May 23. She reiterated that these revisions related to Schedule BA would be effective Jan. 1, 2025, to incorporate the non-bond risk security reporting lines related to the previously adopted bond project.

Tip Tipton (Thrivent), representing interested parties, stated that interested parties have no concerns over the additional wording or date.

Hudson made a motion, seconded by Walker, to adopt the agenda item and support the adoption of the modified blanks proposal 2023-12BWG with the additional modifications discussed (Attachment 2). The motion passed unanimously.

B. Agenda Item 2023-28

Bruggeman directed the Working Group to agenda item 2023-28: Collateral Loan Reporting. Gann stated that on Feb. 20, the Working Group adopted a new collateral loan disclosure for year-end 2024 and exposed proposed reporting lines to Schedule BA for collateral loans. She stated that the Working Group also exposed proposed reporting lines to collect more granular data on Schedule BA. Gann stated that the Working Group also requested

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feedback from industry regarding how the collateral loans lines should map through for risk-based capital (RBC) purposes.

Gann stated that several interested parties' comments were received with regard to those reporting lines, with the most relevant comment having to do with the collateral loan lines with underlying characteristics of mortgage loans. Gann stated that some collateral loans with underlying characteristics of mortgage loans or backed by mortgage loans were not being captured in the collateral loan line but instead in the non-registered private fund line, which is being eliminated. She stated that interested parties provided comments suggesting a temporary change to the life RBC calculation that would allow collateral loans, with mortgage loans as collateral, to still be reported on the collateral loan line and allow them to map through with this RBC treatment for year-end until the more granular reporting lines of collateral loans are added.

Gann stated that a proposal was sent to the Life Risk-Based Capital (E) Working Group, incorporating this change for RBC purposes. She stated that NAIC staff are recommending two actions: 1) for the Working Group to direct NAIC staff to prepare a memorandum to the Blanks (E) Working Group to incorporate a change to the instructions and allow the collateral loans backed by mortgage loans to flow through as other invested assets with underlying characteristics; and 2) to direct NAIC staff to move forward with sponsoring a blanks proposal for the reporting of collateral loans, using the collateral loan lines that were shown in the agenda item and to work with state insurance regulators and interested parties in the interim regarding how these would flow through to RBC.

Donna Kiernan (MetLife) asked about the time allowance for the Life Risk-Based Capital (E) Working Group to make a decision on this. She also asked whether the existing Schedule BA would be available until the new format is adopted for 2026. Gann stated that the Life Risk-Based Capital (E) Working Group does not currently have a meeting scheduled before the Summer National Meeting. She also stated that the current Schedule BA will be available until the new format is adopted.

Tipton stated that interested parties are supportive of the first item. He stated that interested parties are waiting for the Blanks (E) Working Group discussion of the second item and will respond to that exposure.

Bruggeman directed NAIC staff to prepare a memorandum to the Blanks (E) Working Group. He also 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 interested parties' comments.

C. Agenda Item 2024-13

Bruggeman directed the Working Group to agenda item 2024-13: Update SSAP No. 107 Disclosures. Robin Marcotte (NAIC) stated that at the Spring National Meeting, the Working Group exposed revisions to *Statement of Statutory Accounting Principle (SSAP) No. 107—Risk-Sharing Provisions of the Affordable Care Act*. She stated that the transitional reinsurance program and the risk corridors program have both expired, and the related disclosures are proposed for deletion. Marcotte stated that the roll forward illustration in Exhibit B was also proposed to be revised to delete the sections related to the transitional reinsurance program and the risk corridors program. She stated that blanks proposal 2024-10BWG was concurrently exposed to allow for the disclosures to be considered for removal beginning with the year-end 2024 financial statements.

Marcotte stated that the comments from interested parties support the exposed revisions and recommend additional deletion of SSAP No. 107, paragraph 62, which would also impact two related items in blanks proposal 2024-10BWG. She stated support for these revisions because SSAP No. 107, paragraph 62 was originally related to the risk corridors program. She stated that NAIC staff recommend that the Working Group adopt the exposed

revisions with modifications to incorporate interested parties' comments effective for year-end 2024. Marcotte stated that the Blanks (E) Working Group received the same comments and received comments regarding additional edits to the Supplemental Health Care Exhibit. She stated that when NAIC staff analyzed the data, there was still information being reported on those lines, possibly erroneously, and that NAIC staff recommend that those edits be addressed by a separate blanks proposal to allow for additional investigation prior to being deleted. This would still delete the disclosures for SSAP No. 107 for year-end 2024.

Tipton stated that interested parties are supportive of moving forward with this agenda item and the changes.

Hudson made a motion, seconded by Malm, to expose revisions with modifications that incorporate interested parties' comments effective year-end 2024. The motion passed unanimously.

2. Exposed the Issue Paper Related to the Principle-Based Bond Project

Gann stated that agenda item 2019-21 is the issue paper related to the principle-based bond project. She stated that the issue paper documents the historical discussions and conclusions and has been previously exposed. She stated that issue papers are historical documents that detail background and discussions when a new statutory accounting principle (SAP) concept is adopted. She stated that issue papers are not authoritative and are strictly for historical reference. Gann stated that NAIC staff recommend exposure of the issue paper with a public comment period ending June 21.

Clark made a motion, seconded by Weaver, to expose the *Statutory Issue Paper No. 1XX—Principles-Based Bond Definition* for a public comment period ending June 21. The motion passed unanimously.

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

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Hearing/02 - May 15, 2024 Meeting Minutes.docx

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

Issue: ASU 2023-01, Leases (Topic 842), Common Control Arrangements

Check (applicable entity):

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

Description of Issue: In March 2023, the Financial Accounting Standards Board (FASB) issued *Accounting Standard Update (ASU) 2023-01, Leases (Topic 842), Common Control Arrangements*. This ASU was issued as part of FASB's post-implementation review to address issues that have been found during the implementation of the new lease guidance from *ASU 2016-02, Leases (Topic 842)*. As a reminder, ASU 2016-02 was rejected for statutory accounting and the operating lease treatment was retained.

ASU 2023-01 focuses on two issues that are 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 to use the written terms and conditions of a common control arrangement to determine 1) whether a lease exists and, if so, 2) the classification of and accounting for that lease. The practical expedient may be applied on an arrangement-by-arrangement basis. If no written terms and conditions exist (including in situations in which an entity does not document existing unwritten terms and conditions in writing upon transition to the practical expedient), an entity is prohibited from applying the practical expedient and must evaluate the enforceable terms and conditions to apply Topic 842. The new U.S. GAAP guidance for this issue is only applicable to non-public entities.

The second issue involves the accounting for leasehold improvements associated with a lease between entities under common control. U.S. GAAP guidance for life of leasehold improvements prior to this update generally agrees to statutory accounting. It was noted in the ASU that private company stakeholders were concerned that amortizing leasehold improvements associated with arrangements between entities under common control determined to be leases (hereinafter referred to as common control leases) over a period shorter than the expected useful life of the leasehold improvements might result in financial reporting that do not faithfully represent the economics of those leasehold improvements, particularly in common control leases with short lease terms. While this issue originally came from private company stakeholder comments, the guidance for this issue is applicable for all lessees that are party to a lease between entities under common control in which there are leasehold improvements.

Existing Authoritative Literature:
The ASUs related to Topic 842 have previously been rejected in *SSAP No. 22R—Leases*. Guidance for leasehold improvements is included in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Heath Care Facilities*, and guidance for related parties is included in *SSAP No. 25—Affiliates and Other Related Parties*.

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

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

Convergence with International Financial Reporting Standards (IFRS): ASC Topic 842 was the result of a joint project between FASB and the International Accounting Standards Board.

Staff Recommendation:
NAIC staff recommends the Working Group move this item to the active listing of the maintenance agenda categorized as a SAP clarification and expose revisions to 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 Heath Care Facilities*, as illustrated in the Form A. The proposed revisions reject the practical expedient for private companies and not-for-profit entities but recommend adoption of the leasehold improvement guidance from the ASU, with modification to the language to align with existing guidance in SSAP No. 19 and SSAP No. 73.

SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter of their estimated useful life or the remaining lease term as defined in SSAP No. 22R. Leasehold improvements associated with a lease between entities under common control shall be amortized over the useful life of those improvements to the holding company group as long as the lessee controls the use of the underlying asset through a lease. If the lessor obtained the right to control the use of the underlying asset through a lease with another entity not within the same holding company group, the amortization period shall not exceed the amortization period of the holding company group. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired. The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity lessee. Such improvements related to the functionality of health care delivery assets shall follow the accounting, reporting and impairment guidance in *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities*, and an exception to the application of this guidance to leasehold improvements necessary for the functionality of health care delivery assets is included in SSAP No. 73. If leased real estate is acquired, recognition of the real estate shall follow the provisions in *SSAP No. 40R—Real Estate Investments*.

20. This statement adopts, with modification, *ASU 2023-01, Leases (Topic 842), Common Control Arrangements*. The practical expedient for private companies and not-for-profit entities that are not conduit bond obligors to use the written terms and conditions of a common control arrangement is rejected for statutory accounting. The guidance for lessees that are a party to a lease between entities under common control in which there are leasehold improvements is adopted, with modification to align with existing statutory guidance.

SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities

9. Furniture, medical equipment and fixtures, and leasehold improvements shall be depreciated over their estimated useful lives but for a period not to exceed three years, except for a leasehold improvement which shall be amortized against net income over the shorter of its estimated useful life or the remaining lease term, using methods detailed in SSAP No. 19. Leasehold improvements associated with a lease between entities under common control shall be amortized over the useful life of those improvements to the holding company group as long as the lessee controls the use of the underlying asset through a lease. If the lessor obtained the right to control the use of the underlying asset through a lease with another entity not within the same holding company group, the amortization period shall not exceed the amortization period of the holding company group. The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity lessee but excludes situations where the real estate lease agreement has a purchase option that contains language that allows leasehold improvements necessary for the functionality of specific health care delivery assets to be excluded from the purchase cost

of the real estate. Upon acquisition, such leasehold improvements necessary for the functionality of healthcare delivery assets shall follow the guidance for health care delivery assets in this statement. If leased real estate is acquired, recognition of the real estate shall follow the provisions in *SSAP No. 40R—Real Estate Investments*.

13. This statement adopts, with modification, *ASU 2023-01, Leases (Topic 842), Common Control Arrangements*. The practical expedient for private companies and not-for-profit entities that are not conduit bond obligors to use the written terms and conditions of a common control arrangement is rejected for statutory accounting. The guidance for lessees that are a party to a lease between entities under common control in which there are leasehold improvements is adopted, with modification to align with existing statutory guidance.

Staff Review Completed by: Jake Stultz, NAIC Staff – February 2024

Status:
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed revisions to adopt, with modification, *ASU 2023-01, Leases (Topic 842), Common Control Arrangements* in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Heath Care Facilities*, as illustrated above. The proposed revisions reject the practical expedient for private companies and not-for-profit entities but recommend adoption of the leasehold improvement guidance from the ASU, with modification to the language to align with existing guidance in SSAP No. 19 and SSAP No. 73.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Hearing/03 - 24-02 - ASU 2023-01 Leases.docx

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

Issue: ASU 2023-08, Accounting for and Disclosure of Crypto Assets

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 Standard Update (ASU) 2023-08, Intangibles—Goodwill and Other—Crypto Assets (Subtopic 350-60), Accounting for and Disclosure of Crypto Assets*. This ASU establishes the accounting and reporting for crypto assets, which are defined in U.S. GAAP as assets that:

1. Meet the definition of intangible assets as defined in the Codification
2. Do not provide the asset holder with enforceable rights to or claims on underlying goods, services, or other assets
3. Are created or reside on a distributed ledger based on blockchain or similar technology
4. Are secured through cryptography
5. Are fungible
6. Are not created or issued by the reporting entity or its related parties.

ASU 2023-08 also clarified the disclosure of crypto assets in the financial statements, which note that crypto assets are to be reported at fair value, are reported separately from the other intangible assets, describe how they are to be disclosed in the income statement and statement of cash flows, and includes a rollforward of activity and balances on an annual basis.

As background, on May 20, 2021, the Working Group adopted *Interpretation (INT) 21-01: Accounting for Cryptocurrencies*, which established statutory accounting for crypto assets. At that time, NAIC staff had received several questions on the proper treatment of cryptocurrencies, so with the absence of U.S. GAAP guidance, the Working Group adopted INT 21-01. The INT established that directly held cryptocurrencies have not been identified in the *Accounting Practices and Procedures Manual* (AP&P Manual) as an admitted asset, and do not meet the definition of any admitted asset that is defined in the AP&P Manual. Accordingly, by default they are a nonadmitted asset per *SSAP No. 4—Assets and Nonadmitted Assets*, paragraph 3, as they are not specifically identified in the AP&P Manual as an admitted asset. Additionally, a disclosure for crypto assets was added to the general interrogatories of the Annual Statement blanks and instructions.

This agenda item intends to codify the guidance that was adopted in INT 21-01, and formally establish that crypto assets are nonadmitted assets for statutory accounting.

Existing Authoritative Literature:
Accounting for cryptocurrencies is currently addressed by *INT 21-01 Accounting for Cryptocurrencies*, and the Annual Statement blanks included a disclosure in the general interrogatories.

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 to adopt, with modification ASU 2023-08 for statutory accounting. The agenda item proposes to adopt the definition of crypto assets from the ASU but establishes that directly held crypto assets are nonadmitted assets for statutory accounting. The recommendation is to add guidance to *SSAP No. 20—Nonadmitted Assets* that clarifies that directly-held crypto assets are nonadmitted assets for statutory accounting and to define crypto assets using the definition from ASU 2023-08. This agenda item does not intend to modify the general interrogatory disclosures that had previously been added to the Annual Statement blanks and instructions. Additionally, NAIC staff recommends that the Working Group expose the intent to nullify *INT 21-01, Accounting for Cryptocurrencies*, upon the adoption of this agenda item. The revisions to SSAP No. 20 are illustrated below.

SSAP No 20—Nonadmitted Assets

Paragraph 4:

f. Crypto assets are defined as intangible digital assets in which transactions are created or reside on a distributed ledger based on blockchain or similar technology and are verified with records maintained by a decentralized system using cryptography, rather than by a centralized authority, and do not provide the asset holder with enforceable rights to or claims on underlying goods, services, or other assets. Directly held crypto assets do not meet the definition of cash in *SSAP No. 2R—Cash, Cash Equivalents, Drafts, and Short-Term Investments*, and due to the volatile nature of the assets and liquidity issues, the assets shall not be considered available to satisfy policyholder obligations.

5. This statement adopts with modification *FASB Emerging Issues Task Force No. 08-7: Accounting for Defensive Intangible Assets* to nonadmit defensible intangible assets. This statement rejects Chapters 3A and 11 of *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins*. This statement adopts, with modification, *ASU 2023-08, Intangibles—Goodwill and Other—Crypto Assets (Subtopic 350-60), Accounting for and Disclosure of Crypto Assets*, which adopts the definition of crypto assets from the ASU and establishes that directly held crypto assets are nonadmitted assets for statutory accounting.

Staff Review Completed by: Jake Stultz, NAIC Staff—February 2024

Status:
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed revisions to adopt, with modification *ASU 2023-08, Accounting for and Disclosure of Crypto Assets* for statutory accounting. The revisions propose to adopt the definition of crypto assets from the ASU but establishes within *SSAP No. 20—Nonadmitted Assets* that directly held crypto assets are nonadmitted assets for statutory accounting. Additionally, the exposure includes the intent to nullify *INT 21-01, Accounting for Cryptocurrencies*. This agenda item does not intend to modify the general interrogatory disclosures that had previously been added to the Annual Statement blanks and instructions.

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

Issue: A-791 Paragraph 2.c.

Check (applicable entity):

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

Description of Issue:
The Valuation Analysis (E) Working Group sent a referral to the Statutory Accounting Principles (E) Working Group which recommends making a clarifying edit to A-791, Life and Health Reinsurance Agreements, Section 2.c's, 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." **(See Existing Authoritative Literature)** The referral notes that:

> First, this sentence is unnecessary, as it is an aside in a discussion about group term life. More importantly, this statement is being misinterpreted as supporting the use of Commissioner's Standard Ordinary (CSO) rates as a "safe harbor," at or below which YRT rates would be automatically considered not to be excessive.
>
> The 791 section 2c QA guidance does not provide a safe harbor based on CSO. It indicates that if the YRT reinsurance premium is higher than the proportionate underlying direct premium for the risk reinsured, then the reinsurance premium is excessive. VAWG observes that the prudent mortality under the *Valuation Manual*, Section 20: Requirements for Principle-Based Reserves for Life Products (VM-20), may appropriately be either higher or lower than the CSO rate depending on the facts and circumstances.

Existing Authoritative Literature:

A-791, Life and Health Reinsurance Agreements, paragraph 2c:

2. No insurer shall, for reinsurance ceded, reduce any liability or establish any asset in any statutory financial statement if, by the terms of the reinsurance agreement, in substance or effect, any of the following conditions exist:

   c. The ceding insurer is required to reimburse the reinsurer for negative experience under the reinsurance agreement, except that neither offsetting experience refunds against current and prior years' losses under the agreement nor payment by the ceding insurer of an amount equal to the current and prior years' losses under the agreement upon voluntary termination of in force reinsurance by the ceding insurer shall be considered such a reimbursement to the reinsurer for negative experience. Voluntary termination does not include situations where termination occurs because of unreasonable provisions which allow the reinsurer to reduce its risk under the agreement. An example of such a provision is the right of the reinsurer to increase reinsurance premiums or risk and expense charges to excessive levels forcing the ceding company to prematurely terminate the reinsurance treaty;

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A-791, Life and Health Reinsurance Agreements, paragraph 2c's, Question and Answer (Underlining added for Emphasis):

> **Q – If group term life business is reinsured under a YRT reinsurance agreement (which includes risk-limiting features such as with an experience refund provision which offsets refunds against current and/or prior years' losses (i.e., a "loss carryforward" provision), under what circumstances would any provisions of the reinsurance agreement be considered "unreasonable provisions which allow the reinsurer to reduce its risk under the agreement" thereby violating subsection 2.c.?**
>
> **A** – 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. So long as the reinsurer cannot charge premiums in excess of the premium received by the ceding insurer under the provisions of the YRT reinsurance agreement, such provisions would not be considered unreasonable. Any provision in the YRT reinsurance agreement which allows the reinsurer to charge reinsurance premiums in excess of the proportionate premium received by the ceding insurer would be considered unreasonable. The revisions to this QA regarding group term life yearly renewable term agreements is effective for contracts in effect as of January 1, 2021.

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): On January 10, 2024, the Statutory Accounting Principles (E) Working Group received the referral from the Valuation Analysis (E) Working Group and directed NAIC staff to prepare an agenda item for future Working Group discussion.

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

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

Staff Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing of the maintenance agenda, categorized as a SAP clarification, and expose revisions to remove the first sentence of the A-791, paragraph 2c's Question and Answer as illustrated below. In addition, the Working Group should notify the Valuation Analysis (E) Working Group, the Life Actuarial (A) Task Force and the Reinsurance (E) Task Force of the exposure.

As noted by the referral, the sentence is not necessary as it is more of an introductory aside. If it is causing confusion and misapplication, as noted by the VAWG, it is better to remove the sentence.

Proposed revision to A-791, Life and Health Reinsurance Agreements, paragraph 2c:

2. No insurer shall, for reinsurance ceded, reduce any liability or establish any asset in any statutory financial statement if, by the terms of the reinsurance agreement, in substance or effect, any of the following conditions exist:

   c. The ceding insurer is required to reimburse the reinsurer for negative experience under the reinsurance agreement, except that neither offsetting experience refunds against current and prior years' losses under the agreement nor payment by the ceding insurer of an amount equal to the current and prior years' losses under the agreement upon voluntary termination of in force reinsurance by the ceding insurer shall be considered such a reimbursement to the reinsurer for negative experience. Voluntary termination does not include situations where termination occurs because of unreasonable provisions which allow the reinsurer to reduce its risk under the agreement. An example of such a provision is the right of the reinsurer to increase reinsurance premiums or risk and expense charges to excessive levels forcing the ceding company to prematurely terminate the reinsurance treaty;

A-791, Life and Health Reinsurance Agreements, paragraph 2c's, Question and Answer):

> **Q – If group term life business is reinsured under a YRT reinsurance agreement (which includes risk-limiting features such as with an experience refund provision which offsets refunds against current and/or prior years' losses (i.e., a "loss carryforward" provision), under what circumstances would any provisions of the reinsurance agreement be considered "unreasonable provisions which allow the reinsurer to reduce its risk under the agreement" thereby violating subsection 2.c.?**
>
> **A** – ~~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.~~ So long as the reinsurer cannot charge premiums in excess of the premium received by the ceding insurer under the provisions of the YRT reinsurance agreement, such provisions would not be considered unreasonable. Any provision in the YRT reinsurance agreement which allows the reinsurer to charge reinsurance premiums in excess of the proportionate premium received by the ceding insurer would be considered unreasonable. The revisions to this QA regarding group term life yearly renewable term agreements ~~is~~ are effective for contracts in effect as of January 1, 2021.

Staff Review Completed by: Robin Marcotte – NAIC Staff, February 2024

Status:
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed the above illustrated revisions to remove the first sentence of *Appendix A-791—Life and Health Reinsurance Agreements* (A-791), paragraph 2c's Question and Answer. In addition, the Working Group directed NAIC staff to notify the Valuation Analysis (E) Working Group, the Life Actuarial (A) Task Force and the Reinsurance (E) Task Force of the exposure.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/03-16-24 Spring National Meeting/Exposures/24-05 - A791 par 2c.docx

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

Issue: Consistency Revisions for Residuals

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 incorporate consistency revisions for residual tranches and residual security interests. Over the last couple of years, a variety of 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 discussion that accompanied these revisions have noted that conforming revisions would be needed coinciding with the effective date of the principles-based bond definition guidance to have consistency of guidance location, terminology and definitions.

With the revisions to *SSAP No. 21R—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. 21R and be reported on Schedule BA.

To ensure consistency in definitions and guidance, this agenda item proposes to centralize the guidance in SSAP No. 21R and use a consistent approach in the other investment SSAPs to exclude residuals from scope and direct to SSAP No. 21R.

Existing Authoritative Literature: - Key references **bolded** for emphasis.

- ***SSAP No. 21R—Other Admitted Assets (Effective 2025) – Adopted March 16, 2024***

  Residual Tranches or Interests/Loss Positions

  28. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. The collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). Once those contractual requirements are met, the remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.

  29. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these

factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined. Additionally, it would be expected that the equity position in an ABS Issuer, as defined in SSAP 26R, would be classified as a residual tranche.

a. Residuals often do not have contractual principal or interest.

b. Residuals may be structured with terms that appear to be stated principal or interest but that lack substance, and result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.

c. Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide subordination to support the credit quality of the typically rated debt tranches.

d. Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after debt tranche holders receive contractual principal and interest payments.

e. Frequently, there are contractual triggers that divert cash flows from the residual holders to the debt tranches if the structure becomes stressed.

30. Residual tranches or interests do not qualify for bond reporting. Residuals shall follow the accounting and admittance guidance within this statement and are required to be reported on Schedule BA: Other Long-Term Invested Assets.

31. As stated in paragraph 22, residuals are permitted to be admitted assets if debt securities from the same structure qualify (or would qualify) as admitted assets. If the debt security from a structure is (or would be) nonadmitted due to the requirements under paragraph 22, then any residual interests or first loss positions held from the same structure also do not qualify as admitted assets and shall be reported as nonadmitted assets.

32. Residuals shall be initially reported at cost, or allocated cost (using proportional fair values if acquired along with debt tranches from the securitization). Subsequent to initial acquisition, residuals shall be reported at either 1) the lower of amortized cost or fair value under the Allowable Earned Yield method detailed in paragraphs 33-34, with temporary reductions in fair value reported as an unrealized loss, or 2) at the calculated practical expedient method detailed in paragraph 35.

33. For purposes of this statement for residuals only, amortized cost shall be defined as the cost to acquire the residual reduced for distributions in excess of the Allowable Earned Yield and other-then-temporary impairments (OTTI). The Allowable Earned Yield shall be established at acquisition as the discount rate that equates the initial best estimate of the residual's cash flows to its acquisition cost. The Allowable Earned Yield is not to be updated after acquisition.

34. Interest income shall be recorded under the effective yield method using the Allowable Earned Yield, capped by the amount of cash distributions received. To the extent that the Allowable Earned Yield, applied to the current amortized cost, exceeds the cash distributions received, such unrecognized interest income may be carried forward to future periods to be recognized when sufficient cash distributions are received. To the extent cash distributions exceed the Allowable Earned Yield (including any unrecognized interest carried forward), the amortized cost shall be reduced by the excess. As a result of this method, the amortized cost shall not be increased unless there is a subsequent investment (i.e., an additional purchase with additional consideration remitted).

35. Reporting entities may elect a practical expedient in lieu of the Allowable Earned Yield detailed in paragraphs 33-34 and calculate Book/Adjusted Carrying Value (BACV) such that all distributions received are treated as a reduction in BACV. With this approach, the reporting entity will not recognize any interest or investment income until the residual tranche has a BACV of zero. Once the residual has a zero BACV, distributions received shall be recognized as interest income.

a. Reporting entities applying the practical expedient shall continue to report residuals on Schedule BA, including those with a zero BACV. Any subsequent distributions shall be reported as interest income until the structure matures/terminates, is unwound, or no longer meets the definition of a residual.

b. Reporting entities are required to apply the practical expedient to all residuals held.

c. Reporting entities that wish to discontinue use of the practical expedient approach and move towards the Allowable Earned Yield method are required to specify and disclose an explicit transition date, and only apply the Allowable Earned Yield method to residuals acquired after that date. Residuals held prior to the disclosed accounting method transition date shall continue to follow the practical expedient until those residuals mature/terminate or are unwound.

36. Residuals shall be assessed for other-than-temporary impairment (OTTI) on an ongoing basis, with required assessment anytime that fair value is less than the reported value.

a. For residuals measured using the Allowable Earned Yield method, as detailed in paragraphs 33-34, an OTTI shall be considered to have occurred if the present value of expected cash flows discounted by the Allowable Earned Yield, is less than amortized cost. Upon identification of an OTTI, the reporting entity shall recognize a realized loss equal to the difference between the amortized cost and the present value of expected cash flows, with the present value of expected cash flows becoming the new amortized cost to which the Allowable Earned Yield is applied. After the OTTI is recognized, distributions received from the residual shall continue to be recorded in accordance with paragraphs 33-34. Subsequent recoveries in cash flows shall not result in increases to the amortized cost.

b. For residuals measured under the practical expedient, as detailed in paragraph 35, an OTTI shall be considered to have occurred if the fair value of the residual is less than the BACV. The reporting entity shall recognize a realized loss equal to the difference between the fair value and the BACV, with the fair value becoming the new BACV. After the OTTI is recognized, distributions received from the residual shall continue to be recorded in accordance with paragraph 35. Subsequent recoveries in cash flows shall not result in increases to the BACV.

37. Residuals recognized on Schedule BA as of December 31, 2024, and accounted for under a different SSAP, shall follow the following measurement transition guidance as of January 1, 2025:

a. Reporting entity shall determine whether they will follow the Allowable Earned Yield method detailed in paragraphs 33-34, or the practical expedient detailed in paragraph 35, for all residuals.

b. Residuals previously accounted for under SSAP No. 26R or SSAP No. 43R shall prospectively apply the Allowable Earned Yield measurement method elected under this Statement using the amortized cost as of December 31, 2024 as the starting point in the calculation. Residuals that will follow the practical expedient shall be recognized on January 1, 2025 at the lower of amortized cost or fair value as of December 31, 2024, realizing any unrealized loss existing at that date.

c. Residuals reported under the equity method or fair value as of December 31, 2024 (as they were previously captured in scope of SSAP No. 30R, 32R or 48) with unrealized gains or losses recognized, shall recognize any unrealized position as realized, with the reported value as of December 31, 2024 becoming the January 1, 2025 cost basis for subsequent measurement under this statement.

Effective Date and Transition

40. 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.

41. Revisions adopted March 16, 2024, to add guidance for "Debt Securities That Do Not Qualify as Bonds" and for "Residual Tranches or Interests/Loss Positions" are initially effective Jan. 1, 2025, to correspond with the effective date of the principles-based bond definition. The guidance for residual tranches is permitted for early application. Reporting entities that apply this guidance in 2024 shall continue to follow the transition guidance in paragraph 37 using the modified dates that correspond to the reporting entity's application date.

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

4. This statement excludes:

a. Mortgage loans and other real estate lending activities made in the ordinary course of business. These investments are addressed in *SSAP No. 37—Mortgage Loans* and *SSAP No. 39—Reverse Mortgages*.

b. Investments that qualify within the principles-based definition as an ABS. These investments shall follow the guidance in *SSAP No. 43R—Asset-Backed Securities*.

c. Securities that provide varying principal or interest based on underlying equity appreciation or depreciation, an equity-based derivative, real estate or other non-debt variable, as described in paragraph 6.d.

d. Securities that do not qualify as bonds pursuant to the principles-based bond definition, including first loss positions that lack contractual payments or substantive credit enhancement. These investments shall follow the appropriate guidance in *SSAP No. 21R— Other Admitted Assets*.

e. Replication (synthetic asset) transactions 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.

f. Investments that are captured specifically within other SSAPs. For example, reporting entity acquired structured settlements are captured in scope of *SSAP No. 21R—Other Admitted Assets*, held surplus notes are captured in scope of *SSAP No. 41R—Surplus Notes* and working capital finance investments are captured in scope of *SSAP No. 105—Working Capital Finance Investments*. Investments captured in scope of other SSAPs are subject to the measurement and admittance provisions of those SSAPs. Furthermore, investments that have specific reporting lines on dedicated schedules (such as with both surplus notes and WCFI) shall be reported on their dedicated lines.

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.

a. 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 required to be in a different economic position is specific to each transaction; determined at origination; and

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refers to the level of credit enhancement a market participant (i.e., knowledgeable investor transacting at arm's length) would conclude is substantive.

b. The first loss position may be issued as part of a securitization in the form of a debt or equity interest, or it may be retained by the sponsor and not issued as part of the securitization. If the first loss position (or a more senior position(s), if the first loss position(s) lacks contractual payments along with a substantive credit enhancement) is issued as part of the securitization, and does not have contractual principal and interest payments along with substantive credit enhancement and is held by a reporting entity, the investment(s) does not qualify for reporting as a bond and shall be reported on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value consistent with the treatment for residuals. (These items are further addressed in *SSAP No. 21R—Other Admitted Assets*.)

- ***SSAP No. 30R—Unaffiliated Common Stock***

1. This statement establishes statutory accounting principles for common stocks.

2. Investments in common stock of subsidiaries, controlled or affiliated entities (investments in affiliates) are not within the scope of this statement. They are addressed in SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities.

3. Investments in the form of common stock that are in substance residual interests or a residual security tranche, as defined in SSAP No. 43R or SSAP No. 48, shall be reported on Schedule BA: Other Long-Term Assets in the dedicated reporting lines for residuals.

- ***SSAP No. 32R—Preferred Stock***

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

2. Investments in preferred stock of entities captured in *SSAP No. 97—Investments in Subsidiaries, Controlled or Affiliated Entities* or *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* as well as preferred stock interests of certified capital companies per *INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company* (CAPCO) are included within the scope of this statement. The requirement to file investments in preferred stock of certain subsidiaries, controlled or affiliated entities with the NAIC pursuant to SSAP No. 97 does not affect the application of the accounting, valuation or admissibility under this statement. In addition to the provisions of this statement, preferred stock investments in SCAs are also subject to the provisions of *SSAP No. 25—Affiliates and Other Related Parties* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.

3. Investments in the form of preferred stock that are in substance residual interests or a residual security tranche, as defined in SSAP No. 43R or SSAP No. No. 48, shall be reported on Schedule BA: Other Long-Term Assets in the dedicated reporting lines for residuals.

- ***SSAP No. 43R—Asset-Backed Securities (Effective 2025)***

4. This statement excludes:

a. Securities captured in scope of *SSAP No. 26R—Bonds*.

b. Mortgage loans in scope of *SSAP No. 37—Mortgage Loans* that qualify under an SVO structural assessment as SVO-Identified Credit Tenant Loans. These investments are excluded as these are captured as issuer credit obligations under SSAP No. 26R.

c. **Securities that do not qualify as Asset-Backed Securities per the bond definition in *SSAP No. 26R—Bonds*. This exclusion includes residual or interests, as well as first loss positions, that do not have contractual payments or substantive credit enhancement. Debt**

securities that do not qualify and residual interests shall follow guidance in *SSAP No. 21R—Other Admitted Assets.*

11. After initial recognition, the carrying value shall be determined in accordance with the reported NAIC designation. The determination of NAIC designations shall be in accordance with the requirements detailed in the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual):

a. For reporting entities that maintain an Asset Valuation Reserve (AVR), asset-backed securities, **excluding residual tranches or interests**, shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value. 3

b. For reporting entities that do not maintain an AVR, asset-backed securities designated highest-quality and high-quality (NAIC designations 1 and 2, respectively), **excluding residual tranches or interests**, shall be reported at amortized cost; loan-backed and structured securities that are designated medium quality, low quality, lowest quality and in or near default (NAIC designations 3 to 6, respectively) shall be reported at the lower of amortized cost or fair value.

c. For residual tranches or interests[4], all reporting entities shall report the item on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value. Changes in the reported value from the prior period shall be recorded as unrealized gains or losses. For reporting entities that maintain an AVR, the accounting for unrealized gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. These items are captured in *SSAP No. 21R—Other Admitted Assets* and subject to admittance restrictions detailed in that statement.

Footnote 4: Reference to "residual tranches or interests" intends to capture securitization tranches and beneficial interests as well as other structures that reflect loss layers without any contractual payments, whether principal or interest, or both. Payments to holders of these investments occur after contractual interest and principal payments have been made to other tranches or interests and are based on the remaining available funds. Although payments to holders can occur throughout an investment's duration (and not just at maturity), such instances still reflect the residual amount permitted to be distributed after other holders have received contractual interest and principal payments.

Residual Tranches or Interests

27. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. The collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). Once those contractual requirements are met, the remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.

28. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive

in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.

a. **Residuals often do not have contractual principal or interest.**

b. **Residuals may be structured with terms that appear to be stated principal or interest but that lack substance, and result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.**

c. **Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide subordination to support the credit quality of the typically rated debt tranches.**

d. **Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after debt tranche holders receive contractual principal and interest payments.**

e. **Frequently, there are contractual triggers that divert cash flows from the residual holders to the debt tranches if the structure becomes stressed.**

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

Residual Interests and Reporting

18. Investments in scope of this statement are reported on *Schedule BA: Other Long-Term Assets*. Schedule BA includes dedicated reporting categories for joint ventures, partnerships, and limited liability company investments as well as for residual interests, both with reporting lines in accordance with underlying asset characteristics. Investments within scope of this standard shall be divided within these reporting categories, with investments that reflect residual interests, or that predominantly hold residual interests captured in the residual interest reporting category.

19. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. The collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). Once those contractual requirements are met, the remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.

20. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.

a. **Residuals often do not have contractual principal or interest.**

b. **Residuals may be structured with terms that appear to be stated principal or interest but that lack substance and result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.**

c. **Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide subordination to support the credit quality of the typically rated debt tranches.**

d. **Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after debt tranche holders receive contractual principal and interest payments.**

e. **Frequently, there are contractual triggers that divert cash flows from the residual holders to the debt tranches if the structure becomes stressed.**

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 2021-15 – SSAP No. 43R – Residual Tranches, was adopted November 10, 2021, to incorporate accounting guidance for residuals and clarify that residuals shall be reported on Schedule BA.

- Agenda item 2023-12 – Residuals in SSAP No. 48 Investments, was adopted September 21, 2023 to define residuals consistently between *SSAP No. 43R—Asset-Backed Securities* and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* and to add Annual Statement Instructions for the Schedule BA residual reporting category.

- Agenda Item 2023-23 – Residuals in Preferred Stock and Common Stock Structures was adopted during the 2023 Fall National Meeting to exclude residual interests from *SSAP No. 30R—Unaffiliated Common Stock* and *SSAP No. 32R—Preferred Stock*.

- Principles-Based Bond Definition – During the 2023 Summer National Meeting, the Working Group adopted the principles-based bond definition in a revised *SSAP No. 26R—Bonds* and *SSAP No. 43R—Asset-Backed Securities*. Subsequent to this adoption, revisions to *SSAP No. 21R—Other Admitted Asset*s were exposed to capture accounting and reporting guidance for non-bond debt securities as well as residual interests. The revisions to SSAP No. 21R for debt securities that do not qualify as bonds to prescribe the measurement method and accounting provisions for residual interests was adopted March 16, 2024 during the 2024 Spring National Meeting.

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 recommend that the Working Group move this item to the active listing of the maintenance agenda categorized as a SAP clarification and expose revisions to incorporate consistency revisions for residuals so that all SSAPs refer to SSAP No. 21R for the formal definition and accounting and reporting guidance. This recommendation involves revisions to *SSAP No. 26R—Bonds* (Effective 2025), *SSAP No. 30R—Unaffiliated Common Stock*, *SSAP No. 32R—Preferred Stock*, *SSAP No. 43R—Asset-Backed Securities* (Effective 2025), and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*.

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

Status:
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed consistency revisions for residuals so that *SSAP No. 26R—Bonds* (Effective 2025), *SSAP No. 30R—Unaffiliated Common Stock*, *SSAP No. 32R—Preferred Stock*, *SSAP No. 43R—Asset-Backed Securities* (Effective January 1, 2025), and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* refer directly to *SSAP No. 21R—Other Admitted Assets* for the formal definition and accounting and reporting guidance.

Proposed Revisions:

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

4. This statement excludes:

   a. Mortgage loans and other real estate lending activities made in the ordinary course of business. These investments are addressed in *SSAP No. 37—Mortgage Loans* and *SSAP No. 39—Reverse Mortgages.*

   b. Investments that qualify within the principles-based definition as an ABS. These investments shall follow the guidance in *SSAP No. 43R—Asset-Backed Securities*.

   c. Securities that provide varying principal or interest based on underlying equity appreciation or depreciation, an equity-based derivative, real estate or other non-debt variable, as described in paragraph 6.d.

   d. Securities that do not qualify as bonds pursuant to the principles-based bond definition, including first loss positions that lack ~~contractual payments or~~ substantive credit enhancement as described in paragraph 10.b., as those items are residual interests. All investments that are in substance residual interests or that is a residual security tranche, as defined in *SSAP No. 21R—Other Admitted Assets*, ~~. These investments~~ shall follow the appropriate guidance in SSAP No. 21R~~—*Other Admitted Assets*~~.

   e. Replication (synthetic asset) transactions 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.

   f. Investments that are captured specifically within other SSAPs. For example, reporting entity acquired structured settlements are captured in scope of *SSAP No. 21R—Other Admitted Assets*, held surplus notes are captured in scope of *SSAP No. 41R—Surplus Notes* and working capital finance investments are captured in scope of *SSAP No. 105—Working Capital Finance Investments*. Investments captured in scope of other SSAPs are subject to the measurement and admittance provisions of those SSAPs. Furthermore, investments that have specific reporting lines on dedicated schedules (such as with both surplus notes and WCFI) shall be reported on their dedicated lines.

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.

a. 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 required to be in a different economic position is specific to each transaction; determined at origination; and refers to the level of credit enhancement a market participant (i.e., knowledgeable investor transacting at arm's length) would conclude is substantive.

b. The first loss position may be issued as part of an ~~securitization~~ ABS structure in the form of a debt or equity interest, or it may be retained by the sponsor and not issued as part of the ~~securitization~~ structure. If the first loss position (or a more senior position(s), if the first loss position(s) lacks ~~contractual payments along with a~~ substantive credit enhancement) is issued as part of the ~~securitization~~structure, and does not have ~~contractual principal and interest payments along with~~ substantive credit enhancement and is held by a reporting entity, the investment(s) does not qualify for reporting as a bond as it is a residual interest. All residual interests shall follow the accounting and reporting guidance in *SSAP No. 21R—Other Admitted Assets*. ~~and shall be reported on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value consistent with the treatment for residuals. (These items are further addressed in SSAP No. 21R—Other Admitted Assets.)~~

- ***SSAP No. 30R—Unaffiliated Common Stock***

1. This statement establishes statutory accounting principles for common stocks.

2. Investments in common stock of subsidiaries, controlled or affiliated entities (investments in affiliates) are not within the scope of this statement. They are addressed in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.

3. Investments in the form of common stock that are in substance residual interests or a residual security tranche, as defined in *SSAP No. 21R—Other Admitted Assets*~~SSAP No. 43R or SSAP No. 48~~, shall follow the accounting and reporting guidance in SSAP No. 21R with reporting ~~be reported~~ on *Schedule BA: Other Long-Term Assets* in the dedicated reporting lines for residuals.

- ***SSAP No. 32R—Preferred Stock***

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

2. Investments in preferred stock of entities captured in *SSAP No. 97—Investments in Subsidiaries, Controlled or Affiliated Entities* or *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* as well as preferred stock interests of certified capital companies per *INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company* (CAPCO) are included within the scope of this statement. The

requirement to file investments in preferred stock of certain subsidiaries, controlled or affiliated entities with the NAIC pursuant to SSAP No. 97 does not affect the application of the accounting, valuation or admissibility under this statement. In addition to the provisions of this statement, preferred stock investments in SCAs are also subject to the provisions of *SSAP No. 25—Affiliates and Other Related Parties* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.

3. Investments in the form of preferred stock that are in substance residual interests or a residual security tranche, as defined in ~~SSAP No. 43R or SSAP No. No. 48~~*SSAP No. 21R—Other Admitted Assets*, shall follow the accounting and reporting guidance in SSAP No. 21R with reporting ~~be reported~~ on *Schedule BA: Other Long-Term Assets* in the dedicated reporting lines for residuals.

- ***SSAP No. 43R—Asset-Backed Securities (Effective 2025)***

4. This statement excludes:

a. Securities captured in scope of *SSAP No. 26R—Bonds*.

b. Mortgage loans in scope of *SSAP No. 37—Mortgage Loans* that qualify under an SVO structural assessment as SVO-Identified Credit Tenant Loans. These investments are excluded as these are captured as issuer credit obligations under SSAP No. 26R.

c. Securities that do not qualify as Asset-Backed Securities per the bond definition in *SSAP No. 26R—Bonds* and residual interests as defined in *SSAP No. 21R—Other Admitted Assets*. ~~This exclusion includes residual or interests, as well as first loss positions, that do not have contractual payments or substantive credit enhancement.~~ These securities ~~Debt securities that do not qualify~~ and residual interests shall follow the accounting and reporting guidance in SSAP No. 21R. ~~—Other Admitted Assets~~

11. After initial recognition, the carrying value shall be determined in accordance with the reported NAIC designation. The determination of NAIC designations shall be in accordance with the requirements detailed in the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual):

a. For reporting entities that maintain an Asset Valuation Reserve (AVR), asset-backed securities~~, **excluding residual tranches or interests**,~~ shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value. 3

b. For reporting entities that do not maintain an AVR, asset-backed securities designated highest-quality and high-quality (NAIC designations 1 and 2, respectively)~~), **excluding residual tranches or interests**,~~ shall be reported at amortized cost; loan-backed and structured securities that are designated medium quality, low quality, lowest quality and in or near default (NAIC designations 3 to 6, respectively) shall be reported at the lower of amortized cost or fair value.

~~**c. For residual tranches or interests[4], all reporting entities shall report the item on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value. Changes in the reported value from the prior period shall be recorded as unrealized gains or losses. For reporting entities that maintain an AVR, the accounting for unrealized gains and losses shall be in accordance with SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve. These items are captured in SSAP No. 21R—Other Admitted Assets and subject to admittance restrictions detailed in that statement.**~~

~~**Footnote 4: Reference to "residual tranches or interests" intends to capture securitization tranches and beneficial interests as well as other structures that reflect loss layers without any contractual payments, whether principal or interest, or both. Payments to holders of these investments occur after contractual interest and principal payments have been made to other tranches or interests and are based on the remaining available funds. Although payments to holders can occur throughout**~~

~~an investment's duration (and not just at maturity), such instances still reflect the residual amount permitted to be distributed after other holders have received contractual interest and principal payments.~~

~~**Residual Tranches or Interests**~~

~~27. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. The collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). Once those contractual requirements are met, the remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.~~

~~28. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.~~

- ~~a. Residuals often do not have contractual principal or interest.~~
- ~~b. Residuals may be structured with terms that appear to be stated principal or interest but that lack substance, and result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.~~
- ~~c. Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide subordination to support the credit quality of the typically rated debt tranches.~~
- ~~d. Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after debt tranche holders receive contractual principal and interest payments.~~
- ~~e. Frequently, there are contractual triggers that divert cash flows from the residual holders to the debt tranches if the structure becomes stressed.~~

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

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.

2. This statement excludes:

a. 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.

b. This statement does not address the accounting for iInvestments in joint ventures, partnerships and limited liability companies that invest in tax credit programs and are in scope of Low-Income Housing Tax Credit Properties as discussed in SSAP No. 93—*Investments in Tax Credit Programs*Low-Income Housing Tax Credit Property Investments. However, investments in certain state Low-Income Housing Tax Credit Property Investments that do not fall within the scope of SSAP No. 93 are covered by the requirements of this statement. ***(Staff Note: This text reflects edits proposed to reflect the revised tax credit guidance in SSAP No. 93 exposed under agenda item 2022-14.)***

c. Investments that are in substance residual interests or a residual security tranche, as defined in *SSAP No. 21R—Other Admitted Assets*, shall follow the accounting and reporting guidance in SSAP No. 21R with reporting on Schedule BA: Other Long-Term Assets in the dedicated reporting lines for residuals.

Residual Interests and Reporting

18. Investments in scope of this statement are reported on *Schedule BA: Other Long-Term Assets*. Schedule BA includes dedicated reporting categories for joint ventures, partnerships, and limited liability company investments as well as for residual interests, both with reporting lines in accordance with underlying asset characteristics. Investments within scope of this standard shall be divided within these reporting categories, with investments that reflect residual interests, or that predominantly hold residual interests captured in the residual interest reporting category.

19. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. The collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). Once those contractual requirements are met, the remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.

20. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.

a. Residuals often do not have contractual principal or interest.

b. Residuals may be structured with terms that appear to be stated principal or interest but that lack substance and result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.

c. Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide subordination to support the credit quality of the typically rated debt tranches.

~~d. Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after debt tranche holders receive contractual principal and interest payments.~~

~~e. Frequently, there are contractual triggers that divert cash flows from the residual holders to the debt tranches if the structure becomes stressed.~~

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Hearing/06 - 24-08 - Residual Consistency Revisions.docx

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

Issue: SSAP No. 2R – Clarification

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 update the guidance in *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to remove a lingering reference to items that have been removed from scope pursuant to the principles-based bond definition project (asset-backed securities) 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 for SSAP No. 43R investments and 'other Invested assets.' This guidance has been revised to only reflect items in scope of SSAP No. 2R.

Existing Authoritative Literature:

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

7. Regardless of maturity date, related party or affiliated investments that would be in scope of *SSAP No. 26R—Bonds, SSAP No. 43R—Loan-Backed and Structured Securities,* or that would be reported as "Other Invested Assets" shall be reported as long-term investments if any of the following conditions apply,[1] unless the reporting entity has re-underwritten the investment, maintained appropriate re-underwriting documentation, and each participating party had the ability to independently review the terms and can terminate the transaction prior to renewal.

   a. The reporting entity does not reasonably expect the investment to terminate on the maturity date. This provision includes investments that are expected to be renewed (or rolled) with a maturity date that ends subsequent to the initial 90-day timeframe.

   b. The investment was previously reported as a cash equivalent investment and the initial maturity timeframe has passed. If an investment is reported as a cash equivalent and it is unexpectedly renewed/rolled, the reporting entity is not permitted to continue to report the held security as a cash equivalent, regardless of the updated maturity date, and shall report the security as a long-term investment. An investment is only permitted to be reported as a cash equivalent for one quarter reporting period. Meaning, if an investment was reported as a cash equivalent in the first quarter, it is not permitted to be reported as a cash equivalent in the second quarter.

   c. The reporting entity reacquired the investment (or a substantially similar investment) within one year after the original security matured or was terminated. These reacquired securities shall be reported as long-term investments. (These securities are also not permitted to be reported as short-term investments, regardless of the maturity date of the reacquired investment.)

15. Regardless of maturity date, related party or affiliated investments in scope of *SSAP No. 26R—Bonds, SSAP No. 43R—Loan-Backed and Structured Securities,* or that would be reported as "Other Invested

[1] Cash equivalents subject to the provisions of paragraph 7 are not permitted to be subsequently reported as short-term investments, even if the updated/reacquired maturity date is within one year. These investments shall be reported as long-term investments. To avoid changes in reporting schedules, reporting entities are permitted to report securities as long-term investments at initial acquisition, regardless of the initial maturity date.

Assets" shall be reported as long-term investments if any of the following conditions apply,[2, 3] unless the reporting entity has re-underwritten the investment, maintained appropriate re-underwriting documentation, and each participating party had the ability to independently review the terms and can terminate the transaction prior to renewal.

a. The reporting entity does not reasonably expect the investment to terminate on the maturity date. This provision includes investments that are expected to be renewed (or rolled) with a maturity date that ends subsequent to the initial "less than one year" timeframe.

b. The investment was previously reported as a short-term investment and the initial maturity timeframe has passed. If an investment is reported as a short-term investment and it is unexpectedly renewed/rolled, the reporting entity is not permitted to continue to report the held security as a short-term investment (or as a cash equivalent) regardless of the updated maturity date and shall report the security as a long-term investment. An investment is only permitted to be reported as a short-term investment for one annual reporting period. Meaning, if an investment was reported as a short-term investment as of December 31, 2018, it is not permitted to be reported as short-term investment as of December 31, 2019.

c. The reporting entity reacquired the investment (or a substantially similar investment) within one year after the original security matured or was terminated. These reacquired securities shall be reported as long-term investments. (These securities are also not permitted to be reported as cash equivalent investments regardless of the maturity date of the reacquired investment.)

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

- *SSAP No. 26R—Bonds* and *SSAP No. 43R—Asset-Backed Securities*, reflecting new guidance to incorporate a principles-based bond definition were adopted during the 2023 Summer National Meeting. This guidance is effective Jan. 1, 2025. Pursuant to the revisions adopted, all ABS are required to be reported as long-term investments on Schedule D-1-2 and are not permitted for cash equivalent or short-term reporting.

- Agenda item 2023-17 – Short-Term Investments, was adopted during the 2023 Fall National Meeting and removes mortgage loans and all Schedule BA investments from being reported as cash equivalents or short-term investments.

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 recommend that the Working Group move this item to the active listing of the maintenance agenda categorized as a SAP Clarification and expose revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to eliminate lingering references that imply that asset-backed securities,

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[2] Reverse repurchase transactions are excluded from these provisions if admitted in accordance with collateral requirements pursuant *to SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.*

[3] Short-term investments subject to the provisions of paragraph 15 are not permitted to be subsequently reported as cash equivalents, even if the updated/reacquired maturity date is within 90 days. These investments shall be reported as long-term investments. To avoid changes in reporting schedules, reporting entities are permitted to report securities as long-term investments at initial acquisition, regardless of the initial maturity date.

mortgage loans, or other Schedule BA items are permitted to be reported as cash equivalents or short-term investments.

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

Status:
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to eliminate lingering references that imply that asset-backed securities, mortgage loans, or other Schedule BA items are permitted to be reported as cash equivalents or short-term investments.

Proposed Revisions to SSAP No. 2R—Bonds (Effective Jan. 1, 2025)

7. Regardless of maturity date, related party or affiliated investments that would be in scope of this statement pursuant to paragraph 6 ~~*SSAP No. 26R—Bonds, SSAP No. 43R—Loan-Backed and Structured Securities,* or that would be reported as "Other Invested Assets"~~ shall be reported as long-term investments if any of the following conditions apply,[4] unless the reporting entity has re-underwritten the investment, maintained appropriate re-underwriting documentation, and each participating party had the ability to independently review the terms and can terminate the transaction prior to renewal.

    a. The reporting entity does not reasonably expect the investment to terminate on the maturity date. This provision includes investments that are expected to be renewed (or rolled) with a maturity date that ends subsequent to the initial 90-day timeframe.

    b. The investment was previously reported as a cash equivalent investment and the initial maturity timeframe has passed. If an investment is reported as a cash equivalent and it is unexpectedly renewed/rolled, the reporting entity is not permitted to continue to report the held security as a cash equivalent, regardless of the updated maturity date, and shall report the security as a long-term investment. An investment is only permitted to be reported as a cash equivalent for one quarter reporting period. Meaning, if an investment was reported as a cash equivalent in the first quarter, it is not permitted to be reported as a cash equivalent in the second quarter.

    c. The reporting entity reacquired the investment (or a substantially similar investment) within one year after the original security matured or was terminated. These reacquired securities shall be reported as long-term investments. (These securities are also not permitted to be reported as short-term investments, regardless of the maturity date of the reacquired investment.)

15. Regardless of maturity date, related party or affiliated investments in scope of this statement pursuant to paragraph 14~~*SSAP No. 26R—Bonds, SSAP No. 43R—Loan-Backed and Structured Securities,* or that would be reported as "Other Invested Assets"~~ shall be reported as long-term investments if any of the following conditions apply,[5, 6] unless the reporting entity has re-underwritten the investment, maintained

[4] Cash equivalents subject to the provisions of paragraph 7 are not permitted to be subsequently reported as short-term investments, even if the updated/reacquired maturity date is within one year. These investments shall be reported as long-term investments. To avoid changes in reporting schedules, reporting entities are permitted to report securities as long-term investments at initial acquisition, regardless of the initial maturity date.

[5] Reverse repurchase transactions are excluded from these provisions if admitted in accordance with collateral requirements pursuant *to SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.*

[6] Short-term investments subject to the provisions of paragraph 15 are not permitted to be subsequently reported as cash equivalents, even if the updated/reacquired maturity date is within 90 days. These investments shall be reported as long-term investments. To avoid changes in reporting schedules, reporting entities are permitted to report securities as long-term investments at initial acquisition, regardless of the initial maturity date.

appropriate re-underwriting documentation, and each participating party had the ability to independently review the terms and can terminate the transaction prior to renewal.

a. The reporting entity does not reasonably expect the investment to terminate on the maturity date. This provision includes investments that are expected to be renewed (or rolled) with a maturity date that ends subsequent to the initial "less than one year" timeframe.

b. The investment was previously reported as a short-term investment and the initial maturity timeframe has passed. If an investment is reported as a short-term investment and it is unexpectedly renewed/rolled, the reporting entity is not permitted to continue to report the held security as a short-term investment (or as a cash equivalent) regardless of the updated maturity date and shall report the security as a long-term investment. An investment is only permitted to be reported as a short-term investment for one annual reporting period. Meaning, if an investment was reported as a short-term investment as of December 31, 2018, it is not permitted to be reported as short-term investment as of December 31, 2019.

c. The reporting entity reacquired the investment (or a substantially similar investment) within one year after the original security matured or was terminated. These reacquired securities shall be reported as long-term investments. (These securities are also not permitted to be reported as cash equivalent investments regardless of the maturity date of the reacquired investment.)

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Hearing/07 - 24-09 - SSAP No. 2R Clarification.docx

NAIC Accounting Practices and Procedures Manual
Editorial and Maintenance Update
March 16, 2024

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

SSAP/Appendix	Description/Revision
Removal of "Revised" and "R" identifiers from SSAP titles and references within the Manual.	Remove the "Revised" and "R," previously intended to identify a SSAP that has been substantively revised, from SSAP titles and SSAP references within the Manual. NAIC staff consider the "Revised" and "R" identifiers to no longer be useful as several SSAPs have now had multiple substantive revisions after their initial adoption.

Staff Recommendation:
NAIC staff recommend that the Statutory Accounting Principles (E) Working Group move this agenda item to the active listing, categorize as a SAP Clarification, and expose editorial revisions as illustrated within.

<u>Removal of "R" identifier from SSAP titles and references within the AP&P Manual</u>
Remove the "Revised" and "R" identifiers from SSAP titles and SSAP references throughout the Manual. NAIC staff consider the "Revised" and "R" identifier to no longer be useful. The following SSAPs currently have an "Revised" and "R" identifier in the title.

2R—Cash, Cash Equivalents, Drafts and Short-Term Investments
5R—Liabilities, Contingencies and Impairments of Assets
16R—Electronic Data Processing Equipment and Software
21R—Other Admitted Assets
22R—Leases
26R—Bonds
30R—Unaffiliated Common Stock
32R—Preferred Stock
35R—Guaranty Fund and Other Assessments
40R—Real Estate Investments
41R—Surplus Notes
43R—Loan-Backed and Structured Securities
51R—Life Contracts
54R—Individual and Group Accident and Health Contracts
61R—Life, Deposit-Type and Accident and Health Reinsurance
62R—Property and Casualty Reinsurance
94R—Transferable and Non-Transferable State Tax Credits
100R—Fair Value
103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities
104R—Share-Based Payments
105R—Working Capital Finance Investments

Status:
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed editorial revisions to the Accounting Practices and Procedures Manual to remove the "Revised" and "R" identifiers from SSAP titles and SSAP references throughout the Manual.

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

Issue: ASU 2023-06, Disclosure Improvements

Check (applicable entity):

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

Description of Issue: In October 2023, FASB issued *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative*, in response to a referral from SEC Release No. 33-10532, Disclosure Update and Simplification, issued August 17, 2018. The changes detailed in the ASU seek to clarify or improve disclosure and presentation requirements of a variety of Topics. Many of the amendments allow users to more easily compare entities subject to the SEC's existing disclosures with those entities that were 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 is the requirement for companies to disclose their the weighted-average interest rate of debt and provide repurchase agreement (repo) counterparty risk disclosures. 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. It was also noted by Staff that the effective date of ASU 2023-06 is unusual as both its timing, and ultimately its implementation within the Codification, is dependent on whether the SEC removes the related disclosures from Regulation S-X, or Regulation S-K becomes effective, prior to June 30, 2027. For this agenda item, Staff believes that the occurrence, or non-occurrence, of future SEC actions is not relevant to discussion concerning the proposed disclosures' merits for inclusion in the statutory accounting framework. If needed, the Working Group will address the effective date of adoption at a later stage.

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

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):
Agenda item 2024-04: Conforming Repurchase Agreements was developed in in response to the American Council of Life Insurers (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.

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 – Spring National Meeting:
NAIC staff recommends that the Working Group expose revisions to adopt, with modification, certain disclosures from *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative,* for statutory accounting within *SSAP No. 15—Debt and Holding Company Obligations* and *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The disclosures revisions we have recommended are:

- Certain disclosures for unused commitments and lines of credit, disaggregated by short-term and long-term.

- Disclosure of accrued interest from repos and securities borrowing, separate disclosure of significant (10% of admitted assets) reverse repos, and counterparty disclosures for significant (10% of adjusted capital and surplus) repos and reverse repos.

NAIC staff also requests regulator and interested party input on whether the accounting policy disclosure for cash flows associated with derivatives, ASC 230-10-50-9, should also be adopted for statutory accounting purposes. This would require companies to provide an accounting policy disclosure for where cash flows associated with derivative instruments and their related gains and losses are presented in the statement of cash flows.

Staff Recommendation – Summer National Meeting:
NAIC staff recommends that the Working Group adopt, with modification, certain disclosures from *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative,* for statutory accounting within *SSAP No. 15—Debt and Holding Company Obligations* and *SSAP No. 86—Derivatives*. The disclosure revisions we have recommended are:

- Certain disclosures for unused commitments and lines of credit, disaggregated by short-term and long-term.
- Disclosure of the derivative cash flow accounting policy

In addition, NAIC staff recommend that the previously exposed revisions to adopt, with modification, certain disclosures from ASU 2023-06 within *No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* be combined with agenda item 2024-04: Conforming Repurchase Agreements. These disclosures revisions include:

- Disclosure of accrued interest from repos and securities borrowing, separate disclosure of significant (10% of admitted assets) reverse repos, and counterparty disclosures for significant (10% of adjusted capital and surplus) repos and reverse repos.

Agenda item 2024-04 is intended to review and revise current statutory guidance for repos and secured lending, as such adoption of additional repo disclosures should be considered as a part of that project.

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

Status:
On December 1, 2023, the Statutory Accounting Principles (E) Working Group deferred exposure of this agenda item as some items were noted which require further consideration.

On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed revisions to adopt, with modification, certain disclosures from *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative*, for statutory accounting within *SSAP No. 15—Debt and Holding Company Obligations* and *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The Working Group also requested input from regulators and interested parties on whether the derivative cash flow accounting policy disclosure, described in ASC 230-10-50-9, would provide useful information to regulators.

Proposed Revisions to SSAP No. 15—Debt and Holding Company Obligations – Proposed for Adoption

22. For unused commitments and lines of credit, the reporting entity shall separately disclose the following, disaggregated by short-term and long-term, in the notes to financial statements:

a. The amount and terms of unused commitments for financing arrangements (including commitment fees and the conditions under which commitments may be withdrawn).

~~a.~~b. The amount and terms of unused lines of credit for financing arrangements (including commitment fees and the conditions under which lines may be withdrawn) and the amount of those lines of credit that support commercial paper borrowing arrangements or similar arrangements.

Relevant Literature

32. This statement adopts, with modification, *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative.* Statutory modifications include:

a. Extending the disclosure requirements to both short-term and long-term unused commitments and lines of credit, whereas ASU 2023-06 only required these disclosures for long-term unused commitments and short-term lines of credit.

b. The requirement to disclose the weighted-average interest rate of short-term borrowings was rejected for statutory accounting purposes.

Proposed revisions to SSAP No. 86—Derivatives – Proposed for Adoption

Disclosure Requirements

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

a. General disclosures:

i. A description of the reporting entity's objectives for using derivatives, i.e., hedging, income generation or replication;

ii. A description of the context needed to understand those objectives and its strategies for achieving those objectives;

iii. The description for hedging objectives shall identify the category, e.g., fair value hedges, cash flow hedges, or foreign currency hedges, and for all objectives, the type of instrument(s) used;

iv. A description of the accounting policies for derivatives including the policies for recognizing (or reasons for not recognizing) and measuring the derivatives used, and when recognized, where those instruments and related gains and losses are reported;

v. Identification of whether the reporting entity has derivative contracts with financing premiums. (For purposes of this term, this includes scenarios in which the premium cost is paid at the end of the derivative contract or throughout the derivative contract.);

vi. The net gain or loss recognized in unrealized gains or losses during the reporting period representing the component of the derivative instruments' gain or loss, if any, excluded from the assessment of hedge effectiveness;~~ and~~

vii. The net gain or loss recognized in unrealized gains or losses during the reporting period resulting from derivatives that no longer qualify for hedge accounting. For portfolio layer method hedges, disclose circumstances that led to the breach; and

~~vii.~~viii. The reporting entity shall disclose its accounting policy for where cash flows associated with derivative instruments and their related gains and losses are presented in the statement of cash flow.

Relevant Literature

74. This statement adopts, with modification, *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative*. The adopted guidance requires the reporting entity to disclose its accounting policy for where cash flows associated with derivative instruments are presented in the statement of cash flow.

Proposed Revisions to SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities – To be Combined with Agenda Item 2024-04

28. A reporting entity shall disclose the following[fn]:

a. For Repurchase and Reverse Repurchase Agreements:

i. If the entity has entered into repurchase or reverse repurchase agreements, information regarding the company policy or strategies for engaging in repo programs, policy for requiring collateral, as well as whether transactions have been accounted for as secured borrowings or as sale transactions. This disclosure shall include the terms of reverse repurchase agreements whose amounts are included in borrowing money. The following information shall be disclosed by type of agreement:

(a) Whether repo agreements are bilateral and/or tri-party trades;

(b) Maturity time frame divided by the following categories: open or continuous term contracts for which no maturity date is specified, overnight, 2 days to 1 week, from 1 week to 1 month, greater than 1 month to 3 months, greater than 3 months to 1 year, and greater than 1 year[fn];

(c) Aggregate narrative disclosure of the fair value of securities sold and/or acquired that resulted in default. (This disclosure is not intended to capture "failed trades," which are defined as instances in which the trade did not occur as a result of an error and was timely corrected. Rather, this shall capture situations in which the non-defaulting party exercised their right to terminate after the defaulting party failed to execute.)

(d) If as of the date of the most recent balance sheet the aggregate carrying amount of reverse repurchase agreements (securities or other assets purchased under agreements to resell) exceeds 10% of total admitted assets, the assets shall be separately disclosed. The entity shall also disclose whether there are any provisions, beyond the collateral requirements in paragraph 113, to ensure that the market value of the underlying assets remains sufficient to protect the entity in the event that the counterparty defaults and, if so, the nature of those provisions.

Staff Note 2: *The Supplemental Investment Risks Interrogatories (Appendix A-001) does require reporting of the amount and percentage of admitted assets subject to reverse repurchase agreements. Staff is of the opinion that if the assets subject to reverse repurchase agreements exceeded 10% then this fact is significant enough to also be included in the notes the financial statements.*

ii. For repurchase transactions accounted for as secured borrowings[fn], the maximum amount and end balance as of each reporting period (quarterly and annual) for the following:

(a) Fair value of securities sold. (Book adjusted carrying value shall be provided as an end balance only.) This information is required in the aggregate, and by type of

security categorized by NAIC designation, with identification of nonadmitted assets. Although legally sold as a secured borrowing, these assets are still reported by the insurer and shall be coded as restricted pursuant to the annual statement instructions, disclosed in accordance with *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures*, reported in the general interrogatories, and included in any other statutory schedules or disclosure requirements requesting information for restricted assets.

(b) Cash collateral and the fair value of security collateral (if any) received. This information is required in the aggregate and by type of security categorized by NAIC designation with identification of collateral securities received that do not qualify as admitted assets.

(1) For collateral received, aggregate allocation of the collateral by the remaining contractual maturity of the repurchase agreements (gross): overnight and continuous, up to 30 days, 30-90 days, greater than 90 days. This disclosure shall also include a discussion of the potential risks associated with the agreements and related collateral received, including the impact arising changes in the fair value of the collateral received and/or the provided security and how those risks are managed.

(2) For cash collateral received that has been reinvested, the total reinvested cash and the aggregate amortized cost and fair value of the invested asset acquired with the cash collateral. This disclosure shall be reported by the maturity date of the invested asset: under 30 days, 60 days, 90 days, 120 days, 180 days, less than 1 year, 1-2 years, 2-3 years and greater than 3 years. To the extent that the maturity dates of the liability (collateral to be returned) does not match the invested assets, the reporting entity shall explain the additional sources of liquidity to manage those mismatches.

(c) Liability recognized, including accrued interest, to return cash collateral, and the liability recognized to return securities received as collateral as required pursuant to the terms of the secured borrowing transaction.

iii. For reverse repurchase transactions accounted for as secured borrowings[fn], the maximum amount and end balance as of each reporting period (quarterly and annual) for the following:

(a) Fair value of securities acquired. This information shall be reported in the aggregate, and by type of security categorized by NAIC designation, with identification of whether acquired assets would not qualify as admitted assets.

(b) Cash collateral and the fair value of security collateral (if any) provided. (If security collateral was provided, book adjusted carrying value shall be provided as an end balance only.) Disclosure shall identify the book adjusted carrying value of any nonadmitted securities provided as collateral. For collateral pledged, the aggregate allocation of the collateral by the remaining contractual maturity of the reverse-repurchase agreements (gross): overnight and continuous, up to 30 days, 30-90 days, greater than 90 days. This disclosure shall also include a discussion of the potential risks associated with the agreements and related collateral pledged, including obligations arising from a decline in the fair value of the collateral pledged and how those risks are managed.

(c) Recognized receivable for the return of collateral. (Generally cash collateral, but including securities provided as collateral as applicable under the terms of the secured borrowing transaction. Receivables are not recognized for securities provided as collateral if those securities are still reported as assets of the reporting entity.)

(d) Recognized liability, including accrued interest, to return securities acquired under the reverse-repurchase agreement as required pursuant to the secured borrowing transaction. (Generally, a liability is required if the acquired securities are sold.)

iv. For repurchase transactions accounted for as a sale[fn], the maximum amount and end balance as of each reporting period (quarterly and annual) for the following:

(a) Fair value of securities sold (derecognized from the financial statements). (Book adjusted carrying value shall be provided as an end balance only, reflecting the amount derecognized from the sale transaction.) This information is required in the aggregate, and by type of security categorized by NAIC designation, with information on the book adjusted carrying value of nonadmitted assets sold.

(b) Cash and the fair value of securities (if any) received as proceeds and recognized in the financial statements. This information is required in the aggregate and by type of security categorized by NAIC designation, with identification of received assets nonadmitted in the financial statements. All securities received shall be coded as restricted pursuant to the annual statement instructions, disclosed in accordance with SSAP No. 1, reported in the general interrogatories, and included in any other statutory schedules or disclosure requirements requesting information for restricted assets.

(c) The forward repurchase commitment recognized to return the cash or securities received. Amount reported shall reflect the stated repurchase price under the repurchase transaction.

v. For reverse repurchase transactions accounted for as sale[fn], the maximum amount and end balance as of each reporting period (quarterly and annual):

(a) Fair value of securities acquired and recognized on the financial statements. (Book adjusted carrying value shall be provided as an end balance only.) This information shall be reported in the aggregate, and by type of security categorized by NAIC designation. The disclosure also requires the book adjusted carrying value of nonadmitted assets acquired.

(b) Cash collateral and the fair value of security collateral (if any) provided. (If security collateral was provided, book adjusted carrying value shall be provided as an end balance only.) Disclosure shall also identify whether any nonadmitted assets were provided as collateral (derecognized from the financial statements).

vi. If as of the date of the most recent balance sheet the amount at risk under repurchase agreements or the amount at risk under reverse repurchase agreements with any individual counterparty or group of related counterparties exceeds 10% of adjusted capital and surplus, an entity shall disclose the name(s) of those counterparties or group of related counterparties, the amount at risk with each, and the weighted-average maturity of the repurchase agreements or reverse repurchase agreements with each.

(a) For the purposes of this statement, the amount at risk under repurchase agreements is the excess of the carrying amount (or market value, if higher than the carrying amount or if there is no carrying amount) of the securities or other assets sold under agreement to repurchase, including accrued interest plus any cash or other assets on deposit to secure the repurchase obligation, over the amount of the repurchase liability (adjusted for accrued interest).

~~(a)~~(b) For the purposes of this statement, the amount at risk under reverse repurchase agreements is the excess of the carrying amount of the reverse repurchase agreements over the market value of assets delivered in accordance with the agreements by the counterparty to an entity (or to a third-party agent that has

affirmatively agreed to act on behalf of the entity) and not returned to the counterparty, except in exchange for their approximate market value in a separate transaction.

Relevant Literature

135. This statement adopts, with modification, *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative*. Statutory modifications include:

a. It is not feasible to require separate reporting of assets subject to reverse repurchase agreements in excess of 10% of total assets. Instead, this was modified to require separate disclosure and the threshold was modified to be "10% of total admitted assets."

b. The disclosure threshold for the amount at risk under repurchase agreements or reverse repurchase agreements was modified to be 10% of adjusted capital and surplus, rather than 10% of total equity.

c. The requirement to disclose the weighted-average interest rate of repurchase liabilities and related repurchase liabilities was rejected for statutory accounting purposes.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Hearing/09 - 23-26 - ASU 2023-06 - Disclosure Improvements.docx

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The last column lists the status of the GAAP source literature for statutory accounting and the recommended action.

Topic	Codification	Abbreviated Summary of Change	Related Paragraphs	SAP Status/Recommendation
Statement of Cash Flows—Overall	230-10	Requires an accounting policy disclosure in annual periods of where cash flows associated with derivative instruments and their related gains and losses are presented in the statement of cash flows.	50-9	NAIC staff noted that this disclosure may be duplicative of *SSAP No. 86—Derivatives*, paragraph 63a.iv. However, this disclosure does not specifically require disclosure of the accounting policy for the presentation of cash flows from derivatives and the statutory statement of cash flows does not currently break out cash flows from derivatives. No comments were received from regulators and Interested Parties had no comments on adoption of this disclosure. **Staff recommends adoption of this disclosure for statutory accounting purposes.**
Accounting Changes and Error Corrections—Overall	250-10	Requires that when there has been a change in the reporting entity, the entity disclose any material prior-period adjustment and the effect of the adjustment on retained earnings in interim financial statements.	50-6	This disclosure is duplicative of *SSAP No. 3—Accounting Changes and Corrections of Errors*, paragraph 13. **This update is not applicable – no action required.**
Earnings Per Share—Overall	260-10	Requires disclosure of the methods used in the diluted earnings-per-share computation for each dilutive security and clarifies that certain disclosures should be made during interim periods. Amends illustrative guidance to illustrate disclosure of the	50-1 55-51 55-52	**This update is not applicable – no action required.**

Topic	**Codification**	**Abbreviated Summary of Change**	**Related Paragraphs**	**SAP Status/Recommendation**
		methods used in the diluted earnings-per-share computation.		
Interim Reporting—Overall	270-10	Conforms to the amendments made to Topic 250.	45-12 45-19 50-1	**This update is not applicable – no action required.**
Commitments—Overall	440-10	Requires disclosure of assets mortgaged, pledged, or otherwise subject to lien and the obligations collateralized.	50-1	This disclosure is duplicative of *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures*, paragraph 23b. **This update is not applicable – no action required.**
Debt—Overall	470-10	Requires disclosure of amounts and terms of unused lines of credit and unfunded commitments and the weighted-average interest rate on outstanding short-term borrowings. Entities that are not public business entities are not required to provide information about the weighted-average interest rate.	15-1 50-6 5-7	Staff do not recommend adoption of the weighted-average interest rate calculation for statutory accounting purposes. Due to the complexity of this computation, this this disclosure is only required for public entities under GAAP. As SAP does not have the public/private entity distinction, adoption of this disclosure would be applicable to all insurance entities. This disclosure is not considered necessary in light of existing debt SAP disclosures and does not provide enough benefit to offset the cost of implementing such a potentially complex calculation. **We recommend adoption, with modification, of the disclosures unused LOC and commitment disclosures.**
Equity—Overall	505-10	Requires entities that issue preferred stock to disclose preference in involuntary	50-4	This disclosure is duplicative of *SSAP No. 72—Surplus and Quasi-Reorganizations*, paragraph 22b.

Topic	Codification	Abbreviated Summary of Change	Related Paragraphs	SAP Status/Recommendation
		liquidation if the liquidation preference is other than par or stated value.		**This update is not applicable – no action required.**
Derivatives and Hedging—Overall	815-10	Adds inter-codification reference to 230-10-50-9 for disclosure of cash flows associated with derivative instruments.	50-8C	**This update is not applicable – no action required.**
Transfers and Servicing—Secured Borrowing and Collateral	860-30	Requires: a. That accrued interest be included in the disclosure of liabilities incurred in securities borrowing or repurchase or resale transactions. b. Separate presentation of the aggregate carrying amount of reverse repurchase agreements on the face of the balance sheet if that amount exceeds 10 percent of total assets. c. Disclosure of the weighted-average interest rates of repurchase liabilities for public business entities. d. Disclosure of amounts at risk with an individual counterparty if that amount exceeds more than 10 percent of stockholder's equity. e. Disclosure for reverse repurchase agreements that exceed 10 percent of total assets on whether there are any provisions in a reverse repurchase agreement to ensure that the market value of the underlying assets remains sufficient to protect against counterparty default and, if so, the nature of those provisions.	15-1 45-2 45-2A 45-3 50-7 50-9 thru 12 55-4	**We recommend adoption, with modification, of the disclosures in bullets a., b., d., and e. (see Abbreviated Summary of Changes)** **The disclosure in bullet c. is not recommended for adoption within SAP – no action required.**
Extractive Activities—Oil and Gas—Notes to Financial Statements	932-235	Requires that paragraphs 932-235-50-3 through 50-36 be applicable for each annual period presented in the financial statements.	50-2A	**This update is not applicable – no action required.**

Topic	Codification	Abbreviated Summary of Change	Related Paragraphs	SAP Status/Recommendation
Financial Services—Investment Companies—Investment Company Activities	946-20	Requires that investment companies disclose the components of capital on the balance sheet.	50-11 50-12	**This update is not applicable – no action required.**
Real Estate—Real Estate Investment Trusts—Overall	974-10	Requires disclosure for annual reporting periods of the tax status of distributions per unit (for example, ordinary income, capital gain, and return of capital) for a real estate investment trust.	50-1	**This update is not applicable – no action required.**
Generally Accepted Accounting Principles—Overall	105-10	Adds in transition and open effective date information.	65-7 65-8	**This update is not applicable – no action required.**

Statutory Issue Paper No. 1XX

Principles-Based Bond Definition

STATUS
Discussion Draft – 2024 Summer National Meeting

Original SSAP: SSAP No. 26 and SSAP No. 43
Current Authoritative Guidance: SSAP No. 26 and SSAP No. 43

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. The guidance within this issue paper introduces details the new statutory accounting concept revisions to *SSAP No. 26R—Bonds* (SSAP No. 26R), and *SSAP No. 43R—Loan-backed and Structured Securities* (SSAP No. 43R) and *SSAP No. 21—Other Admitted Assets* (SSAP No. 21) pursuant to the Statutory Accounting Principles (E) Working Group's (Working Group) Investment Classification Project as well as in response to expanding investment structures that have been reported on Schedule D-1: Long-Term Bonds. The revisions and discussions detailed within The Investment Classification Project reflects a comprehensive review, referred to as the "Principles-Based Bond Project," to establish principal concepts for determining whether a debt security qualifies for reporting as a bond. address a variety of issues pertaining to definitions, measurement and overall scope of the investment SSAPs. Although SSAP No. 26R was previously revised pursuant to the Investment Classification Project in 2017, it was identified that some entities were classifying securities issued from special purpose vehicles (SPVs) in scope of SSAP No. 26 instead of SSAP No. 43R. As the focus of this Principles-Based Bond Project current project is on the substance of investments, regardless of whether they include an SPV for issuance, this project includes all debt securities and encompasses both SSAP No. 26R and SSAP No. 43R.

SUMMARY CONCLUSION

2. Investments eligible for reporting as bonds on Schedule D-1[1] shall comply with the principles-based definition of a bond or be specifically noted in scope of SSAP No. 26 or SSAP No. 43. Revisions to reflect the principles-based bond definition will behave been incorporated to SSAP No. 26, with SSAP No. 43 revised for accounting and reporting guidance for investments that qualify as asset-backed securities under the SSAP No. 26 bond definition. SSAP No. 21—Other Admitted Assets has been revised to detail accounting and reporting guidance for debt securities that do not qualify as bonds under SSAP No. 26 and to provide guidance for the accounting and reporting of residual interests. Lastly, various revisions to other SSAPs have been incorporated to update guidance and/or references to the bond guidance. The final adopted SSAPs and other revisions are shown in the exhibits to this issue paper.

DISCUSSION

3. The discussion of this issue originally began in August 2019 with agenda item 2019-21: SSAP No. 43 – Equity Investments. This agenda item was drafted to consider clarification to SSAP No. 43 particularly with regards to collateralized fund obligations and similar structures that reflect underlying equity interests.

[1] Pursuant to reporting changes adopted in response to the principles-based bond definition, issuer credit obligations (ICO) in scope of *SSAP No. 26—Bonds* will be reported *on Schedule D-1-1: Bonds* and asset-backed security (ABS) investments that qualify as bonds under SSAP No. 26 but follow *SSAP No. 43—Asset-Backed Securities* for accounting and reporting will be reported on *Schedule D-1-2: Asset-Backed Securities*. Throughout this issue paper, these bond investments (both ICO and ABS) are collectively referred to as bonds reported on Schedule D-1.

In response to the discussion of comment letters in January 2020, this project was expanded to include a comprehensive review of SSAP No. 43 under the Working Group's Investment Classification Project, with NAIC staff directed to prepare a discussion document for subsequent review.

4. A preliminary discussion document was exposed for comment on March 18, 2020. Although there were no proposed recommendations in that exposed document, it captured the following:

a. History of the definition / scope development of SSAP No. 43. (This history has been retained in ~~Exhibit ___ of~~ this issue paper, beginning with paragraph 124.)

b. Definitions of asset backed securities (ABS) from the Code of Federal Regulations (CFR), the Securities Exchange Act of 1934 and NAIC Model 280, Investments of Insurers Model Act (Defined Limits Version).

c. Potential options for the accounting and reporting of ABS based on whether they were considered traditional securitizations in accordance with the Code of Federal Regulations (CFR) (17 CFR 229.1101(c)) definition of an ABS or non-traditional securitizations that did not comply with the CFR definition.

5. In response to this initial exposure, a detailed comment letter dated July 31, 2020, was received from interested parties. Although a variety of elements were noted, two key issues were the primary focus:

a. Separation between SSAP No. 26 and SSAP No. 43: Pursuant to the comments ~~received~~, it was identified that many insurers had different interpretations of the adopted 2010 revisions that separated investments between SSAP No. 26 and SSAP No. 43 due to the presence of a "trust" or an "SPV" structure. As such, investment designs that had been identified as concerning due to the underlying investments in the SPV (e.g., equity-driven investments) believed by some to be limited to SSAP No. 43 were, under some interpretations, eligible to be captured in scope of SSAP No. 26.

b. Defining an asset backed security: The comments received focused heavily on whether the 17 CFR definition captured securities within the 1933 or 1934 Securities Act. The proposed use of the 17 CFR definition, which is the ABS definition used by the SEC as a nationally recognized statistical ratings organization (NRSRO) registered for asset-backed securities, was intended to allow consistency in ABS items permitted for NRSRO designations. Furthermore, it was only the first "broad brush" in determining whether an investment would be initially captured in scope of SSAP No. 43. Regardless, based on the comments received, which noted variations between the 1933 and 1934 Securities Act, differences of assessments based on whether an entity is the issuer or acquirer, the legal scrutiny that may be required in determining whether an investment complies with the definition, as well as a recommendation for independent principles for determining an investment as an asset backed security, it was identified that further discussion should occur before utilizing the CFR definition of an asset-backed security.

6. After considering the interested parties' July 31, 2020, comments, the Working Group directed that a small group of industry work with Iowa representatives and NAIC staff to ~~first~~ define what should be considered a bond for reporting on Schedule D-1. It was identified that some investment designs, which have been previously captured on Schedule D-1 or are proposed for inclusion on that schedule, may be well-performing assets, but are not bonds and should not be captured on Schedule D-1. It was also noted that regulators are not anticipating these sorts of investment structures when reviewing D-1 and assessing investment risk. These small group discussions began December 1, 2020, and continued until the bond proposal was initially exposed for public comment on May 20, 2021.

7. After considering the comment letters from the May 2021 exposure, on August 26, 2021, the Working Group affirmed the direction of the principle-based bond concepts and directed NAIC staff to utilize those concepts in proposing statutory accounting revisions. With this explicit direction, it was noted that all elements of the principles-based bond proposal, and the reflection of those concepts in statutory accounting guidance, is subject to continued discussion and deliberation. Revised guidance for Schedule D-1 investment classification will not be considered authoritative statutory guidance until the specific effective date detailed in ~~the~~ adopted authoritative SSAP. With the direction to proceed with the development of statutory guidance to reflect the principle-based concepts, the Working Group directed that NAIC staff continue to work with the small group of regulators and industry to discuss concepts, review proposed language and consider innovating investment designs. (During this meeting, the small group was repurposed and referred to as the "study" group with additional regulators participating.)

8. From September 2021 through January 2022, the study group of regulators and industry met to continue discussions on the bond proposal definition. Key elements discussed during this timeframe included 1) the requirement for a credit enhancement that puts the holder of an ABS in a different economic position from holding the underlying collateral directly, 2) the contractual stapling restriction, and 3) guidance for when a debt instrument is issued from an SPV that owns a portfolio of equity interests. Revisions from these discussions, as well as other aspects to clarify the definition and an initial issue paper were presented to the Statutory Accounting Principles (E) Working Group on March 2, 2022, and exposed. Subsequently, the full Working Group discussed and exposed revisions to the draft guidance until adoption.

9. This issue paper intends to provide information on discussions that occurred when considering the principles-based bond definition and the ~~needed~~ statutory accounting revisions to specify the types of investments that shall be reported on Schedule D-1: Long-Term Bonds. A summary of the exposure periods and adoption actions are detailed below:

a. On March 2, 2022, this issue paper, along with the principles-based bond definition, was exposed, with comments due May 6, 2022. The Working Group heard comments on July 18, 2022, and directed limited edits to be reflected while also deciding not to incorporate revisions for a number of industry-proposed comments.

b. On August 10, 2022, this issue paper, along with the principles-based bond definition, and proposed revisions to SSAP No. 26 and SSAP No. 43 was exposed, with comments due October 7, 2022. Comments were received from Interested Parties, Fermat Capital and the industry Lease-Backed Securities Working Group. After considering comments, the Working Group incorporated certain revisions.

c. On November 16, 2022, after considering comments from the August 2022 exposure, the Working Group exposed revisions to SSAP No. 26 and SSAP No. 43. The Working Group also exposed revisions to other SSAPs that will be impacted with the bond project revisions. These edits included revisions to detail the short-term and cash equivalent restriction for ABS in *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* as well as guidance for debt securities that do not qualify as bonds in SSAP No. 21. This guidance was exposed until February 10, 2023.

d. On March 22, 2023, during the 2023 Spring National Meeting, the Working Group considered comments received and exposed updated guidance, with a comment period ending June 9, 2023, to reflect most of the interested party comments.

e. On August 13, 2023, during the 2023 Summer National Meeting, the Working Group adopted the exposed revisions to SSAP No. 26, SSAP No. 43 and the document detailing revisions to other SSAPs with an effective date of January 1, 2025. With this action, it was noted that no comments had been received on these exposed items. Also on August 13,

2023, the Working Group considered comments on the exposed SSAP No. 21 on the guidance for non-bond debt securities that do not qualify as bonds and on residual interests and exposed a revised SSAP No. 21 until September 29, 2023.

f. On December 1, 2023, during the 2023 Fall National Meeting, the Working Group considered comments received on SSAP No. 21, predominantly focused on the accounting and measurement of residual interests and exposed an updated SSAP No. 21 until January 22, 2024.

g. On February 20, 2024, the Working Group received a revised SSAP No. 21 that was updated to reflect interested parties' comments during the interim. The Working Group exposed the revised SSAP No. 21 for a shortened comment period ending March 7, 2024, to allow for possible adoption consideration during the 2024 Spring National Meeting.

h. On March 16, 2024, during the 2024 Spring National Meeting, the Working Group adopted new statutory accounting guidance within SSAP No. 21 for "Debt Securities That Do Not Qualify as Bonds" and for "Residual Tranches or Interests/Loss Positions." The new sections are effective January 1, 2025, but reporting entities may elect to adopt the residual guidance for year-end 2024. With this action, all planned statutory accounting guidance for the principles-based bond definition was adopted.

Discussion of Principles-Based Bond Concepts

~~9.~~10. Pursuant to the "small group" discussions comprised of industry, Iowa regulators ~~representatives~~ and NAIC staff, the broad principle-based bond concepts discussed on August 26, 2021, reflected the following key concepts:

a. Definition of a bond requires a security structure, representing a creditor relationship, that is considered an Issuer Credit Obligation (ICO) or an Asset Backed Security (ABS).

b. The assessment of whether a security represents a creditor relationship requires consideration of the substance, rather than the legal form of the document, as well as consideration of other investments owned in the investee and other contractual arrangements. A security that possesses equity-like characteristics or that represents an ownership interest in the issuer in substance does not represent a creditor relationship.

c. An ABS is a bond issued by an entity created for the primary purpose of raising debt capital backed by financial assets or cash generating non-financial assets owned by the ABS Issuer, whereby repayment is primarily derived from the cash flows associated with the underlying defined collateral rather than the cash flows of an operating entity.

d. There are two defining characteristics that must be present for a security to meet the definition of an ~~asset backed security~~ABS: 1) 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, and 2) When the assets owned by the ABS are non-financial assets, the assets are expected to generate a meaningful level of cash flows towards repayment of the bond other than through the sale or refinancing of the non-financial assets.

~~10.~~11. Various discussions and components were addressed in the establishment of these broad concepts and throughout the development of the principles-based bond definition. Specific elements and discussion points are detailed within this issue paper.

Security Structure Representing a Creditor Relationship

~~11.~~12. Similar to long-standing guidance in defining a bond, the principles-based bond concepts only permits security structures to be considered eligible for Schedule D-1 reporting. Although the concepts continue reference to the adopted security definition from U.S. GAAP, the guidance is expanded to require that the evaluation of the structure under the security definition considers the substance of the instrument rather than solely its legal form.

~~12.~~13. The consideration of whether a structure reflects a "security" is a key factor in determining the appropriate SSAP for accounting and reporting. A structure with one or more future payments that qualifies as a security has historically been captured as a bond, with measurement and risk-based capital (RBC) charges based on the NAIC designation. Under the prior SSAP guidance, bond securities did not require additional provisions for admittance and would likely only be subject to nonadmittance based on state investment limits. This treatment is distinctly different than a "non-security' structure considered to be a loan under SSAP No. *20—Nonadmitted Assets* or SSAP No. 21. For these structures, the ability to admit the loan under the SSAP provisions is contingent on the nature of the loan and qualifying collateral or related party assessments. (State investment limits may have additional loan~~-~~-to~~-~~-value requirements that impact admittance.) Loans (other than mortgage loans) are captured on Schedule BA: Other Long-Term Invested Assets and are likely limited by state investment limits along with other invested assets reported on Schedule BA. Although the RBC charge for admitted collateral loans is lower than other Schedule BA investments, the RBC charge is still higher than Schedule D-1 investments with most NAIC designations.

~~13.~~14. Over time, since the codification of statutory accounting principles, various industry comments have been received questioning the difference between loans and securities (e.g., bonds), particularly with the different reporting outcomes. This discussion was also revisited as part of the principles-based bond proposal, and it was concluded that structures must meet the security definition to be captured as a bond on Schedule D-1. Although industry requested "loans with recourse" to be added to the bond scope paragraph as well as an explicit reference to "loans" as a type of investment captured in the bond definition, these proposals were not supported for inclusion. This discussion highlighted that the security definition is not a high threshold to meet, and direct loans should not be reflected as bonds if they do not qualify as securities. With this discussion it was noted that an investment could meet the definition of a bond regardless of the legal form (paper) it was written on and/or how it was described (such as a bond, note, obligation, etc.). Although an instrument could be described as a "loan," if it meets the security definition requirements and other principle concepts, it shall be captured as a bond. The same concept would be true for instruments named as a "bond" but that do not meet the security or other principle-based bond requirements, as they would not be permitted for reporting as a bond on Schedule D-1 ~~reporting~~.

~~14.~~15. The statutory accounting guidance in SSAP No. 26 and *SSAP No. 37—Mortgage Loans* adopts the U.S. GAAP definition of a security as it is used in FASB Codification Topic 320 and 860:

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

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

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

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

~~15.~~16. The "security/non-security" discussion highlighted that the naming convention of an investment (as a "note," "bond," "obligation," "loan," or other such term) does not determine the correct underlying SSAP or reporting location. Non-security structures (other than mortgage loans) shall be captured as collateral or non-collateral loans pursuant to SSAP No. 20 or SSAP No. 21 as applicable. To prevent incorrect assumptions that all loans could be captured as issuer credit obligations, the group agreed not to include explicit reference to loan structures within the principles-based bond concepts and instead refer to the substance of the investment structure. Additionally, the following existing guidance was noted as support for this conclusion and to further highlight that the naming convention does not override the structural design of an investment when it comes to reporting or the application of statutory accounting principles.

a. Existing guidance in SSAP No. 21 states that if an instrument meets the definition of a bond, but has supporting collateral, then the investment is not classified as a collateral loan. This concept was affirmed as part of the principles-based bond discussion, noting that ~~such arrangements~~investments that qualify for bond reporting on Schedule D-1 shall not be classified as collateral loans regardless of whether there is collateral backing the investment.

b. Guidance in *SSAP No. 25—Affiliates and Other Related Parties* applies to all transactions, regardless of the SSAP that governs the underlying accounting and reporting. As such, the provisions in SSAP No. 25 that require assessment of "loans or advances (including debt, public or private)" ~~is~~ are intended to apply to all forms of lending from a reporting entity to a related party. As such, this guidance applies regardless of the naming convention of the agreement (e.g., loan, bond, note, obligation, etc.). ~~Structures~~ Investments reported as bonds on Schedule D-1 that reflect related party transactions shall only be admitted if the requirements in SSAP No. 25 are met. In addition to having a specific due date and written agreements, these requirements include specific assessments based on whether the arrangement is with a parent or principal owner or to other related parties.

~~16.~~17. After determining whether a structure represents a security, the next component for the principle-based bond definition is assessing whether the security represents a creditor relationship. Although the reference to a "creditor relationship" may seem very similar to prior guidance in SSAP No. 26, that prior guidance did not explicitly detail the intended meaning of a "creditor relationship" but simply identified that such structures have a fixed schedule for one or more future payments. This prior guidance resulted with interpretations that structures qualified as "bonds" strictly on legal form. With the focus of the principles-based definition, it is explicit that the assessment of a whether a security represents a creditor relationship requires consideration of the substance, rather than just the legal form, along with consideration of other investments owned in the investee and other contractual arrangements.

~~17.~~18. Original regulator concerns with the ~~current~~ historical guidance and reporting were in part due to the identification of investments with underlying equity interests that were structured to resemble bond instruments. ~~This d~~Discussions that occurred as part of the principles-based bond project identified that there is a significant incentive for insurers to characterize equity exposures, which would traditionally be captured on Schedule BA, as bonds due to the favorable capital treatment. Transferring or acquiring them as debt issued by an SPV (such as through a collateralized fund obligation (CFO) ~~type~~ structure) is a mechanism to reclassify these equity instruments and characterize them as bonds. These discussions noted that ~~T~~the lack of ~~current~~ historical safeguards in existing SSAPs also provides significant opportunity for these reclassifications.

~~18.~~19. Equity investments differ from other types of financial assets in that they generally do not have contractual pre-determined principal or interest payments. Distributions are typically at the discretion of whichever decision maker has control of the entity. However, certain types of entities have greater

likelihood and predictability of cash flows than others. For example, private equity and debt funds are often designed to have finite lives that begin with a capital raising and investment phase, and once the portfolio is built and seasoned, investments are monetized, returns are realized, and distributed to investors. Therefore, while there can be variability in timing and amounts of cash flows, distributions can be expected with some level of predictability compared to other types of equity investments (e.g., publicly traded companies). Private debt funds are more predictable still given that the underlying investments of the fund have contractual cash flows. If a large, diversified pool ~~of such types~~ of seasoned funds are securitized, (often ~~referred to as~~in the form of a CFO), there can be a level of predictable cash flows that is suited to support a bond, when coupled with the overcollateralization, liquidity facilities, and other protections that are built into the structure.

~~19.~~20. ~~A r~~Regulator concerns arise~~s~~ when features that facilitate the production of predictable cash flows are not present. In such ~~a case~~situations, when there are not predictable cash flows equipped to service the debt, repayment may rely on sale or refinancing of the underlying equity investments at maturity in order to satisfy the debt. In that case, equity valuation risk may be the primary risk for the non-payment of the ~~SPV~~ issued debt. If repayment predominantly relies on a point-in-time equity valuation (such as at maturity), then the substance of the risk is not consistent with what is expected of a bond reported on Schedule D-1.

~~20.~~21. Although the full disallowance of equity-backed debt would prevent these regulator concerns, there is a position that there are CFO securitizations (or other investments) of well-diversified, seasoned funds for which there is compelling evidence that there will be sufficient cash distributions to amortize the debt and structure protections that minimize the residual equity exposure. The approach to allow such CFO securitizations/investments to be reported as bonds only works when there are appropriate safeguarding principles established, which require a relatively high standard of proof.

~~21.~~22. An investment for which the primary non-payment risk ~~for non-payment~~ is equity devaluation is not consistent with the substance-intent for what is expected to be reported as a bond on Schedule D-1 under the principles-based definition. Allowing ~~these items~~such investments to be reported as bonds on Schedule D-1 could result with the regulatory arbitrage that regulators are concerned about without any real mitigants. This could ultimately result in a situation where industry has taken on significantly more equity risk that they have historically, all while characterizing the investment as a bond exposure. As such, it was noted as critical that appropriate safeguards be incorporated into the principles-based bond definition to address this concern. ~~, which~~This is why the ~~small group supported~~guidance reflects a rebuttable presumption that equity-backed ABS do not qualify to be reported as bonds on Schedule D-1 unless a documented analysis supporting the predictability of cash flows is completed that demonstrates bond-like cashflows that supports different treatment from ~~to overcome~~ that~~-~~ presumption.

~~22.~~23. The principles-based bond definition is clear that a security that possesses equity-like characteristics or that represents an ownership interest in the issuer in substance does not represent a creditor relationship. Examples of equity investments, equity holdings and equity-like interests include any security ultimately reflecting an ownership or membership interest in an entity (such as common stock, preferred stock, private equity holdings, investments in joint ventures, partnerships, and LLCs) as well as any structure that reflects the performance of an entity (such as dividends or capital gains). Furthermore, examples of equity instruments also include any debt instrument where the risk/reward profile is substantially similar to an equity interest.

~~23.~~24. With the prohibition of equity-like structures or items that represent ownership interests, there is a rebuttable presumption that debt instruments collateralized by equity interests do not qualify as bonds because they do not reflect a creditor relationship in substance. Notwithstanding this rebuttable presumption, it is possible for such a debt instrument to represent a creditor relationship if the characteristics of the underlying equity interests lend themselves to the production of predictable cash flows and the underlying equity risks have been sufficiently redistributed through the capital structure of the issuer.

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~~24.~~25. With the establishment of the principles-based bond definition, this rebuttable presumption was specifically discussed, and it was concluded that the determination of whether debt instruments collateralized by equity interests qualify as bonds inherently requires significant judgment and analysis. Unlike debt instruments collateralized with contractual cash flows, or debt instruments collateralized by cash-generating non-financial assets, debt instruments collateralized by equity interests may be dependent on cash flow distributions that are not contractually required to be made, predetermined, and/or may not be controlled by the issuer of the debt. In some instances, sale or refinancing of the underlying equity interests may be the only means of generating cash flows to service the debt instruments. If this is the situation, then it is expected that compensating factors from other characteristics of the structure will be present that supports ~~to qualifying~~ classifying the investment as a bond. For example, if the source of cash flows is driven from the sale or refinancing, then an appropriate, compensating level of overcollateralization would be required to overcome the presumption that the structure does not qualify as a bond.

~~25.~~26. For debt instruments that are collateralized by equity interests, various factors should be considered in determining whether debt collateralized by equity interests qualify as bonds. Additionally, to overcome the presumption that the structure does not qualify as a bond, it is presumed that reporting entities will have sufficient documentation supporting this conclusion. Factors to consider include, but are not limited to, the following:

a. Number and diversification of the underlying equity interests

b. Characteristics of the equity interests

c. Liquidity facilities

d. Overcollateralization

e. Waiting period for the distributions / paydowns to begin

f. Capitalization of interest

g. Covenants (e.g., loan-to-value trigger provisions)

h. Reliance on ongoing sponsor commitments

i. Source(s) of expected cash flows to service the debt (i.e., dividend distributions from the underlying collateral vs. sale of the underlying collateral)

~~26.~~27. The assessment of equity~~-~~-backed securities should be looked at, not only in form, but in substance. For example, a common arrangement exists where debt is issued from a feeder fund, and the feeder fund has an equity interest in another fund which predominantly holds debt instruments. The fund passes those fixed~~-~~-income cash flows through the structure to the ultimate feeder fund debt holder(s), in a way that produces substantially the same risk profile to the debt holders as a collateralized loan obligation (CLO). Accordingly, such an arrangement may have its substance aligned with a debt investment rather than a single equity investment, despite the direct holding being a fund investment. This conclusion would be supported if the terms of the structure ensure that the underlying fixed~~-~~-income cash flows are passed through. Factors that add additional uncertainty as to the timing and/or amount of the pass~~-~~-through of ~~the~~ cash flows from the underlying debt instruments may call into question a conclusion that a feeder fund structure is a debt-backed structure in substance. For example, discretion of an underlying fund manager to withhold distribution of the underlying cash flows passed through from underlying debt instruments may create uncertainties as to the timing and/or amount of cash flows in such a manner that is more characteristic of an equity investment. Likewise, a feeder fund structure that is not expected to provide for regular cash interest payments would also call into question the substance as a debt-backed investment. ~~Note, f~~Features that are customary to CLOs and other asset~~-~~-backed securities would not ordinarily call the investment's substance into question on its own. For example, a waterfall structure dictating the pass-through and order

of payments or retaining sufficient funds for covering contractual underlying fund level payments (e.g., investment management fees, legal costs, and other customary fund level expenses) are common to CLOs and other ABS, as are customary payment in kind (PIK) features designed to address temporary liquidity issues where the PIK then gets prioritized in the waterfall structure. These customary features do not constitute manager discretion that would call into question a conclusion that a feeder fund structure is a debt-backed structure in substance.

~~27.~~28. Conversely, if the feeder fund debt ultimately relies on equity interests for repayment (the final fund holds equity interests that generate the pass-through cash flows), the held debt instrument from the feeder fund would have to meet the requirements of paragraph 26 while looking at the substance of equity interests supporting the debt. Regardless of the underlying collateral, feeder fund arrangements would have to meet the other relevant parts of the standard (e.g., have a substantive credit enhancement, etc.) to qualify for bond reporting. Investments that resemble feeder fund structures will require entity review to determine the underlying source of cash flows and identify the uncertainties or vulnerabilities that could impact the cash flows that will be passed through to the reporting entity holder. Ultimately, the conclusion that a structure represents a feeder fund shall not automatically qualify the structure for bond classification but shall not automatically preclude bond classification. Substance over form should be the determining factor in these and similar situations.

Determination of Issuer Credit Obligation or Asset Backed Security (ABS)

~~28.~~29. Security structures that qualify as creditor relationships are divided between ICO~~issuer credit obligations~~ and ABS. The initial distinction between ~~an issuer credit obligation~~ICO and an ABS is a key factor with the principle-based bond concepts. Given their differing characteristics, investments that qualify as ~~issuer credit obligations~~ICO are not required to complete assessments for qualifying credit enhancements or meaningful cash flow generation. As such, it is critical to ensure that structures which should be considered ABS or that reflect non-qualifying Schedule D-1 structures, are not classified as ~~issuer obligations~~ICO to avoid those detailed assessments.

~~29.~~30. Determining whether an investment reflects an ~~issuer credit obligation~~ICO or an ABS focuses on the issuer and the primary source of repayment of the instrument. An ~~issuer credit obligation~~ICO represents a bond structure where the repayment is supported primarily[2] by the general creditworthiness of an operating entity or entities. The support for this structure consists of direct or indirect recourse to an operating entity or entities. An "operating entity" can be any sort of business entity, not-for-profit organization, or other provider of goods or services, but cannot be a natural person or an Asset Backed Security (ABS) Issuer. An ABS is a bond issued by an entity (an ABS Issuer) created for the primary purpose of raising debt capital backed by financial assets or cash generating non-financial assets owed by the ABS Issuer, whereby repayment is primarily derived from the cash flows associated with the underlying defined collateral rather than the cash flows of an operating entity.

~~30.~~31. The prior assessments to divide structures between SSAP No. 26 and SSAP No. 43 seemed to focus primarily on legal form (issued by trust/SPV that held pledged assets) or on the basis of prepayment

[2] To clarify the phrase "supported primarily by the general creditworthiness of an operating entity," this means that the full repayment is expected to come from cash flows generated by the operating entity, not from collateral, although secondary recourse to collateral may be present. If it is expected that a majority of repayment will come from operating entity cash flows, but it is expected that some cash flows will come from collateral, this investment does not qualify as an issuer credit obligation and shall be assessed as an asset-backed security. The expectation must be that full repayment will be generated from operating entity cash flows. For asset-backed securities, the expectation is that the source of cash flows will come from collateral, even though there may be secondary recourse to an operating entity.

risk within the structure (meaning, that the expected timing of cash flows may vary, impacting the effective interest rate). Under the principle-based bond definition, neither of these components shall be used as a determinant in concluding whether a structure represents an issuer credit obligationICO or an ABS.

a. The prior guidance which focused on the use of an SPV relied more on legal form than the substance of the transaction. Although it is common that many ABS Issuers are in the form of a trust or SPV, the presence or lack of a trust or SPV is not a definitive criterion in determining that a security meets the definition of bond intended as a Schedule D-1 investment, or that it is limited to a classification as an ABS. A key component of the principles-based bond definition is that it will not be possible for insurers to classify recognize a non-qualifying investment as a bond simply by moving it to a debt-issuing SPV to that resembles a creditor relationship with a future payment obligation. Furthermore, the guidance does not preclude the use of SPVs in ICO structuresissuer credit obligations. Such structures are commonly utilized in project finance arrangements to separate business operations that support specific debt instruments, or to facilitate efficient marketing of an issuer credit obligationspecific ICO design (e.g., funding agreement backed notes). Although packaging investments together in an SPV, with an SPV-issued note may currently result with better RBC charges due to the current ability to report such items as bonds, such structures that simply reflect a pass-through of cash flows or performance from the underlying collateral and provide no economic difference than if holding the underlying collateral items directly should shall not be characterized as bonds under the principles-based bond definition.

b. With regards to the prior interpretation that SSAP classification was based on the presence of prepayment risk, which was not an interpretation based on any explicit guidance to that effect, under the principles-based bond definition, the presence or absence of prepayment risk will continue to play no role in SSAP classification. Classification is based on whether the investment has the substance of an issuer obligationICO or asset backed securityABS. This distinction aligns the accounting and measurement with the characteristics of the bond structure. As asset backed securitiesABS rely on the cash flows of underlying collateral, the measurement method described in SSAP No. 43, which requires a quarterly review of underlying cash flow assumptions, is appropriate regardless of whether variations in timing of cash flows impact the effective yield. This methodology captures variations in both timing and amount of the underlying cash flows.

31.32. Whether an issuer of debt represents an operating entity or ABS Issuer is expected to be clear in most instances, but certain instances may be less clear. Ultimately, for an issuer credit obligationICO, it comes down to whether support for repayment consists of direct or indirect recourse to an operating entity or entities. In addition to "traditional bond" structures previously included in SSAP No. 26, examples of issuer credit obligations include:

a. Investments in the form of securities for which repayment is fully supported by an underlying contractual obligation of a single operating entity. (Examples can include 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 principle 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.

b. Bonds issued by real estate investment trusts (REITS) or similar property trusts.

c. Bonds issued by funds representing operating entities. Determining whether a fund represents an operating entity can generally be made by evaluating the substance of the entity and its primary purpose. A fund representing an operating entity has the primary purpose of raising equity capital and generating returns to its equity investors. Ancillary debt may be issued to fund operations or produce levered returns to equity holders. These debt issuances occur in accordance with the fund's primary equity-investor objective. Debt securities issued by closed-end funds and business development corps registered under the 1940 Act are permitted automatic qualification as issuer credit obligations as those funds are subject to strict limits or reporting components on the leverage (debt issuance) within the fund. This safe harbor for SEC-registered funds should not be viewed to extend to funds that are not SEC-registered by analogy, through comparison of leverage levels for example. All other funds should be classified in accordance with the determination of the issuer's primary purpose. (For example, although some registered funds allow a large percentage of debt, non-registered funds with comparable amounts of issued debt may reflect debt securities from feeder funds or equity-backed ABS, and those debt securities are required to be assessed as ABS. As such the percentage of debt permitted for a registered funds should not be utilized as a proxy in determining whether debt issued from a fund is permitted to be captured within the guidance.) ~~Bonds issued by business development corporations, closed-end funds or similar operating entities, in each case registered under the 1940 Act. With this inclusion, it is important to highlight that the intent is specific to bonds issued from SEC-registered entities. The reference to "similar entities" is not intended to capture items issued from collateralized fund obligations (CFOs) or other such structures. In contrast, an ABS Issuer has a primary purpose of raising debt capital and its structural terms and features serve to support this purpose.~~ In contrast, an ABS Issuer has a primary purpose of raising debt capital and its structural terms and features serve to support this purpose. More distinctively, the contractual terms of the structure generally define how each cash flow generated by the collateral is to be applied. For these structures, there is little or no discretion afforded to the manager/servicer of the vehicle and any discretion that is allowed is narrowly defined in the contractual agreements. The hardwiring of debtholder protections allows for the issuance of higher amounts of debt securities to be issued than what would be possible for a fund representing an operating entity. These features support the entity's primary purpose of raising debt capital. Although some may consider CFOs or feeder funds to be similar to closed-end funds, that assessment is not supported for classification as an ~~issuer credit obligation~~ICO. Instruments considered to reflect CFOs (and other like structures) are required to be assessed as ~~asset-backed securities~~ABS for inclusion as a bond reported on Schedule D-1. Paragraphs 27-28 also detail the assessment expected in classifying feeder funds, and the requirement to determine the source of the underlying cash flows in determining classification and if the structure qualifies for reporting as a bond on Schedule D-1.

Note: If agenda item 2024-01 is not adopted, and debt issued by funds is restricted to only SEC registered funds, paragraph 32c will read as follows:

Bonds issued by business development corporations, closed-end funds or similar operating entities, in each case registered under the 1940 Act. With this inclusion, it is important to highlight that the intent is specific to bonds issued from SEC-registered entities. The reference to "similar entities" is not intended to capture items issued from collateralized fund obligations (CFOs), feeder funds or other such structures. Although some may consider CFOs to be similar to closed-end funds, that assessment is not supported for classification as an ICO. Instruments considered to reflect CFOs (and other like structures) are required to be assessed as ABS for inclusion as a bond reported on Schedule D-1. Paragraphs 27-28 also detail the assessment expected in classifying feeder funds, and the

requirement to determine the source of the underlying cash flows in determining classification and if the structure qualifies for reporting as a bond on Schedule D-1.

~~c.~~d. Project finance debt issued by operating entities. These investments reflect financing of a single asset or "operation" (such as a toll road or power generation facility) that collateralizes a debt issuance and the cash flows produced by the asset/operation service the debt, where the issuer may also represent an operating entity. These designs have characteristics of both ~~issuer credit operations~~ICO, as the operation constitutes a stand-alone business, as well as characteristics of ABS, as they are formed for the purpose of raising debt capital backed by the cash flows from collateral held by a bankruptcy-remote entity. When viewed holistically, these issuing entities are typically used to facilitate the financing of an operating component of a project sponsor or municipality. Although the use of a bankruptcy-remote entity (e.g., SPV) facilitates the efficient raising of debt as a source of financing, the primary purpose is to finance an operating project. Therefore, when the issuing entity represents a stand-alone business producing its own operating revenues and expenses, where the primary purpose is to finance an operating project, the issuing entity shall be considered an operating entity despite certain characteristics that resemble ABS issuances.

i. It is important to highlight that the guidance for project finance is strictly for instruments issued by operating entities, similar to other instruments that qualify as ~~issuer credit obligations~~ICO under the principles-based bond definition. Consistent with other concepts, the naming convention (e.g., referring to an instrument as project finance) or the presence or absence of an SPV/trust structure are not definitive components in determining whether an investment qualifies for reporting as a bond on Schedule D-1, or is classified as an ~~issuer credit obligation~~ICO or ABS. Instruments (even if identified as "project finance") that do not qualify as ~~issuer credit obligations~~ICO as they are not issued by operating entities, shall be assessed for qualification for reporting on Schedule D-1 as ABS. If the instruments do not qualify for reporting as ABS, they shall not be reported on Schedule D-1.

~~d.~~e. U.S. Treasury Inflation-Protected Securities (TIPs): The inclusion of U.S. TIPs specifically as an ~~issuer credit obligation~~ICO intends to highlight a specific exception to the determination as a creditor relationship as the variation is due to plain-vanilla inflation adjustment mechanisms. Although U.S. TIPs are specific as ~~issuer credit obligations~~ICO, ~~Under~~ under the bond definition ~~encompassing both issuer credit obligations and asset-backed securities~~, in order for a debt instrument to represent a creditor relationship for both ICO and ABS, 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 (e.g., performance) of any underlying collateral value or other non-debt variable[3]. For example, an issued security that has varying principal and interest

[3] The principles-based bond definition ~~requiring~~ requirement for pre-determined principal and interest payments with contractual payments that do not vary based on the performance of an underlying collateral value or other non-debt variable does not intend to encompass nominal interest rate adjustments. 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.

payments based on the appreciation of referenced equity, real estate or other non-debt variables are precluded from bond treatment as they do not reflect creditor relationships. Although US TIPS are indexed to the consumer price index and grow~~s~~ with inflation, these securities shall be captured as ~~issuer credit obligations~~ICO on Schedule D-1-1.

~~32.~~33. This principles-based bond ~~Schedule D-1~~ project is not expected to reconsider certain investments previously considered by the Working Group and explicitly permitted for bond reporting on Schedule D-1~~ reporting~~. As such, unless subsequently addressed~~ within this project~~, the following investment types are expected to continue to qualify as Schedule D-1 investments, ~~and be~~ classified as ~~issuer credit obligations~~ICO. (By including these investments as ~~issuer credit obligations~~ICO, these investments are not subject to the assessments of sufficient~~cy~~ credit enhancement or meaningful cash flow generation required for ABS securities.)

a. Certificates of deposit that have a fixed schedule of payments and a maturity date in excess of one year from the date of acquisition.

b. Bank loans that are obligations of operating entities, issued directly by a reporting entity or acquired through a participation, syndication or assignment.

c. Debt instruments in a certified capital company (CAPCO).

d. SVO-Identified Bond ETFs.

~~33.~~34. The investment structures explicitly permitted for Schedule D-1 reporting no longer includes a generic reference to "hybrid securities." Under prior guidance in SSAP No. 26, hybrid securities, defined in the annual statement instructions as securities with characteristics of both debt and equity securities, were included and captured on a specific Schedule D-1 reporting line. Examples in the annual statement instructions included Trust Preferred Securities and Yankee Tier 1 bonds, however, both types of securities are no longer overly prevalent, although some insurers may continue to have them in their portfolios. Pursuant to the intent of the principle-based bond definition~~proposal~~, a broad exception for securities that have characteristics of both debt and equity is not viable. Rather, to ensure that securities are classified and reported based on the substance of the investments, securities with characteristics of both debt and equity shall be assessed for inclusion as a bond for reporting on Schedule D-1 in accordance with the principal-based bond definition. If the securities qualify as ~~issuer credit obligations~~ICO or ABS, then they can be reported on Schedule D-1.

a. Trust Preferred Securities – With these securities, there is a trust funded by debt where shares of the trust are then sold to investors in the form of preferred stock. The shares held are referred to as "trust preferred" securities. These securities have characteristics of both stock and debt. While the trust is funded with debt, the shares are considered to be preferred stocks and pay dividends like preferred stock. However, since the trust holds the bank's debt as the funding vehicle, the payments received by investors are considered interest payments. These securities are considered equities under U.S. GAAP but are taxed as debt obligations by the IRS. With the Dodd-Frank reforms, the incentives for banks to issue trust-preferred securities decreased, resulting ~~with~~ in a significant reduction in the issuance of these securities. If these securities continue to be held by insurers, they should be assessed for reporting as a bond on Schedule D-1 under the principal-based bond ~~proposal~~definition. If these securities do not qualify as a bond for reporting on Schedule D-1, presumably, these securities would be reported as preferred stock on Schedule D-2-1.

b. Yankee Bond – A Yankee bond is one issued by a foreign bank or company but that is traded in the U.S and priced in U.S. dollars. Yankee bonds are normally issued in tranches, with a large debt structure financing arrangement, with each tranche having different levels of risk, interest rates and maturities. The non-U.S. issuers have to register Yankee bonds with the SEC before offering the bond for sale. If these securities are held by insurers, they should be assessed for reporting as a bond on Schedule D-1 under the principal-based bond ~~proposal~~definition.

c. Other Hybrid Securities – From information received, it was noted that some reporting entities have previously reported securities on Schedule D-1 as hybrids due to a code in Bloomberg that identified the security as having characteristics of both debt and equity. Such securities shall be reviewed in accordance with the principles-based bond definition and reported as a bond on Schedule D-1 only if they qualify.

~~34.~~35. For securities that represent principal-protected securities and structured notes that have been previously captured within SSAP No. 26 or SSAP No. 43, the principles-based bond definition will no longer permit these security structures to be reported as bonds on Schedule D-1. Fundamentally, these structures have the potential for variable principal or interest / returns, or both, due to appreciation or depreciation (i.e., performance) of an underlying collateral value or other non-debt variable. This structural characteristic precludes these investments from being captured as ~~issuer credit obligations~~ICO or ABS as the investment does not represent a creditor relationship in substance. It should be clear that the principles-based bond definition is intended to require a structural assessment inclusive of all investment components, therefore it is not permissible to segregate components within a structure, such as bond collateral supporting principal and interest payments to determine bond reporting on Schedule D-1 ~~reporting~~ when the structure also includes other collateral with the potential to generate additional interest or returns. Such structures must be viewed holistically within the principles-based bond definition, with all potential returns considered in determining whether the structure qualifies as a creditor relationship.

a. A principal-protected security is defined in *the Purposes and Procedures Manual of the NAIC Investment Analysis Office*, but generally includes a high-quality traditional bond (such as a U.S. Treasury) that is used to safeguard principal repayment at the structure's maturity, ~~has~~ along with performance components where payments originate from, or are determined by, non-fixed-~~-~~income securities. These returns, often based on underlying equity factors, prevent~~s~~ these structures from qualifying as a creditor relationship. In addition to the traditional design of principal-protected notes, other designs have been identified that may provide "interest" payments in the form of tax-credits based on underlying equity exposures. (So, a high-quality bond ~~still~~ safeguards principal returns, but the structure ~~acquires~~ includes equity elements that provide tax credits to the note holder as a form of interest.) Although the classification of a creditor-relationship may not be as clear in this example, such designs would further be disqualified from reporting as a bond on Schedule D-1 ~~reporting~~ as they would not qualify as ~~issuer credit obligations~~ICO due to the different forms of collateral within the structure (considering both the bond and equity items) and such structures would not qualify as ABS as there is generally no credit enhancement. These investments shall follow the guidance for non-bond debt securities in *SSAP No. 21—Other Admitted Assets*.

b. A structured note is a security that otherwise meets 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 failure of the borrower to pay the principal amount due. These instruments, 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 current fluctuations are not structured notes.

~~35.~~36. The guidance in the principles-based bond ~~proposal~~ definition requires "assessment at origination" in determining whether a security ~~complies~~ qualifies for reporting as a bond ~~for~~on Schedule D-1 ~~reporting~~. This provision intends to reflect the reporting entity's understanding of the intent and ultimate structure of the security's focus at origination, not simply what a structure holds on the day of origination. It is not permissible to conclude that a principal-protected security is an ~~issuer credit obligation~~ICO at origination (when the structure includes only a US Treasury and cash) and disregard the intended use of the cash in the structure to subsequently acquire other investments to generate additional returns. The determination of whether an investment qualifies as a creditor-relationship, and then as an ~~issuer creditor obligation~~ICO or ABS (as applicable), requires an assessment by the reporting entity of the full structure at the time of acquisition as it ~~is~~ was ultimately intended by the ~~reporting entity~~issuer at the time of ~~acquisition~~origination.

~~36.~~37. Consistent with prior guidance in SSAP No. 26, mortgage loans and other real estate lending activities, which are not securities, made in the ordinary course of business are excluded from bond classification on Schedule D-1. Those investments shall follow the applicable~~application~~ statutory accounting guidance in SSAP No. 37 and *SSAP No. 39—Reverse Mortgages*.

Asset Backed Securities and Required Components

~~37.~~38. An ~~Asset Backed Security (~~ABS~~)~~ is a bond issued by an entity (an ABS Issuer) created for the primary purpose of raising debt capital backed by financial assets or cash generating non-financial assets owed by the ABS I~~i~~ssuer, whereby repayment is primarily derived from the cash flows associated with the underlying defined collateral rather than the cash flows of an operating entity. In most instances, the ABS ~~i~~Issuer is not expected to continue functioning beyond the final maturity of the debt initially raised by the ABS Issuer. As previously noted, ABS Issuers are often in the form of a trust or special purpose vehicle, though the presence or lack of a trust or special purpose vehicle is not a definitive criterion for determining that a security meets the definition of an asset backed security.

~~38.~~39. To qualify for bond reporting on Schedule D-1 as an ABS, there are two defining characteristics that must be present. If the structure is a not an ~~issuer credit obligation~~ICO or identified for specific inclusion on Schedule D-1, and does not meet these ABS requirements, the instrument is not permitted to be reported as a bond. Assessment on these aspects is investment specific, with determination at origination by the reporting entity based on the overall intent and ultimate expected holdings of the structure:

a. Substantive Credit Enhancement: The holder of the debt obligation issued by the ABS Issuer is in a different economic position than if the holder owned the ABS Issuer's assets directly.

b. Cash Generating Collateral Assets: The assets owed by the ABS iIssuer are either financial assets or cash-generating non-financial assets. Cash-generating non-financial assets are defined as assets that are expected to generate a meaningful source of cash flows for repayment of the bond through use, licensing leasing, servicing or management fees, or other similar cash flow generation other than through the sale or refinancing of the assets.

39.40. Substantive Credit Enhancement: The component for substantive credit enhancement is required for all ABS structures. There are no practical expedients or thresholds that can be applied in determining whether a structure reflects substantive credit enhancement. Although certain structures may only require a limited analysis (such as agency-backed mortgage-backed securities—MBS), and insurers may benefit from prior analysis when acquiring similar subsequent structures, an automatic assessment is not permitted for this requirement.

40.41. To qualify as an ABS, the holder of the debt obligation is required to be in a different economic position than if the holder owned the ABS issuer's assets directly. For purposes of this assessment, the holder of the instrument is considered to be in a different economic position if the instrument benefits from substantive credit enhancement through guarantees (or other similar forms of recourse), subordination and/or overcollateralization. This element is required for all ABS designs, regardless of the collateral that is backing the ABS.

41.42. The requirement for substantive credit enhancement is intended to address investment designs crafted to appear as a debt / bond structure for reporting and RBC purposes, but for which the holder does not have a "more than nominal" change to the risk or reward profile than if they held the underlying investment directly. This guidance prevents using a specifically designed legal form (such as transferring assets to an SPV and acquiring an SPV-issued note), but which lacks any economic substance, to obtain favorable measurement and RBC impact or to avoid nonadmittance that would occur if the assets were directly held by the reporting entity.

42.43. The intent of the "substantive" threshold requiring the holder to be in a different economic position is to distinguish qualifying bonds from instruments with equity-like characteristics or where the substance of the transaction is more closely aligned with that of the underlying collateral. To qualify as a bond under this standard, there is a requirement that there are substantive credit enhancements within the structure that absorb losses before the debt instrument being evaluated would be expected to absorb losses. This is inherent in the context of an Issuer Credit ObligationICO 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 securitiesABS. If substantive credit enhancement did not exist, the substance of the investment 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.

43.44. The original exposure (May 2021) detailed this ABS requirement as a "sufficient" credit enhancement and detailed the provision as the level of credit enhancement a market participant (i.e., reasonable investor) would conclude is expected to absorb losses (or decreases in cash flows) to the same degree as other debt instruments of similar quality, under a range of stress scenarios (i.e., scenarios are similar to stress scenarios performed for other debt instruments of the same quality). This original proposal noted that losses are those a market participant would estimate with consideration of historical losses (including loss recoveries) on similar collateral, current market conditions, reasonable and supportable forecasts, and prepayment assumptions associated with the collateral. Excluded from the estimate of expected losses are historical gains on similar collateral and expected market appreciation on the collateral. After further discussion of this concept, it was identified that the term sufficient and its proposed definition implieds a quantitative assessment of credit quality is was required. As a result, the proposed concept could be interpreted to mean that a reperformance of the credit underwriting process would be needed to support accounting classification, which is not the intent and could be seen to violate the policy that credit ratings

do not determine accounting classification, as well as introduce an administrative reporting burden that is both duplicative and lacking any added value. Further, a misinterpretation could occur that would permit satisfaction of this component if a credit rating or NAIC designation was obtained. The intent of the concept is not to address credit quality. Rather, the intent is to require that there must be economic substance to support the transformation of the underlying collateral risk, to bond risk. As a result of these discussions, revisions were incorporated to revise the terminology and related definition to reflect a "substantive credit enhancement." In addition to eliminating a perception that reporting entities could use credit ratings to support this distinction, this guidance incorporates principle concepts to ensure that the provision cannot be satisfied with structural elements that are merely nominal or lack economic substance.

~~44.~~45. Substantive credit enhancement can come in various forms, including but not limited to, subordination/overcollateralization, guarantees, or other forms of recourse. In whatever form the credit enhancement comes in, it must be of a level of significance that the holder of the debt instrument is in a substantively different position than owning the underlying collateral directly. ~~Evaluation~~ Assessment of whether a credit enhancement has substance may involve an evaluation of the level of overcollateralization (loan-to-value orLTV) or the capacity of whatever form of subordination, guarantee or recourse to absorb collateral losses. ~~As noted, t~~The guidance intends to be specific that an NAIC designation, obtained from either the NAIC Securities Valuation Office (SVO) or from a Credit Rating Provider (CRP) does not provide standalone evidence to support a conclusion that the structure includes a substantive credit enhancement. Although the presence of independent market validation may provide evidence supporting the substance of a credit enhancement, that provision shall not be interpreted to indicate that the presence of an NRSRO rating is automatic validation that the substantive threshold has been met.

~~45.~~46. The following elements were specifically discussed with regards to the requirement for a substantive credit enhancement:

a. Agency-Backed Pass-Through Structures (e.g., RMBS/CMBS): These structures, when they have an agency guarantee, are expected to meet the substantive credit enhancement requirement with little analysis. Although the reporting entity participates on a proportional basis in the cash flows from the underlying mortgage loans held by the SPV, the reporting entity is in a different economic position than if it owned the underlying mortgages directly because the credit risk has been redistributed and assumed by the agencies.

b. Non-Agency Backed Pass-Through Structures: Unlike the above agency-backed example, a pass-through MBS without a credit enhancement, if one were to exist, would not put the holder in a different economic position as owning the mortgage loans directly as they would participate proportionally in the first dollar of losses on the underlying loans. Pursuant to the intent of the overall principles-based bond / Schedule D-1 project and required substantive credit enhancement, the guidance does not permit use of an SPV to recharacterize an asset to qualify for reporting as a bond on Schedule D-1 ~~reporting~~ if the holder is in the same economic position as holding the underlying investments directly. This would apply to any type of underlying asset. In contrast, if ~~the holder of the~~a debt instrument ~~held~~ represents a senior interest in the pool of loans, through existence of a subordinated tranche for example, the holder may conclude that it is in a different economic position from holding the loans directly, provided the subordination is determined to be substantive.

c. Loan-To-Value (LTV) Assessments: An assessment of LTV at origination may provide evidence of substantive credit enhancement through overcollateralization. The review should be a holistic assessment, evaluating the expected LTV over the life of the transaction, in conjunction with the liquidity and market value volatility of the underlying collateral, particularly in points in time when the underlying equipment is expected to be off-lease or at the time of maturity if refinancing or sale is required. It is appropriate to

consider any expected economic depreciation, but it is not appropriate to factor in any expected economic appreciation. Although an expected decline in the LTV ratio may support the presence of a credit enhancement, a declining LTV is not required, and an increasing LTV is not prohibited, as long as the structure continues to provide a substantive credit enhancement. An expected high LTV at maturity, relative to the market value volatility of the underlying collateral, is considered to lack substantive overcollateralization and would require other forms of credit enhancement in order to meet the substantive credit enhancement criteria.

d. The first loss position may be issued as part of an ABS structure~~the securitization~~ in the form of debt or equity interest, or it may be retained by the sponsor and not be issued as part of the ~~securitization~~structure. The holder of the loss position, ~~or~~ regardless of if ~~whether~~ it is issued as a tranche or retained by the issuer, does not impact the determination of whether the loss position provides substantive credit enhancement. Rather, the assessment focuses on whether the holder of the debt instrument is in a substantively different position than owning the underlying collateral directly. This assessment includes consideration on the first loss position (or more senior positions, if the first loss position is not sufficient) regardless of the holder of the loss positions. If the first loss position (or a more senior position(s), if the first loss position(s) lacks ~~contractual payments along with a~~ substantive credit enhancement) is issued as part of the ~~securitization~~ structure and does not have ~~contractual principal and interest payments along with~~ substantive credit enhancement and is held by a reporting entity, the investment(s) does not qualify for reporting as a bond as it is a residual interest. All residual interests shall follow the accounting and reporting guidance in SSAP No 21. ~~and shall be reported on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value consistent with the treatment for residuals. (These items are further addressed in *SSAP No. 21R—Other Admitted Assets*.)~~

~~46.~~47. Meaningful Level of Cash Flows to Service Debt: The element for meaningful cash flow generation is only a requirement for ABS that are backed by non-financial assets. ABS designs backed by financial assets, when there is no future performance obligation outside of default risk that could impact the ability to generate cash flows to service the debt, are not required to be assessed under the meaningful cash flow requirement.

~~47.~~48. To qualify as an ABS, there must be a meaningful level of cash flows generated from non-financial assets backing an ABS to service the debt, other than through the sale or refinancing of the assets. The evaluation is specific to each transaction and should consider the market volatility and remarketing potential of the underlying collateral, the variability of the cash flows produced, as well as the diversification of the source of cash flows within the structure. The main intent of this guidance is to ensure that non-financial assets supporting structures reported as bonds on Schedule D-1 encompass a level of "cash generation" that is conducive to servicing traditional bond-like cash flows.

~~48.~~49. Consistent with the substance theme of the principles-based bond proposal, this guidance intends to prohibit situations in which the legal form of an investment is utilized to receive favorable accounting and reporting treatment, while the primary non-payment risk is the point-in-time valuation of an underlying asset. The prior guidance in SSAP No. 43 that focused on placing collateral assets in trust, with the SPV issuing a debt instrument, enabled situations in which non-cash generating structures could be reported as bonds on Schedule D-1. As a simple example, this guidance prevents artwork from being captured as the collateral backing a debt instrument issued by an SPV, with the reporting entity then reporting the SPV-issued note as a bond investment that reflects the expected future value that will be received upon the ultimate sale of the artwork.

~~49.~~50. The guidance requires meaningful cash generation to satisfy the debt instrument throughout the duration of the debt term. The timing of the cash generation, at points prior to maturity of the investment, is a key element as it intends to specifically exclude transactions in which the underlying assets must be sold or refinanced at maturity to produce cash to meet the meaningful requirement. However, this restriction is not intended to automatically exclude all structures that may incorporate collateral asset sales or refinancing throughout the debt duration as part of the expected cash generation. An example could be the securitization of short-term rental car receivables. Such a design could encompass both the rental car lease payments as well as periodic sales of the rental cars as the means to generate meaningful cash flows to service the debt. This design, with planned periodic sales of the non-financial collateral assets over the debt term, is distinctly different than a structure in which cash flows are not meaningfully generated over the course of the debt term and would rely predominantly on the sale or refinancing of the underlying collateral at maturity to satisfy the debt obligation. This restriction also does not exclude all structures that have any amount of sales or refinancing at the end of the debt term. Such investments can qualify for reporting as a bond on Schedule D-1 ~~reporting~~ if they meet the meaningful cash generation criteria throughout the term of the instrument other than through the sale/refinancing at maturity.

~~50.~~51. The assessment of meaningful cash flows may require detailed evaluations as it is not permissible to conclude that the presence of any cash flows generated within the structure will result with the investment reaching the "meaningful" threshold. It is also not expected to commonly see ~~asset-backed securities~~ABS structures that include both financial and non-financial collateral. Such designs shall be reviewed to determine that the structure is in line with the principle intent of the bond definition and has not been developed to circumvent separate assessment or reporting of non-financial asset components. As a simplistic example, including mortgage-backed securities and artwork in a single structure, and identifying that the cash flows of the MBS satisfies the meaningful threshold~~,~~ with the artwork representing a minimal residual element, with a conclusion ~~so~~ that the full structure qualifies for reporting as a bond on Schedule D-1 ~~reporting~~ is not reflective of the intent of the principles-based standard. If there are instances in which financial asset and non-financial asset collateral are combined in a single ~~asset-backed~~ABS structure, consideration should occur on the intent of commingling these collateral elements pursuant to the intent of the principles-based bond definition and in assessing the meaningful cash flow requirements. Structures identified that have been developed to circumvent the provisions of the principle-based bond definition are not permitted to be reported as a bond on Schedule D-1 and shall be captured as a non-bond debt security in scope of SSAP No. 21~~reported on Schedule BA at the lower of amortized cost or fair value~~.

~~51.~~52. The assessment of meaningful cash flows is specific to each transaction, determined at origination, and should consider various factors collectively in determining if the meaningful threshold is met. For this assessment, it is noted that an increase in price volatility or variability of cash flows requires a greater percentage of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral. On the flip side, as liquidity, diversification or overcollateralization increase, the required percentage of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral is permitted to decrease. The following factors should be considered with the assessment of meaningful cash flows:

a. Price volatility in the principal market in the underlying collateral.

b. Liquidity in the principal market for the underlying collateral.

c. Diversification characteristics of the underlying collateral (i.e., types of collateral, geographic locations, sources of cash flows within the structure, etc.,)

d. Overcollateralization of the underlying collateral relative to the debt obligation.

e. Variability of cash flows, from sources other than sale or refinancing, expected to be generated from the underlying collateral.

~~52.~~53. The assessment of meaningful cash flows does permit a practical expedient under the principles-based bond definition. A reporting entity may consider an asset for which less than 50% of the original principal relies on sale or refinancing to meet the meaningful cash-flow generating criteria. (A structure with contractual cash flows that does not satisfy all of the interest stipulated in the structure does not qualify under the practical expedient.) In applying this practical expedient, only contractual cash flows of the non-financial asset may be considered. This practical expedient should not be construed to mean that assets cannot meet the meaningful criteria if they rely on the sale or refinancing to service any interest, an amount greater than 50% of the original principal or if they rely on cash flows that are not contracted at origination. Rather, such instances do not qualify under the practical expedient and would require a complete analysis of the noted factors in determining whether the meaningful cash-generating criteria has been met.

Additional Elements for Asset Backed Securities

~~53.~~54. When establishing the ABS definition and required components, various aspects were discussed to improve clarity on the application of the guidance.

~~54.~~55. Determination of "Assets" Backing Securities: Although the definition of an asset detailed in *SSAP No. 4—Assets and Nonadmitted Assets*, is applied throughout ~~the~~ statutory accounting principles, the question was raised as to where the asset definition would be applied in determining a qualifying ABS. For example, an entity that expects to have subsequent receivables from future operations does not have recognized "assets" from those expectations as the requirements of the asset definition have not been met. However, if that entity were to sell the rights to future cash flows from expected operations, the selling entity would receive cash (a qualifying asset), and the acquiring entity would also have a recognized asset from the acquired right to future cash flows.

~~55.~~56. For purposes of qualifying as an "asset" permitted in an ABS structure, the definition of an asset must be met by the ABS Issuer. In some situations, particularly when the asset represents a right to future cash flows, the asset may not be in a form that could be liquidated to provide payment towards the debt obligations. (For example, if the asset represents acquired rights to future royalties, those royalty rights would have to materialize to have liquid assets available toward the debt obligations.) The ability to liquidate the backing collateral asset at a single point in time does not impact the structural determination of whether the issued security meets the definition of an ABS provided that the assets are expected to produce meaningful cash flows to service the debt terms. Additionally, the inability to liquidate the assets backing the instrument may impact the assessment of what constitutes substantive credit enhancement. Failure of cash flows to materialize may impact recoverability and require impairment of an ABS.

~~56.~~57. There is no requirement for a collateral asset backing an ABS structure to qualify as an admitted asset under statutory accounting. Assessing whether the underlying asset qualifies for admittance is not necessary as non-financial assets backing ABS must meet the meaningful cash-generating criteria. If the structure fails to meet the meaningful cash-generating requirement, the instrument does not qualify for reporting as a bond on Schedule D-1. ~~Note that s~~Statutory accounting has not historically restricted bonds backed by inadmissible assets from being admissible ~~either~~, nor has it included any kind of evaluation of the cash flow producing ability of underlying assets. The ~~proposed~~ principles-based bond definition adds a requirement to evaluate the cash flow producing ability of the underlying collateral, but continues to recognize that assets that may not be admissible if held individually on an insurer's balance sheet, may be well suited to support bond-like cash flows when securitized in large numbers with appropriate structuring (e.g. prioritization of cash flows).

~~57.~~58. Determining Whether the Structure Reflects "Financial" or "Non-Financial" Assets: The definition of a "financial asset" has previously been adopted from U.S. GAAP and is reflected in *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* as cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right 1) to receive cash or

another financial instrument from a second entity or 2) to exchange other financial instruments on potentially favorable terms with the second entity.

~~58.~~59. For purposes of excluding financial assets from the ABS meaningful cash generation criteria, the financial asset definition was clarified, for the avoidance of doubt, to not include assets for which the realization of benefits ~~conveyed by~~from the rights to receive or exchange financial assets depends on the completion of a performance obligation such as with a lease, mortgage servicing right, royalty rights, etc. For purposes of applying the ABS guidance, when there is a performance obligation required before the cash flows are generated, the assets represent non-financial assets, or a means through which non-financial assets produce cash flows, until the performance obligation has been satisfied. As another way to assess this clarification, if the assets backing the ABS are only subject to default risk (meaning the risk of nonpayment is solely based on failure of the underlying payer to satisfy its unconditional promise to pay), then the asset is a financial asset. If the asset is subject to any other risk in addition to default risk, then the assets represent non-financial assets. As simple illustrative examples:

a. A mortgage-backed security (MBS), where the underlying mortgages have been securitized into a structure, the mortgage receivables represent unconditional promises to pay, with no further performance obligation of the lender or any other party. This structure is considered to be backed by financial assets. Although this structure is excluded from the meaningful cash flow assessment, it must still comply with the substantive credit enhancement requirement.

b. A structure that represents the securitization of rental car leases is contingent on the lessor performing its side of the transaction (providing the car for use) before the lessee is obligated to pay. Therefore, a lease is a non-financial asset due to the performance obligation that must be satisfied in order for payment to become unconditional. Additionally, as is the case with short-term car rentals, the lease (rental agreement) may not ~~themselves~~ be in place and the structure may represent a securitization of the rights to future rental payments, which adds an additional performance condition. This structure combines performance risk with default risk, resulting with the structure not qualifying for classification as being backed by financial assets. For this structure, the reporting entity would have to complete assessments that 1) the structure results with substantive credit enhancement and 2) the structure produces meaningful cash flows over the term of the instrument to satisfy the debt obligation other than through the sale or refinancing at maturity. If at origination, the contractual cash flows from the underlying collateral (leased rental cars) would be sufficient to satisfy ~~are expected to generate~~all of the interest and at least 50% of the original principal, then the meaningful criteria would be met through the practical expedient. That means, as discussed in SSAP No. 26, paragraph 9b, that the practical expedient can only be used if less than 50% of the principal relies upon sale or refinancing.

~~59.~~60. Whole-Business Securitizations: In most ABS structures, the assets backing the cash flows are specified and limited to a distinct collateral pool. For example, dedicated cash flows from specific lease arrangements, or specific receivables from credit cards or mortgages. However, ABS structures can exist that represent an entire range of operating revenues or cash flows generated by the business. These structures are often referred to as "whole business" or "operating asset" securitizations.~~"~~ These structures, ~~(~~which could only include cash flows from certain operating segments, and not necessarily the entire business of a company's operations,~~)~~ transfer the cash flows from the dedicated operations first to the investment holders, with the operating entity receiving their "operation proceeds" after the investment holders have been paid. This is different from a traditional bond structure where the operating entity first receives the proceeds from their operations~~,~~ and has discretion ~~for~~ on how it uses those proceeds to continue operations and pay expenses and then ultimately pay the bond holders according to the debt terms. Further,

debt holders in a whole-business securitization generally only have recourse to the cash flow streams pledged to support the debt, unlike a general credit obligation of the operating entity.

~~60.~~61. For the principles-based bond definition, structures that refer to whole-business securitizations, or that refer to operation proceeds as the collateral for the source of debt repayment still meet the definition as an ABS and do not reflect ~~issuer credit obligations~~ICO. For these structures, the dedicated operational cash flows represent the defined collateral pool and should not be classified as ~~issuer credit obligations~~ICO based on an interpretation that the proceeds represent the cash flows of an operating entity as they are not supported by the general creditworthiness of an operating entity, but rather only on referenced cash flow streams from the entity's operations.

~~61.~~62. Residual Tranches / "Equity" Components of Schedule D-1 Qualifying Structures: The assessment of qualifying Schedule D-1 investments has to consider the overall investment structure but focuses primarily on the specific instrument held by the reporting entity. Structures, particularly ABS, may include residual tranches that ~~do not have contractual principal or interest payments, but rather~~ provide payment after ~~contractual~~ pre-determined principal and interest payments have been made to other tranches or interests based on remaining available funds. Although payments to residual note holders could occur throughout an investment's duration, and not just at maturity, such instances still reflect the residual amount permitted to be distributed after other holders have received ~~contractual~~ interest and principal payments. In all instances, despite whether other tranches of the investment structure qualify for reporting as a bond on Schedule D-1 reporting, residual tranches do not qualify for bond reporting on Schedule D-1.

~~62.~~63. Under prior guidance in SSAP No. 43, there was no exclusion that restricted residual tranches of qualifying securitizations from being captured in scope and being reported as bonds. From the outreach performed in developing the principles-based bond definition, it was identified that several insurers have ~~previously~~ historically reported these residual tranches on Schedule BA: Other Long-Term Invested Assets. However, it was noted that some reporting entities have reported these ~~tranches~~ items as a bond on Schedule D-1 as a component of the securitization or as a beneficial interest in scope of SSAP No. 43. Although residual tranches (first loss tranches) ~~are not rated~~do not receive CRP ratings or NAIC SVO designations, when reported on Schedule D-1, an NAIC designation ~~would be~~is required. From information obtained, entities reporting residual tranches on Schedule D-1 have either been reporting as self-assigned 6* or they applied the NAIC 5GI concept to self-designate these securities. Under the 5GI concept, the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) permits self-designation as an NAIC 5 if the documentation necessary for a full SVO credit analysis does not exist, the issuer is current on all principal and interest payments, and the reporting entity has an expectation that they will receive all contracted interest and principal. The use of the NAIC 5GI concept to self-designate residual tranches on Schedule D-1 is a misapplication of this guidance. It is faulty to conclude that an investment is current and will provide all contractual interest and principal payments when the investment ~~has no contractual interest or principal payments~~ provides payments based on remaining funds after obligations to other issued debt instruments from the structure are satisfied. Furthermore, the 5GI provision was intended to prevent an NAIC 6 designation simply because the documentation for a full credit analysis could not be provided or reviewed, such as situations involving foreign securities when the supporting documents ~~may be~~ are in a foreign language. The NAIC 5GI provision was not intended to permit self-assignment of an NAIC 5 designation to securities that would not qualify as a fixed-income instrument eligible for an NAIC designation under the P&P Manual.

~~63.~~64. With the identification that residual tranches are inconsistently reported, with some entities reporting as bonds on D-1 and others reporting on Schedule BA, the Working Group drafted and exposed agenda item 2021-15: SSAP No. 43 – Residual Tranches in September 2021 as an interim action prior to the conclusion of the bond ~~proposal~~ project. The guidance within ~~this~~ that agenda item clarifie~~s~~d that residual tranches shall be reported on Schedule BA at lower of amortized cost or fair value. The guidance also clarifie~~s~~d that the reference to residual tranches intends to capture securitization tranches and beneficial interests, as well as other structures captured in scope of SSAP No. 43 that reflect loss layers where failing

to remit without contractual interest or principal payments does not result in an act of default. Payments to holders of residual intereststhese items occur after contractual interest and principal payments have been made to holders of other tranches or interests and are based on the remaining available funds. Although payments can occur throughout an investment's duration, such instances still reflect the residual amount permitted to be distributed after other holders have received contracted interest and principal payments.

64.65. On November 10, 2021, the Statutory Accounting Principles (E) Working Group adopted the agenda item 2021-15, clarifying that residual tranches are required to be reporting on Schedule BA: Other Long-Term Assets beginning December 31, 2022, with early adoption permitted. The effective date of this action allowsed time for reporting entities to implement this change and to corresponds with a Blanks (E) Working Group proposal to incorporate separate reporting lines for residuals, based on underlying characteristics of the structure, on Schedule BA. With the adoption of this guidance, the Working Group noted that reporting entities may elect to reclassify residual tranches or interests to Schedule BA in advance of the effective date. As of the effective date, residual tranches or interests previously reported on Schedule BA shall be reclassified to the appropriate residual tranche Schedule BA reporting line based on the underlying characteristics of the investment structure.

66. Along with the action to specify the Schedule BA reporting for residuals, the Statutory Accounting Principles (E) Working Group and the Valuation of Securities (E) Task Force provided a joint memorandum to the Blanks (E) Working Group to specifically identify that application of the NAIC 5GI process to residuals is an inaccurate application. Residual tranches or interests reported on Schedule D-1 for year-end 2021 shall be reported with an NAIC 6. The Working Group also provided the Task Force also received a referral requesting clarification of the NAIC 5GI process so future misapplications could be mitigated. The Task Force considered specific changes to address residuals and adopted those revisions during the 2021 Fall National Meeting.

65.67. Subsequent to the guidance adopted in agenda item 2021-15, additional revisions were adopted to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* (agenda item 2023-12) and to *SSAP No. 30—Unaffiliated Common Stock* and *SSAP No. 32R—Preferred Stock* (agenda item 2023-23) to clarify that all residuals, regardless of legal form of the investment, shall be reported on the dedicated residual reporting lines on Schedule BA.

66.68. The adoption of SSAP No. 21 in accordance with the principles-based bond project, incorporated guidance for non-bond debt securities and residual interests. The residual guidance includes the definition, common traits in identifying residuals as well as accounting and reporting guidance. Although adopted with a January 1, 2025 effective date consistent with the bond project, reporting entities are permitted to early-adopt the residual guidance in 2024.With the specific removal of residuals from being classified as a bond, guidance has been incorporated to SSAP No. 21R to specific and accounting and reporting guidance for residuals. This SSAP No. 21 residual guidance has the following key aspects:

a. Residuals are permitted to be admitted assets if debt securities from the same securitization qualify (or would qualify) as bonds under SSAP No. 26R as an issuer credit obligation or asset-backed securityadmitted assets. If a debt security held from the same securitization structure is (or would be) nonadmitted, then any residual interests or first loss positions held from the same structure do not qualify as admitted assets. Residuals in the legal form of a SSAP No. 48 investment are not subject to the SSAP No. 48 audit requirements for admittance as they are captured in scope of SSAP No. 21 and not SSAP No. 48.

b. Residuals shall be initially reported at cost, or allocated cost (using proportional fair values) if acquired along with debt tranches from the securitization. Subsequent to initial acquisition, residuals shall be reported at either 1) the lower of adjusted cost (as defined in paragraph 67c) or fair value under the Allowable Earned Yield method, with temporary reductions in fair value reported as unrealized losses, or 2) at the calculated practical

expedient method permitted in SSAP No. 21~~changes in fair value (or from adjusted cost to fair value) reported as other-than-temporary impairments~~. For the residual guidance, amortized cost is defined as the cost the residual reduced for distributions in excess of the Allowable Earned Yield and other-then-temporary impairments (OTTI). The Allowable Earned Yield is established at acquisition as the discount rate that equates the initial best estimate of the residual's cash flows to its acquisition cost. With this approach, interest income is recorded under the effective yield method using the Allowable Earned Yield, capped by the amount of cash distributions received. Amounts received in excess of the Allowable Earned Yield reduces amortized cost. The practical expedient calculates book/adjusted carrying value (BACV) such that all distributions received are treated as a reduction in BACV. With this approach, the reporting entity will not recognize any interest or investment income until the residual tranche has a BACV of zero.

c. Residuals shall be assessed for OTTI on an ongoing basis, with required assessment anytime that fair value is less than the reported value. For residuals measured using the Allowable Earned Yield method, an OTTI is considered to have occurred if the present value of expected cash flows discounted by the Allowable Earned Yield is less than amortized cost. For residuals measured under the practical expedient, an OTTI shall be considered to have occurred if the fair value of the residual is less than the BACV.

~~b.~~d. The residual guidance is adopted prospectively and includes transition guidance in applying the revised measurement method for securities previously captured in scope of another SSAP. This guidance mirrors concepts from the transition of the principles-based bond definition.

~~c. The adjusted cost basis shall be calculated such that all cash flows received attributed to the residual tranche shall be treated as a return of principal and a reduction to the adjusted cost. In other words, cash flows received as a holder of the residual tranche shall not be recognized as interest or investment income until the residual tranche has a BACV (adjusted cost basis) of zero. Once the residual has a zero BACV, cash flows received shall be recognized as interest income. The residual shall continue to be reporting on Schedule BA, with the zero BACV, with reporting of the received cash as interest income until the structure matures/terminates, is unwound or no longer meets the definition of a residual tranche. With this guidance, the BACV (adjusted cost basis) shall not be increased prospectively or retrospectively based on a reporting entity's estimates of future cash flows, and there shall be no amortization or accretion. Furthermore, adverse changes in estimated cash flows, resulting in an expectation that cash flows will not be received to cover the adjusted cost basis shall be recognized as an other-than-temporary impairment.~~

~~d. At the point the residual ceases to meet the definition of a residual tranche (i.e., when all senior debt has been repaid), and the investment structure is expected to continue for more than a year, the investment shall be reclassified and accounting for prospectively in the scope of whichever SSAP applies. Although dependent on the resulting structure, presumably structures that cease to reflect a residual will likely be considered a debt security that does not qualify as a bod or an equity tranche in scope of SSAP No. 48. Reporting entities are not required to reclassify an investment if the resulting structure is unwound within 12 months of the senior debt being repaid.~~

~~67.~~69. Stapling of ~~i~~Investments: The original exposure of the principles-based bond definition (May 2021) included an initial example ~~(originally referred to as Appendix I – Example I)~~ detailing a situation where "equity interests" from a tranche (such as residuals) were required to be held by a reporting entity when holding debt tranches. ~~(~~That language identified situations where the reporting entity would be restricted from selling, assigning, or transferring the unsecured debt investment without also selling,

assigning or transferring the equity interest to the same party. This restriction is often referred to as the "stapling" of investments.) Pursuant to the guidance in the original initial example, although the debt instrument would separately qualify as a creditor relationship for bond reporting, when considering the entirety of the holdings (both the residual/equity interests and debt tranches combined), the investment would be considered an equity instrument in substance. Although the debt instrument would appear to have a higher priority of payment, that priority would be supported by the residual/equity interest the reporting entity has to hold. (Ultimately, the reporting entity would be subordinate to themselves as they would recognize a loss on the residual/equity tranche to safeguard payment under the debt tranche.) Under that initial proposed exampleguidance, all holdings under such situations, including the debt tranches, would not qualify as creditor relationships and would not qualify for bond reporting.

68.70. After considering comments from the first exposure period, as well as discussing within the small group of industry and regulators, this example was eliminated from the principles-based bond definition. These discussions ultimately concluded that tranches that separately qualify as bonds should be reported as bonds even if other tranches from a structure that do not qualify as bonds are also held by the reporting entity. Elements noted as part of the decision to remove the stapling restriction include:

a. A key element in the initial proposal to require all of the entire holdings as equity was to ensure that the risk of the holdings was properly captured. It was noted that recent developments to tranche investments that were previously reported as investments in LLCs or joint ventures could result in RBC arbitrage. This is because the risk of the investment would be concentrated in a specific tranche intended to absorb losses, and only that limited tranche would be reported on Schedule BA with higher RBC charges. This would allow the debt tranches (as they are subordinated by the equity tranche) to likely qualify as bonds with Schedule D-1 reporting and lower RBC charges. However, because risk has been concentrated into the smaller equity tranche as a result of leverage, and because Schedule BA RBC charges are fixed and insensitive to leverage, there is a lowering of risk-based capital in total despite no change in risk. The subsequent discussions highlighted that this is an RBC issue for the equity tranche and is not an accounting classification issue. As consideration on appropriate risk charges for residual tranches has been requested to the Financial Condition (E) Committee and is a discussion item for the RBC Investment Risk and Evaluation (E) Working Group, this issue is not within the focus of the Statutory Accounting Principles (E) Working Group. It was also noted that consideration of statutory accounting provisions (such as nonadmittance) to achieve a desired risk assessment would be an inappropriate use of the accounting guidance. It was also noted that the investments within scope of these discussions are likely permitted for admittance under state law, and incorporating statutory guidance different from state lawdiffering SAP guidance would only result with identification of prescribed practices as domiciliary state laws and statutes are the ultimate authority for the application of SAP.

b. It was also identified that the initial exposed example was specific to investments that were "stapled" under contractual terms. This guidance would have only been applicable to dynamics in which there was an explicit restriction in the sale, assignment, or transfer of the residual/equity tranche separately from a debt tranche. It was identified that without an active market for residual/equity tranches (which is common) the explicit restrictions would not be necessary to achieve a similar result. Structures would only need to be designed to require initial acquisition of residual/equity tranches when acquiring debt tranches (with removal of the explicit disposal restrictions) to avoid the proposed stapling guidance. Since the proposed guidance could be easily avoided, the guidance would not address the underlying concern.

c. This discussion noted that it is quite common for acquisitions to require purchases of a vertical slice of a structure and for investments to be stapled for a short duration of time.

These provisions are generally made~~done~~ for easier marketing and for easier compliance with conflict-of interest provisions. The short-term aspect of some stapled investments raised concerns as to how bond-qualifying debt tranches would be reported if stapling provisions to a~~n~~ residual/equity tranche were subsequently eliminated. This was identified as likely requiring a schedule move (from BA to D-1) with potential other accounting and reporting impacts (such as with NAIC designations and measurement method). This discussion noted that an issuer's stapling of investments may reflect a legitimate business purpose, and not intend for RBC arbitrage, and the elimination of such components after the stated timeframe could cause confusion or unnecessary noise in the financial statements from the reclassification of investments. This discussion further supported that the acquisition of different tranches, even if explicitly stapled, should not prevent separate debt (bond) and residual/equity recognition based on the characteristics of the specific tranche.

~~69.~~71. ABS as Short-Term or Cash Equivalent~~s~~: With the required ~~focus~~ assessments and requirements ~~to be met for~~for a security to qualify as ~~asset-backed securities~~ABS, as well as dedicated reporting based on the underlying collateral assets, ABS will no longer be permitted to be reported as short-term or cash equivalents. All qualifying ABS will be required to be reported on Schedule D-1-2, even if acquired within one year or less from the maturity date, to allow for full assessment of ~~the extent of~~ ABS held by a reporting entity by ~~the~~ regulators. Investments captured in scope of SSAP No. 2R are intended to reflect situations in which limited risk remains, either from changes in credit-quality or interest rates, due to the short-duration until maturity. As ultimate cash flows from ~~asset-backed securities~~ABS may have other risks beyond default risk or interest rate risk (such as performance factors, balloon payments, collateral quality), reporting as a cash equivalent or short-term investment is not permitted to prevent inappropriate assumptions of the investment's remaining potential risk.

Key Discussions / Aspects in Developing the Definition

~~70.~~72. Refinancing Risk / Residual Risk Exposure: Discussion of refinancing risk (where there is outstanding debt owed at maturity that will need to be refinanced for the remaining principal to be received by the note holder) was a key element discussed in accordance with the meaningful cash flow~~s~~ requirement for non-financial ~~asset-backed securities~~ABS. This discussion highlighted that traditional refinancing risk is accepted in the context of corporate debt but is viewed differently when assessing the cash flows of non-financial assets in an ABS structure. This differentiation was confirmed, with identification that there are concerns unique to non-financial ~~asset-backed securities~~ABS.

~~71.~~73. The requirement for a non-financial ~~asset-backed security~~ABS to produce meaningful cash flows to service the debt other than through the sale or refinancing of the collateral assets ensures that structures captured as a bond on Schedule D-1 actually reflect bond-like cash flows. Structures that rely on the sale or refinancing at maturity to generate cash flows to repay debt obligations ultimately reflect a point-in-time reliance on the underlying collateral asset values that does not reflect the intent of Schedule D-1 reporting of bond-like cash flows. These structures are more reflective of the underlying collateral risk, ultimately contingent on the market at a future point in time and whether the underlying assets can be sold or refinanced in accordance with original expectations at the time of the structure origination.

~~72.~~74. A key comment raised by industry with regards to the meaningful cash flow requirement, and the restriction against relying on the sale/refinancing at maturity to produce meaningful cash flows, is that consideration should be given to the level of overcollateralization that exists in a structure if the meaningful requirement will not be met without sale or refinancing. These industry comments take the position that as the level of overcollateralization to the debt obligation increases, then there is a greater likelihood that the debt issuer will be successful in refinancing or selling the assets and generate the means to repay the debt obligation. Although overcollateralization is a factor in securities for bond classification, allowing overcollateralization to override the requirement for meaningful cash flows other than the refinancing / sale at maturity is not permitted for the following reasons:

a. The intent of the principles-based bond ~~proposal~~ definition is to clarify what shall be reported as ~~long-term~~ bonds on Schedule D-1. Non-financial ~~asset backed securities~~ABS that do not generate meaningful cash flows and rely on the refinancing or sale of the underlying assets do not reflect bond-like cash flows and are not characteristic of bond investments. These structures ultimately reflect equity (point-in-time) valuation risks of the assets held as collateral.

b. The industry position that overcollateralization safeguards the asset performance is an argument that supports the quality of the structure, but not the substance of the investment design. The principles-based bond ~~proposal~~ definition does not factor in investment or credit quality within the determination of whether a structure qualifies for reporting as a bond on Schedule D-1. Permitting an assessment based on overcollateralization would introduce a concept that credit quality determines bond / Schedule D-1 reporting, and that is not an accurate conclusion in line with the principle concepts of bond classification.

~~73.~~75. Consistent with prior conclusions, reporting an investment as a bond on Schedule D-1 is not indicative of the quality of the investment, but rather reflects securities expected to generate bond-like cash flows. Securities reported as bonds~~ing~~ on Schedule D-1 may be of high-quality or low-quality, but the reporting is based on the substance of the structure, which ultimately requires bond-like cash flows for all investments. This includes a requirement that non-financial ~~asset backed securities~~ABS must produce meaningful cash flows through the use of the underlying collateral assets other than through the sale or refinancing of the assets.

~~74.~~76. Additionally, through the small group discussions around the refinancing restriction ~~noted above~~, it was noted that even if a debt instrument meets all of the criteria to be reported as a bond on Schedule D-1, there will still be a potential for unintentional RBC arbitrage related to securitizations, because the residual tranches absorb all of the redistributed risk of the underlying collateral, but receives a fixed RBC charge that is not in any way risk-rated. While this could be the case in any type of securitization, it is particularly pronounced if the underlying collateral is equity investments. Equity investments generally receive a base 30% RBC charge for life companies. If equity investments are securitized, the bond tranches will get low bond charges (<2%), while the residual tranche will continue to receive a flat 30% base charge. This will have the effect of bringing the overall weighted-average capital charge on the underlying investments from 30% to approximately 10-15%~~, as an example~~. This will occur even if the bond tranches have all of the substance associated with a bond. Following these discussions, it was identified that this regulatory concern may not be ~~able or~~ appropriate to address through the accounting standards but may warrant discussion ~~for~~ under the Capital Adequacy (E) Task Force. Subsequent discussions from the Financial Condition (E) Committee directed the new RBC working group (the RBC Investment Risk and Evaluation (E) Working Group) to evaluate this and any other investment-related RBC items. Subsequent to these discussions, the RBC Investment Risk and Evaluation (E) Working Group assumed a project to assess RBC factors for residual interests. An interim approach was adopted to include a 30% base RBC factor with a 15% sensitivity test for year-end 2023, with a 45% base RBC factor and 0% sensitivity for year-end 2024. Continued discussion is expected under a long-term project.

~~75.~~77. Use of NAIC Designation / SVO Review in Determining Bond / Schedule D-1 Reporting: The accuracy of the financial statements, and compliance with statutory accounting provisions, is the responsibility of the reporting entity. Assessment and compliance with key concepts, such as the "meaningful cash flow generation" and "substantive credit enhancement" concepts for ABS are also the responsibility of the reporting entity, along with appropriate documentation of these assessments for regulator review when requested. ~~As such, c~~Consistent with the existing *NAIC Policy Statement on Coordination of the Accounting Practices and Procedures Manual and the Purposes and Procedures Manual of the NAIC Investment Analysis Office*, a reporting entity cannot ~~obtain~~ utilize an NAIC designation to conclude on the substance of an investment or the resulting reporting schedule. Pursuant to the policy statement, obtaining an NAIC designation does not change an investment's applicable SSAP,

annual or quarterly statement reporting schedule, or override ~~other~~ SSAP guidance required for an investment to be an admitted asset.

~~76.~~78. Questions have been received whether an NAIC designation in the AVS+ product or an assessment of an investment from a~~n~~ "Regulatory Treatment Analysis Service" (RTAS) submission from the SVO can be utilized as support that an investment qualifies as a bond for Schedule D-1 reporting. These are inaccurate interpretations on the use of NAIC designations within those products. The assignment of an NAIC designation (either from the SVO or CRP) reflects the credit quality of an investment. An assessment of credit quality does not provide assurances that the investment qualifies for reporting as a bond on Schedule D-1 as an ~~issuer credit obligation~~ICO or an ABS. As part of this principles-based bond project, consideration is planned to expand the ability to report and use NAIC designations on Schedule BA ~~(or other schedules)~~ so that investments that do not qualify as bonds can have appropriate risk assessments that factor in the credit quality of the investment. This capability would ultimately depend on action by the Capital Adequacy (E) Task Force.

~~77.~~79. Although the NAIC designation and RTAS processes cannot be used in determining Schedule D-1 compliance, it is envisioned that a small group of regulators and NAIC staff could be formed to review specific investment structures under the principle-based concepts to assist in assessments of complex new investment designs. If formed, ~~I~~it is anticipated that NAIC staff on the statutory accounting side and within the SVO would assist this small group.

~~78.~~80. Interest Only / Principal Only Strips: Discussion occurred on whether specific guidance should direct the reporting of interest only (IO) and principal only (PO) strips. The resulting conclusion from this discussion was that the principle concepts from the bond definition should continue to be applied ~~for~~ to these investments. If the strips qualify within the definition as ~~issuer credit obligations~~ICO, they would be captured in scope of that guidance. If the strips qualified as ~~asset-backed securities~~ABS, they would be captured in scope of that guidance. It was noted that interest-~~-~~only strips shall also be assessed in accordance with the residual guidance. If the interest-~~-~~only strip reflects excess interest (e.g., remaining differential spread from interest collected from interest paid), these investments would be akin to a residual investment without contractual interest or principal payments and shall be captured in scope of that guidance. (Residuals are in scope of SSAP No. 21 and required to be reported on Schedule BA. Residuals are ~~and~~ not permitted to be reported on Schedule D-1.)

~~79.~~81. The discussion of IO/PO strips with industry representatives identified that they are not overly prevalent investments with insurance reporting entities. It was also noted that IO/PO based on RMBS are relatively rare due to the prepayment risk, however those based on CMBS generally have contractual provisions that prohibit prepayments, thus ensuring that they act more akin to typical bonds. This discussion further highlighted that changes to the principal-based bond definition are not justified for IO/PO investments, and insurers should document their accounting policies for these investments to demonstrate compliance with the bond definition.

~~80.~~82. The discussion of IO/PO strips focused on U.S. Treasury strips and mortgage-backed securities as likely investments, but it was noted that the application of the overall bond definition concepts should be applied to any future design of these investments. Specific elements noted for the two general designs:

a. U.S. Treasury Strips: Treasury Strips are created when a bond's coupons are separated from the bond. The coupons separated from the bond are ~~also~~ sold individually (IO), becoming separate securities from the principal payments due at maturity (PO). U.S. Treasury Strips are backed by the U.S. government. U.S. Treasury strips (IO and ~~/~~PO) ~~were noted to be~~are considered U.S. government issues and would be captured with other securities backed by the U.S. government as ~~issuer obligations~~ICO. Specific identification of U.S. Treasury strips as a separate reporting line of ICO investments~~specific elements as~~

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issuer credit obligations, captured within the U.S. government category, was noted to be repetitive and not necessary.

b. Mortgage-Backed Securities and Other Non-Treasury Strips: Other IO and PO strips are required to be assessed in accordance with the principle concepts of the bond definition. It is anticipated that non-U.S. strips (including mortgage-backed security strips) would not qualify as issuer credit obligationsICO and shall be reviewed in accordance with the asset-backed securityABS concepts to determine whether the strip qualifies for reporting as a bond on Schedule D-1. The separation of the principal and interest components into separate securities does not change the application of the principle concepts for determining whether a security qualifies as a bond. It was noted that IO strips could be high in the capital structure (supported by subordination) or could represent residual interests (reflecting the spread between proceeds collected and contractual interest). The specific details of the individual IO/PO security shall determine the appropriate accounting and reporting.

81.83. The discussion of IO/PO strips identified that there is likely no current need to have separate reporting lines to identify these items within the investment schedules. However, it was identified that the ability to identify these investments with a code (or other feature) would allow for future aggregation and assessment. This was requested to be considered as part of the reporting revisions.

82.84. Embedded Derivatives / Underlying Variables: Discussion occurred on the language that precludes bond reporting based on the appreciation or depreciation of an underlying collateral value or other variable. Although industry comments noted that the intent of the language was understood, it was identified that the language could be interpreted to mean that amounts in both the magnitude and timing of principal and interest payments must be known in advance, and it could also be interpreted to mean the amounts need to be contractual in nature but can still vary as long as the variability is not dependent on the appreciation or depreciation of an asset or variable. It was also noted that the reference to "other variable" could be interpreted to mean interest is not allowed to vary based on any variable or just the appreciation or depreciation of the variable. After discussing these comments, revisions were drafted to clarify that the 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), scheduled interest rate step-ups, or credit-quality related interest rate adjustments. (Furthermore, Aas detailed in footnote 32, this exclusion is not intended to encompass nominal interest rate adjustments.) This guidance has also been incorporated within the provisions for determining whether a debt instrument represents a creditor relationship and is applicable for debt instruments structured as issuer credit obligationsICO and asset-backed securitiesABS.

Accounting for Debt Securities That Do Not Qualify as Bonds

83.85. Securities that reflect debt instruments have a fixed schedule for one or more future payments, but for which the securitythat does not qualify for bond reporting as an issuer credit obligationICO or an asset backed securityABS shall follow specific guidance captured in SSAP No. 21 and be reported on Schedule BA. Investments in scope of this guidance are limited to items that would be in scope of SSAP No. 26, but that do not qualify for bond reporting as they reflect:

a. Debt securities for which the investment does not reflect a creditor relationship in substance.

b. Debt securities that do not qualify for bond reporting due to a lack of substantive credit enhancement.

c. Debt securities that do not qualify for bond reporting due solely to a lack of meaningful cash flows.

84.86. The debt securities captured in the SSAP No. 21 guidance within SSAP No. 21R meet the definition of assets as defined in SSAP No. 4 and are admitted assets to the extent they conform to the requirements within SSAP No. 21. The provisions are specific that the guidance for non-bond debt securities in SSAP No. 21 shall not be inferred to other securities or investment structures.

85.87. Debt securities in scope of this standardSSAP No. 21 that do not qualify as bonds under SSAP No. 26 and for which the primary source of repayment is derived through rights to underlying collateral, qualify as admitted assets if the underlying collateral primarily qualify as admitted invested assets. As detailed in the SSAP No. 21 guidancesection pertaining to residual tranches, any residual tranches or first loss positions held from the same securitization that did not qualify as a bond under SSAP No. 26 also only qualify as admitted assets to the extent the underlying collateral primarily qualifies as admitted invested assets.

88. Debt securities in scope of the SSAP No. 21 guidance shall be reported at acquisition at cost, including brokerage and other related fees on Schedule BA: Other Long-Term Invested Assets. Subsequent measurement shall reflect the lower of amortized cost or fair value. Changes in measurement to reflect the lower value or to reflect changes in fair value shall be recorded as unrealized gains or losses. Debt securities in scope of SSAP No. 21 shall then follow the guidance in SSAP No. 43 for calculating amortized cost, for determining and recognizing other-than-temporary impairments and for allocating unrealized and realized gains and losses between the asset valuation reserve (AVR) and the interest maintenance reserve (IMR).

86.89. During the SSAP No. 21 discussion, industry inquired on the direction to utilize SSAP No. 43 for the components detailed in paragraph 88, and not separately assess securities to determine if they are more akin to ICO or ABS and using either SSAP No. 26 or SSAP No. 43 based on those assessments for the calculation of amortized cost, OTTI and allocating AVR/IMR. With this discussion, it was noted that investments that fail the creditor relationship test are identified before determining whether the security would be an ICO or ABS, and as the components of SSAP No. 43 are more relevant for debt securities that do not qualify as bonds, and to ensure consistency for all non-bond debt securities in scope of SSAP No. 21, the decision to utilize SSAP No. 43 for all debt securities that do not qualify as bonds was retained.

Transition Guidance

87.90. At the time of transition to apply the guidance adopted to reflect the principles-based bond definition, reporting entities shall make their best efforts to assess investments to determine whether they qualify within the bond definition for reporting on Schedule D-1. The bond definition requires assessments at the time of acquisition (as of the origination date), and it is recognized that reporting entities may not have the means to complete historical assessments for securities held at the time of transition. For these instances, if information is not readily available for reporting entities to assess a security as of the date at origination, reporting entities may utilize current or acquisition information in concluding that a security qualifies for reporting as a bond as either an issuer obligationICO or asset-backed securityABS.

88.91. Investments that were reported as a bond on Schedule D-1: Long-Term Bonds as of December 31, 2024, that do not qualify under the principle-based bond concepts definition shall be reported as a disposal from that schedule, with a reacquisition on the appropriate reporting schedule as of January 1, 2025. These investments shall be accounted for in accordance with the resulting SSAP that addresses the specific investment structure. For securities that are reported at the lower of amortized cost or fair value under the new applicable guidance in SSAP No. 21 for non-bond debt securities, this could result with an unrealized loss in the measurement of the investment at the time of the reclassification. Although the adoption of this guidance is considered a change in accounting principle under *SSAP No. 3—Accounting Changes and Corrections of Errors*, the following transition guidance shall be applied on January 1, 2025, to ensure consistency in reporting and to allow investment schedules to roll appropriately:

a. Securities reclassified from Schedule D-1 as they no longer qualify under the bond definition shall be reported as a disposal from Schedule D-1 at amortized cost. Although no proceeds are received, amortized cost at the time of disposal shall be reported as consideration on Schedule D-4.

i. For securities held at amortized cost at the time of disposal, ~~book adjusted carrying value~~BACV and amortized cost shall agree, preventing gain or loss recognition at the time of reclassification.

ii. For securities held at fair value under the lower of amortized cost or fair value measurement method, previously reported unrealized losses shall be reversed on January 1, 2025, prior to disposal, resulting with a reported value that mirrors amortized cost at the time of disposal. This action prevents realized loss recognition at time of reclassification.

b. Securities reclassified from Schedule D-1 shall be recognized on the subsequent schedule (e.g., Schedule BA) with an actual cost that agrees to the disposal value (amortized cost). Immediately subsequent to recognition on the resulting schedule, the securities shall be reported in accordance with the measurement method prescribed by the applicable SSAP:

i. For securities previously reported at fair value on Schedule D-1 (under a lower of amortized cost or fair value measurement method), the reporting entity will recognize an unrealized loss to match the previously reported ~~book adjusted carrying value~~BACV. Subsequently, the security will continue to reflect a lower of amortized cost or fair value measurement method.

ii. For securities previously reported at amortized cost on Schedule D-1, if the subsequent applicable SSAP guidance ~~statement~~ requires a lower of amortized cost or fair value measurement method, then the reporting entity shall recognize an unrealized loss to the extent fair value is less than amortized cost.

c. After application of the transition guidance all securities shall reflect either the same reported value as of December 31, 2024 (amortized cost or fair value) or a lower reported value (if the security is subject to the lower of amortized cost or fair value measurement method). There should be no instances that result with a security having a greater reported value than what was presented on December 31, 2024. Subsequent to transition, securities reported at fair value may incur unrealized gains or losses due to fair value fluctuations, but should never have unrealized gains that result with a ~~book adjusted carrying value~~BACV that exceeds amortized cost.

~~89.~~92. With this transition guidance, changes in measurement for securities reclassified under the bond definition will be reported as a change in unrealized capital gains (losses) in the first quarter 2025 financial statements (unless sold in the interim with a realized gain or loss) and not as a change in accounting principle. To enable regulators the ability to identify the impact of securities reclassified under the bond definition, the following disclosure for the 2025 first quarter financial statement is required:

a. Aggregate ~~book adjusted carrying value~~BACV for all securities reclassified off Schedule D-1.

b. Aggregate ~~book adjusted carrying value~~BACV after transition for all securities reclassified off Schedule D-1 that resulted with a change in measurement basis. (This shall be a subset of the aggregate BACV reclassified off Schedule D-1 and captures the securities that moved from an amortized cost to a fair value measurement method under the lower of amortized cost or fair value approach.)

c. Aggregate surplus impact for securities reclassified off Schedule D-1. This shall include the difference between ~~book adjusted carrying value~~BACV as of December 31, 2024 and ~~book adjusted carrying value~~BACV after transition for those securities that moved from an amortized cost to a fair value measurement method under the lower of amortized cost or fair value approach.

~~90.~~93. ~~Asset-backed securities~~ABS that were previously reported as short-term (Schedule DA) or as a cash equivalent (Schedule E2) shall be reclassified to be reported on Schedule D-1-2 on January 1, 2025. Similar to the process detailed above, the securities shall be removed from Schedule DA and E2 at amortized cost, with reversal of any unrealized loss prior to the reclassification. The amortized cost shall be reported as "consideration received on disposals' on Schedule DA – Verification Between Years or Schedule E-2 – Verification Between Years, as applicable based on the prior reporting location. The security shall be recognized as an ABS acquired on Schedule D-3 at amortized cost. Immediately after initial recognition, if the security was required to be held at fair value, under the lower of amortized cost or fair value measurement method, the reporting entity shall recognize an unrealized loss.

~~91.~~94. The transition guidance shall be applied prospectively beginning with the first year of adoption (January 1, 2025). For disclosures that provide comparative information, reporting entities shall not restate the prior year's information in the 2025 disclosure.

Investment Examples – Securities That Do Not Represent Creditor Relationship Despite Legal Form

~~92.~~95. As detailed in the principles-based bond definition, an initial determinant ~~in the principles-based bond definition~~ is whether the investment is a security that represents a creditor relationship in substance. Examples included intend to identify scenarios that do not reflect an in-substance creditor relationship.

~~93.~~96. Example 1: Debt Instrument from SPV with Large Number of Diversified Equity Interests: A reporting entity invests in a debt instrument issued by a SPV that holds a large number of diversified equity interests with characteristics that support the production of predictable cash flows. The structure contains sufficient overcollateralization and liquidity provisions to ensure the production of adequate cash flows to service both principal and interest payments without significant reliance on refinancing or sale of the underlying equity investments. The debt instrument's periodic principal or interest payments, or both, contractually vary based on the appreciation or depreciation of the equity interests held in the SPV.

~~94.~~97. Example 1 Rationale: Because the instrument's principal or interest payments, or both, contractually vary with the appreciation or depreciation of the underlying equity interests, it contains an equity-like characteristic that is not representative of a creditor relationship. It would be inappropriate to conclude that a security with any variation in principal or interest payments, or both, due to underlying equity appreciation or depreciation, or an equity-based derivative, is a bond under ~~this standard~~the principles-based bond definition as such security would contain equity-like characteristics.

~~95.~~98. Example 2: Debt Instrument from SPV with Few Equity Interests, Not an Issuer Credit Obligation: A reporting entity invests in a debt instrument issued from a SPV that owns a portfolio of equity interests, and the debt instrument does not meet the definition of an ~~issuer credit obligation~~ICO.

~~96.~~99. Example 2 Rationale: Determining whether debt instruments collateralized by equity interests qualify as bonds under ~~this statement~~the principles-based bond definition inherently requires significant judgment and analysis. Unlike debt instruments collateralized by assets with contractual cash flows, or debt instruments collateralized by cash-generating non-financial assets, debt instruments collateralized by equity interests may be dependent on cash flow distributions that are not contractually required to be made and/or may not be controlled by the issuer of the debt. In some instances, sale or refinancing of the underlying equity interests may be the only means of generating cash flows to service the debt instruments. As a result, there is a rebuttable presumption that a debt instrument collateralized by equity interests does not qualify as a bond. Notwithstanding this rebuttable presumption, it is possible for such debt instruments to qualify as bonds, if the characteristics of the underlying equity interests lend themselves to the production of predictable cash flows and the underlying equity risks have been sufficiently redistributed through the capital structure of the issuer. Factors to consider in making this determination include but are not limited to:

a. Number and diversification of the underlying equity interests

b. Characteristics of the underlying equity interests (vintage, asset-types, etc.)

c. Liquidity facilities

d. Overcollateralization

e. Waiting period for distributions/paydowns to begin

f. Capitalization of interest

g. Covenants (e.g., loan-to-value trigger provisions)

h. Reliance on ongoing sponsor commitments

i. Source(s) of expected cash flows to service the debt (i.e., dividend distributions from the underlying collateral vs. sale or refinancing of the underlying collateral)

~~97.~~100. While reliance ~~of the debt instrument~~ on the sale of underlying equity interests or refinancing at maturity does not preclude the rebuttable presumption from being overcome, it does require that ~~the~~ other characteristics mitigate the inherent reliance on equity valuation risk to support the transformation of underlying equity risk to bond risk. As reliance on sale or refinancing increases, the more compelling the other factors needed to overcome the rebuttable presumption become.

~~98.~~101. ~~Furthermore, this~~The analysis of the underlying structure should be conducted and documented by a reporting entity at the time such an investment is acquired. The level of documentation and analysis required will vary based on the characteristics of the individual debt instrument, as well as the level of third-party and/or non-insurance company market validation to which the issuance has been subjected. For example, a debt instrument collateralized by fewer, less diversified equity interests would require more extensive and persuasive documented analysis than one collateralized by a large and diversified portfolio of equity interests. Likewise, a debt instrument that has been successfully marketed to unrelated and/or non-insurance company investors~~,~~ may provide enhanced market validation of the structure compared to one held only by related party and/or insurance company investors where capital relief may be the primary motivation for the securitization.

Investment Examples – Analysis of ABS Under the Meaningful Cash Flows and Substantive Credit Enhancement Concepts

~~99.~~102. All ~~asset-backed security~~ABS structures are required to provide substantive credit enhancement to qualify for bond reporting on Schedule D-1 ~~reporting~~. Furthermore, ~~asset-backed security~~ABS structures that are backed by non-financial assets must generate meaningful cash flows to service the debt without reliance on the sale or refinancing at the maturity of the investment. ~~Examples 4-7~~The following provides examples of analysis under these criteria:

~~100.~~103. Example 3 – Agency Mortgage-Backed Securities: A reporting entity invests in debt instruments issued from a SPV sponsored by the Government National Mortgage Association (GNMA), the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, "Agency or Agencies"). These debt instruments pass through principal and interest payments received from underlying mortgage loans held by the SPV to the debtholders proportionally, with principal and interest guaranteed by the Agencies. While there is prepayment and extension risk associated with the repayment of the underlying mortgage loans, the credit risk associated with the mortgage loans is assumed by the Agencies.

~~101.~~104. Example 3 Rationale: Although the reporting entity participates on a proportional basis in the cash flows from the underlying mortgage loans held by the SPV, the reporting entity is in a different economic position than if it owned the underlying mortgage loans directly because the credit risk has been redistributed and assumed by the Agencies. This is a substantive credit enhancement because a market participant (i.e., knowledgeable investor transacting at arm's length) would conclude the Agency guarantee is expected to absorb all losses ~~before~~ from the debt instrument ~~being evaluated~~. Therefore, the holder of the debt instrument is in a substantively different economic position than if the holder owned the ABS Issuer's unguaranteed assets directly. When guarantees do not cover 100% of principal and interest as the Agency guarantees do in this example, it is still appropriate to determine if the guarantee is substantive in accordance with the requirements of the principles-based bond definition to determine if the holder is in a substantively different economic position than if the holder held the ~~ABS Issuer's~~underlying assets directly.

~~102.~~105. Example 4 – Debt Instrument Issued by an SPV: A reporting entity invested in a debt instrument issued by a SPV. Payments under the instrument are secured by a note, a legal assignment from the borrower of a lease for real property and an assignment of the lease payments from an operating entity tenant. Additional security is provided by a mortgage on the leased property (the "underlying collateral"). The leased property is owned by the borrower under the note and~~–~~ the SPV does not have any ownership interest in the underlying collateral, though it has legal recourse to it through the mortgage. The tenant makes contractually-fixed payments over the life of the lease to the borrower, who has assigned both the lease and the lease payments to the SPV as security for the debt. While the debt is outstanding, the lease, the lease payment, and the mortgage all serve as security for the debtholders. Should a default occur, the debtholders can foreclose on and liquidate the real property as well as submit an unsecured lease claim in the lessee's bankruptcy for any defaulted lease payments. The loan-to-value (LTV) (as a percentage of property value) at origination is 100%.

~~103.~~106. The existing lease payments are sufficient to cover all interest payments and all scheduled debt amortization payments over the life of the debt instrument. However, at debt maturity, there is a balloon payment due, totaling 50% of the original outstanding debt principal amount. The corresponding lease has no balloon payment due at lease maturity, so the SPV will either need to refinance the debt or sell the underlying collateral to service the final debt balloon payment. The property has a high probability of appreciating in value over the term, however, ignoring any potential for appreciation, the 50% loan-to-value at maturity is the expected figure at the end of the debt term based solely on scheduled amortization payments. The real property is expected to be subject to some market value volatility and periods of lower liquidity at certain points in time but has a predictable value range and ready market over a longer period of time, such that the property could be liquidated over a reasonable period of time, if necessary.

~~104.~~107. Example 4~~5~~ Rationale: The reporting entity determined that as a ~~debtholde~~debtholder, they are in a ~~r was in a~~ fundamentally different position than if the real estate was owned directly. The lease is a

cash generating non-financial asset which is expected to generate a meaningful level of cash flows for the repayment of the bonds which covers all interest payments and 50% of the principal payments. The level of reliance on the collateral value for sale or refinancing is just over the cutoff for using the practical expedient (greater than ~~<~~50%), so a full analysis is required. In reaching its determination, the reporting entity considered the predictable nature of the cash flows, which are contractually fixed for the life of the debt instrument, as well as the ability of the underlying collateral value to provide for the balloon payment through sale or refinancing in light of its characteristics. While the real property may have some market value volatility and periods of lower liquidity at points in time, the cash flows produced by the lease were concluded to reduce the loan balance to a level (50% loan-to-value) that would be able to be recovered by sale or refinancing at the maturity of the loan.

~~105.~~108. The reporting entity also determined that the structure provides substantive credit enhancement in the form of overcollateralization to conclude that investors are in a different economic position than holding the real property directly, in accordance with the requirements of the principles-based bond definition. In reaching this conclusion, the reporting entity noted that although the debt instrument starts with a 100% loan-to-value (not including the value of the contractually required lease payments), contractual fixed payments from the lease provide additional security such that the reporting entity is in a different economic position than owning the property directly. Lease cash flows are sufficient to cover the payment of all interest and 50% of the outstanding principal over the term of the lease. In the context of the predictable nature of the cash flows and collateral value range over time, the reporting entity concluded that a market participant (i.e., a knowledgeable investor transacting at arm's length) would consider this level of overcollateralization to put the investor in a substantially different economic position than owning the underlying property~~-~~ directly.

~~106.~~109. For the purpose~~s~~ of determining whether there is substantive overcollateralization, it is appropriate to consider any expected economic depreciation, if it is reasonably expected, but it is not appropriate to consider any expected economic appreciation. Note that a debt instrument with a ~~loan-to-value~~LTV that is expected to decrease over time is not necessarily deemed to have substantive overcollateralization.

~~107.~~110. Example 5~~6~~ – Debt Instrument Issued by an SPV With Lease Term Less than Debt Instrument: A reporting entity invested in a debt instrument with the same characteristics as described in Example 4~~5~~, except that the existing lease at the time of origination has a contractual term that is shorter than that of the debt instrument. It is expected with a high degree of probability that the lease will be renewed, and a substantial leasing market exists to replace the lessee should they not renew. However, in the unlikely circumstance that the property cannot be re-leased, there would not be enough cash flows to service the scheduled principal and interest payments, and the property would have to be liquidated to pay off the debt upon default.

~~108.~~111. Example 5~~6~~ – Rationale: All details of this example, including the expected collateral cash flows, are consistent with those in Example 4~~5~~, except that the cash flows in Example 4~~5~~ are contractually fixed for the duration of the debt while the cash flows in this example are subject to re-leasing risk. Notwithstanding the involvement of re-leasing risk, the reporting entity concluded that the ability to re-lease the property was highly predictable and supported the conclusion that the underlying collateral was expected to produce meaningful cash flows to service the debt.

~~109.~~112. This distinction is to highlight that the expected cash flows of a cash-generating non-financial asset may or may not be contractually fixed for the term of the bond. Certain securitized cash flow streams may not by their nature lend themselves to long-term contracts (e.g., single-family home rentals), but may nevertheless lend themselves to the production of predictable cash flows. While the non-contractual nature of the cash flows is an important consideration in determining whether a non-financial asset is

expected to produce meaningful cash flows to service the debt, it does not, in and of itself, preclude a reporting entity from concluding that the assets are expected to produce meaningful cash flows.

~~110.~~113. Example 6~~7~~ – Lease in SPV with 80% Balloon Payment: A reporting entity invested in a debt instrument issued by a SPV that owns equipment which is leased to an equipment operator. The equipment operator makes lease payments to the SPV, which are passed through to service the SPV's debt obligation. While the debt is outstanding, the equipment and lease are held in trust and pledged as collateral for the debtholders. Should a default occur, the debtholders can foreclose on and liquidate the equipment as well as submit an unsecured lease claim in the lessee's bankruptcy for any defaulted lease payments. The ~~loan-to-value~~LTV at origination is 70%.

~~111.~~114. The existing lease payments are sufficient to cover all interest payments and all scheduled debt amortization payments over the life of the debt instrument. However, at maturity, there is a balloon payment due, totaling 80% of the original outstanding principal amount. The corresponding lease has no balloon payment due at lease maturity, so the SPV will either need to refinance the debt or sell the underlying equipment to service the final debt balloon payment. The ~~loan-to-value~~LTV at maturity is expected to increase to 95% considering the scheduled principal amortization payments net of the expected economic depreciation in the equipment value over the term of the debt. The equipment is expected to be subject to some market value volatility and periods of lower liquidity at certain points in time, but has a predictable value range and ready market over a longer period of time, such that the equipment could be liquidated over a reasonable period of time, if necessary.

~~112.~~115. Example 6~~7~~ Rationale: The equipment is a cash generating non-financial asset which is not expected to generate a meaningful level of cash flows for the repayment of the ~~bonds~~ issued debt via the existing lease that covers all interest payments and 20% of principal payments. In reaching this determination, the reporting entity considered that, while the cash flows being produced are predictable, the ability to recover the principal of the debt investment is almost entirely reliant on the equipment retaining sufficient value to sell or refinance to satisfy the debt.

~~113.~~116. The reporting entity also determined that the structure lacks a substantive credit enhancement to conclude that investors are in a different economic position than holding the equipment directly, in accordance with the requirements of the principles-based bond definition. In reaching this conclusion, the reporting entity noted that the debt starts with a 70% ~~loan-to-value~~LTV, but the overcollateralization is expected to deteriorate over the term of the debt as the equipment economically depreciates more quickly than the debt amortizes. This results in a high ~~loan-to-value~~LTV (i.e., 95%) at maturity, relative to the market value volatility of the underlying collateral. Despite the predictable nature of the cash flows, the reporting entity concluded that the debt instrument lacked a substantive level of overcollateralization to conclude that the investor is in a different economic position than owning the underlying equipment directly. It was determined that the level of overcollateralization, as determined by a market participant (i.e., a knowledgeable investor transacting at arm's length), is nominal. Therefore, the reporting entity concluded that it was in a substantively similar position as if it owned the equipment directly.

~~114.~~117. For the purposes of determining whether there is substantive overcollateralization, it is appropriate to consider any expected economic depreciation, if it is reasonably expected, but it is not appropriate to factor in any expected economic appreciation. Note that a debt instrument with a ~~loan-to-value~~LTV that is expected to increase over time is not necessarily deemed to have nominal overcollateralization.

Reflecting the Principles-Based Bond Proposal in ~~S~~SAP

~~115.~~118. The ~~This issue paper proposes that statutory accounting principles reflect the~~ principles-based bond definition ~~concepts~~ and the specific accounting guidance for bonds, including ~~both issuer obligations~~ICO and ~~asset backed securities~~ABS, and the guidance for ~~and~~ debt securities that do not qualify as bond be captured as ~~substantive revisions~~new SAP concepts to existing SSAPs:

a. *SSAP No. 26—Bonds* *(Exhibit 1)*

b. *SSAP No. 43—Asset-Backed Securities* (renamed from Loan-Backed and Structured Securities) (Exhibit 2)

c. *SSAP No. 21—Other Admitted Assets* *(Exhibit 3)*

~~116.~~119. For SSAP No. 26, the revisions capture the full bond definition, and the guidance for determining whether a security qualifies as either an ~~issuer credit obligation~~ICO or an ~~asset backed security~~ABS. The accounting guidance for ~~issuer credit obligations~~ICO is retained within SSAP No. 26 and is not changed with the inclusion of the bond definition. Other key revisions include transition guidance~~,~~ to reclassify debt securities that do not qualify as bonds from Schedule D-1 to the subsequent schedule and to delete the glossary as no longer necessary.

~~117.~~120. For SSAP No. 43, in addition to revising the name to "Asset-Backed Securities," revisions reorder and streamline the existing guidance. Although the broad measurement concepts and requirements to assess cash flows have not changed, the guidance specific to whether collection of cash flows is probable, not probable, ~~or~~ and pertains to ~~a~~ beneficial interests has been eliminated. ~~Instead, t~~The guidance has been rewritten to provide consistent guidance for the assessment of cash flows and considering the impact of prepayments. These revisions are not expected to result in significant deviations from past practice~~,~~ as the resulting guidance is believed to be reflective of prominent past industry interpretations. Clarifications have been included to ensure recognition of an other-than-temporary impairment whenever a security is in an impaired state (fair value is less than amortized cost, regardless of if an unrealized loss has been recognized) and there is an adverse change in cash flows expected to be collected. ~~-~~Other key revisions include transition guidance to reclassify debt securities that do not qualify as bonds from Schedule D-1 to the subsequent schedule as well as to incorporate guidance that prohibits reporting ABS as cash equivalents ~~/~~or short-term investments and ~~transition~~ the process to reclassify any securities reported as such as of the effective date.

~~118.~~121. For SSAP No. 21, revisions incorporate new guidance for the accounting and reporting for debt securities that do not qualify as bonds as well as residual interests. For both sections, the revisions specify new measurement and admittance concepts for these securities and specify reporting ~~These investments are reported~~ on Schedule BA in designated reporting lines. For residuals, guidance is included for the recognition of other-than-temporary impairments and transition guidance for situations where the residual had a different measurement method prior to the effective date.

~~119.~~122. In addition ~~to SSAP No. 26R and SSAP No. 43R~~, Exhibit ~~___,~~ 4, details "revisions to other SSAPs" adopted in accordance with the principles-based bond definition. ~~."~~ This section identifies all SSAPs that have modified guidance, which predominantly reflects updated terms and references, but includes the ~~including~~ revisions to SSAP No. 2R to restrict ABS from being in scope.

Discussion of Comments Received and Exposures

~~120.~~123. This section details key comments received from exposures of the principles-based bond definition revisions and the Working Group's consideration for potential edits.

a. ~~This issue paper, along with the principles-based bond definition, was exposed~~ Per the exposure of the issue paper and principles-based bond definition on March 2, 2022, with comments due May 6, 2022. The Working Group heard comments on July 18, 2022, and directed limited edits to be reflected as followed:

   i. Revise the guidance related to U.S. Treasury Inflation Protected Securities (TIPs) and to clarify the guidance regarding variable contractual principal and interest payments. These revisions clarified that securities with plain-vanilla inflation adjustment mechanisms are not intended to be captured within the provisions that restrict bond classification due to varying principal or interest payments, as well as clarified that other variances in contractual amounts due to reference variables (and not just equity interests) are intended to be precluded from bond treatment.

   ii. Revise guidance describing substantive credit enhancements, particularly to revise reference to the first loss "tranche" as the first loss "position" and clarify that securitization tranches that do not have contractual principal and interest payments along with substantive credit enhancement do not qualify as a Schedule D Bond and shall be reported on Schedule BA. (Tranches without contractual principal and interest payments are considered residual tranches shall be on Schedule BA.) (Subsequent to these edits further discussion and updates to the residual guidance were adopted. These revisions improve the guidance and remove specific references to contractual principal and interest payments.)

   iii. Document the outcome of small group discussions around the application of the bond principles, ~~(~~particularly the equity-backed example~~ in Appendix I)~~, to feeder fund structures. Feeder fund structures shall not automatically be assumed to qualify for bond classification (even if the ultimate collateral is fixed income), nor be automatically precluded bond classification. The substance of the investment should be the determining factor in these and other similar situations. In particular, the assessment of feeder fund structures should evaluate whether the structure ensures the pass through of the underlying cash flows, or whether uncertainty as to the timing or amount of cash flows is introduced by the structure.

   iv. Requested interested parties to work with NAIC staff in proposing revisions to capture the elements that may introduce equity-like characteristics ~~examples currently in Appendix I of the bond definition~~ into the main components of the bond definition.

b. In addition to the revisions incorporated from the July 18, 2022, call, the Working Group also heard comments and elected not to incorporate revisions for the following items:

   i. The Working Group identified that non-bond items that are specifically scoped into SSAP No. 26 will not be identified in the bond definition. The Working Group was explicit that the inclusion of an investment in-scope of SSAP No. 26 did not make the investment a "bond" and such a distinction is necessary to prevent scope-creep or inference of other investments into the bond definition. For example, although SVO-Identified Bond ETFs, SVO-Identified CTLs and certificates of deposit that exceed one year are explicit inclusions to SSAP No. 26 and reported on Schedule D-1, these investments are not bonds.

   ii. The Working Group did not incorporate industry-~~-~~proposed edits to limit guidance that requires the consideration of all returns to equity-backed ABS. Rather, the Working Group clarified that all investments that have contractual principal and

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interest that can fluctuate due to a referenced variable shall consider all returns in excess of principal repayment as interest when determining whether the investment qualifies for bond reporting under the principles-based definition.

iii. The Working Group did not agree with comments supporting ABS to be reported as cash equivalents or short-term investments even if acquired with a maturity date that is less than 90-days or 1-year away. ~~within those timeframes.~~ To ensure proper assessment under the bond definition, and reporting based on the underlying components of the investments, the Working Group retained the provisions that all ABS shall be captured within SSAP No. 43 and be reported on Schedule D-1-2.

iv. The Working Group did not direct changes to the ~~exposed~~ bond definition or issue paper after considering the industry "Lease-Backed Securities Working Group" May 5, 2022, comment letter. That letter, which is consistent with their prior comments, proposes to capture securities as ~~issuer credit obligations~~ICO if they pass-through cash flows unaltered (such as with certain lease-backed structures) and are supported primarily by a single rated credit payor, though principal repayment is not fully supported by the obligation of that payor. The discussion noted that these securities shall follow the guidance for ~~asset backed securities~~ABS if they are not fully supported by an underlying contractual obligation of a single operating entity, including the criteria for substantive credit enhancement and meaningful cash flows. The Working Group identified that these structures are not based on the credit worthiness of a single operating entity and rely on the underlying collateral for repayment, which is why they should be considered ~~asset backed securities~~ABS rather than ~~issuer credit obligations~~ICO. The comment letter also raised concerns around the guidance ~~included~~ for evaluating project finance debt ~~as it is perceived that~~noting a perception that inconsistent classification may occur for investments with similar characteristics. As a result of the discussion, there were no changes to the exposed bond definition. Working Group members and other interested parties noted during the discussion that the guidance pertaining to project finance is intended to provide guidance for evaluating issuers that share characteristics of both operating entities and ABS Issuers (i.e., the middle of the spectrum). Nevertheless, the guidance is clear that issuers of project finance debt must themselves have the characteristics of operating entities in order for the debt instrument to qualify as an ICO ~~issuer obligations~~. As such, project finance bonds issued by operating entities and other municipal revenue bonds will be retained as ~~issuer credit obligations~~ICO as the design of these structures are supported by the credit worthiness of a single operating entity and are therefore different than the investment structures presented by the industry Lease-~~-~~Backed Securities Working Group.

c. ~~This issue paper, along with~~Per the exposure of the principles-based bond definition, and proposed revisions to SSAP No. 26 and SSAP No. 43 ~~was exposed~~on August 10, 2022, with comments due October 7, 2022, ~~. C~~comments were received from Fermat Capital, the industry Lease-Backed Securities Working Group and Interested Parties. After considering the comments, the following key revisions were incorporated:

i. Revisions to incorporate the entire bond definition within SSAP No. 26, with a deletion of bond definition guidance from SSAP No. 43. With this change, ~~S~~securities that qualify as ABS after application of the bond definition will follow the measurement and reporting guidance within SSAP No. 43. This edit prevents unintended inconsistencies in the guidance that could occur if aspects of the bond definition are in both SSAPs.

ii. Revisions to incorporate the guidance for determining a creditor relationship, which was in an exhibit, into the body of guidance within SSAP No. 26.

iii. Revisions to the examples for ABS analysis, which were moved to SSAP No. 26, to reflect a scenario in which payments under the instrument are secured by a note, a legal assignment from the borrower of a lease for real property and the assignment of the lease payments from an operating entity tenant. This revision was in response to comments from the industry Lease-Backed Security Working Group and detail that the SPV does not need to have ownership interest in the underlying collateral for the security to qualify as an ABS.

iv. Revisions to SSAP No. 26 to clarify that investments with specific guidance and reporting lines (such as surplus notes, working capital finance investments (WCFI) and structured settlements) shall follow the guidance in their specific SSAP and be reported on designated reporting lines. This edit was made in response to the comments from Fermat Capital, who identified that WCFI meet the definition of ~~issuer credit obligations~~ICO. These investments shall follow the guidance *in SSAP No. 105R—Working Capital Finance Investments* and be reported on~~f~~ their specific reporting lines on Schedule BA.

v. Revisions to SSAP No. 26, and the addition of a new footnote, to clarify that the general creditworthiness of an entity can be direct or indirect recourse and is the primary source of repayment for issuer credit obligations.

vi. Revisions to SSAP No. 26 to clarify application when interest and principal vary based on the performance of an underlying value or variable. The revised guidance adds language to clarify that the exclusion is not intended to restrict variables that are commonly linked to debt instruments, such as plain-vanilla inflation or benchmark interest rates.

vii. Revisions to SSAP No. 26 to delete the proposed glossary, with the inclusion of the bank loan definition into a footnote. Other definitions were identified as not being necessary for retained inclusion in the statement.

viii. Revisions to SSAP No. 43 to identify Freddie-Mac When Issued Trust Certificates, pursuant to *INT 22-01: Freddie Mac When Issued K-Deal (WI Trust) Certificates*, as an explicit scope inclusion.

ix. Revisions to SSAP No. 43 to clarify the guidance for prospective adjustment method for high-credit quality investments, and on the assessment of cash flows. This guidance clarifies that if a security is in an unrealized loss position, and there is an adverse change in cash flow, the entity shall recognize an other-than-temporary impairment.

x. Revisions to both SSAP No. 26 and SSAP No. 43 to provide specialized transition and disclosure guidance for the reclassification of securities previously reported that will no longer qualify for reporting as bonds.

xi. Revision to the issue paper to clarify the application of the principles-based bond definition to ~~the~~ feeder funds~~ guidance~~.

d. ~~After considering the comments and proposed revisions, on November 16, 2022, the Working Group exposed revisions to SSAP No. 26R and SSAP No. 43R for comment. The~~

Working Group also exposed proposed revisions to other SSAPs that will be impacted with the revisions under the bond project. This includes revisions to detail the short-term and cash equivalent restriction for ABS in SSAP No. 2R as well as guidance for debt securities that do not qualify as bonds in SSAP No. 21R. This guidance wasPer an exposure on November 16, 2022 of SSAP No. 26, SSAP No. 43 and other SSAPs that will be impacted under the bond project, exposed until February 10, 2023, revisions were incorporated to reflect . The Working Group considered comments during the 2023 Spring National Meeting and exposed updated guidance, with a comment period ending June 9, 2023, to reflect most of the interested party comments. The revised documents were discussed and exposed at the 2023 Spring National Meeting. Most of the edits were minor, but the following elements are specifically noted:

i. Revisions to SSAP No. 26 incorporated an exception for nominal interest rate adjustments. The guidance defines the exception as being too small to be taken into consideration when assessing an investment's substance as a bond. This revision was added based on industry's comments on inadvertent impact to sustainability-linked bonds, but the exception guidance is not limited to those specific bonds.

ii. Revisions clarify that replication (synthetic asset) transactions are addressed in *SSAP No. 86—Derivatives* and are not impacted by the principles-based bond definition.

iii. Revisions to SSAP No. 26 to explicitly identity that residuals, including first loss positions that lack contractual payments or substantive credit enhancement, do not qualify as bonds and shall be captured in *SSAP No. 21—Other Admitted Assets*.

iv. Revisions specific to transition that clarify that investment assessments are required as of origination and to permit current or acquisition information in determining whether investments qualify as bonds at the time of transition. Furthermore, theThe guidance was also clarified that the transition guidance shall be applied prospectively beginning with the first year of adoption. For disclosures that provide comparable information, reporting entities shall not restate the prior year's information in the 2025 disclosure.

v. With an exposure of the revised documents, Aan updated SSAP No. 21 was also exposed to update guidance for the measurement of debt securities at the lower of amortized cost or fair value and to incorporate proposed accounting and reporting guidance for residuals.

e. The Statutory Accounting Principles (E) Working Group received comments on June 9, 2023, from the 2023 Spring National Meeting exposure. No comments were received on SSAP No. 26, SSAP No. 43 or the document that detailed revisions to other SSAPs. The Working Group adopted the SSAP revisions reflected in these documents on August 12, 2023, during the 2023 Summer National Meeting, effective January 1, 2025.

f. During the 2023 Summer National Meeting, the Working Group considered comments received on SSAP No. 21 pertaining to on the guidance for debt securities that do not qualify as bonds and for residual interests and exposed a revised SSAP No. 21 until September 29, 2023. The revisions for debt securities that do not qualify as bonds reflect a majority of interested parties' comments.

i. For debt securities that do not qualify as bonds, ~~the~~ revisions clarify that if the primary source of repayment is derived through underlying collateral, the investment shall only be admitted if the underlying collateral qualifies as admitted invested assets. For residuals, ~~the~~ revisions clarify that if the reporting entity holds a debt tranche from the same securitization, and the debt tranche does not qualify as a bond (either an ~~issuer credit obligation~~ICO or ~~asset-backed security~~ABS), and the debt security does not qualify as an admitted asset under SSAP No. 21, then the residual does not qualify as an admitted asset.

~~i.~~ii. ~~In addition, the r~~Revisions ~~to SSAP No. 21R included a~~ proposed new measurement method for residuals. This guidance is different from what was proposed by interested parties but intends to reflect the highly uncertain amount and timing of residual cashflows. This proposed guidance will require all cash flows received to be treated as a return of principal ~~/ investment~~ until the ~~residual book adjusted carrying value (~~BACV~~)~~ is zero. At that point, all cashflows received would be treated as interest income. This proposed guidance was noted to ~~intends to~~ best suit how residuals work conceptually. The reporting BACV will reflect the potential risk of loss prior to recovering the initial investment, rather than requiring an assessment of potential loss over the entire life of the securitization. ~~Comments on the proposed measurement method for residual tranches in general, and also for individual types of residuals, were specifically requested.~~

g. During the 2023 Fall National Meeting, the Working Group considered comments and exposed an updated SSAP No. 21 until January 22, 2024. No comments were received on the section for non-bond debt securities, but comments focused on the guidance for residual interests. Revisions reflected in the 2023 Fall National Meeting exposure:

i. Revisions capture an Allowable Earned Yield method for the measurement of residuals. This guidance will limit the extent interest income can be recognized without recognizing cash flows as return of principal. Provisions were also included to permit a practical expedient to allow all cash flows received to be taken as a reduction of BACV. Under the practical expedient, interest income would not be recognized until BACV was zero.

ii. Revisions clarified the treatment of reductions in fair value as unrealized losses and updated OTTI guidance to be consistent with SSAP No. 43 and the assessment of the present value of expected cash flow to the BACV.

h. On February 22, 2024, an updated SSAP No. 21 reflecting a variety of edits from working with industry throughout the interim was exposed until March 7, 2024. The shortened comment period was proposed to allow for adoption consideration during the 2023 Spring National Meeting.

i. Revisions for residual incorporate the definition and characteristics captured in other SSAPs to make SSAP No. 21 the location for all residual guidance. All residuals shall follow the accounting, admittance and reporting guidance detailed in SSAP No. 21.

ii. Revisions clarified that residuals shall be accounted for at the lower of Allowable Earned Yield method or fair value, or under the practical expedient.

iii. Revisions eliminated the guidance that directed reclassification of residuals to other SSAPs and reporting schedules in situations when the residual tranches cease

to meet the definition of residual tranches. With the deletion, once classified as a residual, an investment would retain that classification and reporting until it is disposed by the reporting entity.

iv. Revisions separate the OTTI calculation between items measured at the Allowable Earned Yield method and those that follow the practical expedient.

v. Revisions incorporate transition guidance for residuals that were accounted for under a different SSAP prior to the effective date.

vi. Revisions prescribe a January 1, 2025, effective date, but permit early adoption of the residual guidance.

History of Definition / Scope Development of SSAP No. 43 – Before the Principles-Based Definition

The following section details the historical development of SSAP No. 43 along with the prior benefits for reporting investments in scope of SSAP No. 43 and key issues from the prior guidance. Due to various revisions that have been reflected since its original adoption, this information is retained for historical reference on the SSAP No. 43 guidance prior to the reflection of the principles-based bond proposal.

~~121.~~124. *SSAP No. 43—Loan-backed and Structured Securities* was originally effective with the SAP codification and resulted with separate guidance for "bonds" (in SSAP No. 26) and "loan-backed and structured securities" (in SSAP No. 43). (The initial guidance indicated that investments in scope of SSAP No. 43 met the definition of a bond in *SSAP No. 26—Bonds, excluding Loan-backed and Structured Securities*.) Although most of the guidance between the original SSAP No. 26 and SSAP No. 43 was the same, the guidance in SSAP No. 43 recognized the need to review (at least quarterly) the assumptions and resulting cash flows of the underlying loans, as changes in assumptions could necessitate a recalculation of the effective yield or other-than-temporary impairment.

~~122.~~125. The original issue paper to SSAP No. 43 (Issue Paper No. 43) cited guidance originally contained in Chapter 1, *Bonds and Loaned Backed and Structured Securities*, from the *Accounting Practices and Procedures Manual of the Life and Accident and Health Insurance Companies*. The issue paper identified that the *Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies* contained similar guidance. In this Issue Paper No. 43, and the original SSAP No. 43, loan-backed securities were defined as "pass-through certificates, collateralized mortgage obligations (CMOs) and other securitized loans…" The reference to "securitized loans" was a key aspect of this original definition.

~~123.~~126. Original definition / scope guidance for SSAP No. 43:

> 2. Loan-backed securities are defined as pass-through certificates, collateralized mortgage obligations (CMOs), and other securitized loans not included in structured securities, as defined below, for which the payment of interest and/or principal is directly proportional to the interest and/or principal received by the issuer from the mortgage pool or other underlying securities.
>
> 3. Structured securities are defined as loan-backed securities which have been divided into two or more classes for which the payment of interest and/or principal of any class of securities has been allocated in a manner which is not proportional to interest and/or principal received by the issuer from the mortgage pool or other underlying securities.
>
> 4. Loan-backed securities are issued by special-purpose trusts (issuer) established by a sponsoring parent organization. Mortgage loans or other securities securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee under the issuer's obligation has been fully satisfied. The investor can only look to the issuer's assets (primarily the trusteed assets or third parties such as insurers or guarantors) for repayment of the obligation. As

a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying mortgage loans. Some sponsors do guarantee the performance of the underlying loans.

5. Loan-backed securities meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted asset to the extent they conform to the requirements of this statement.

~~124.~~127. In agenda item 2007-26, *FAS 156: Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140,* the Working Group adopted with modification FAS 156 in *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, revising the terminology for "retained interests" to "interests that continue to be held by the transferor." This action also clarified that beneficial interests from the sale of loan-backed and structured securities shall be accounted for in accordance with SSAP No. 43. This initial adoption identified that the holder of a beneficial interest in securitized financial assets should recognize the excess of all cash flows attributed to the beneficial interest estimated at the acquisition date over the initial investment as interest income over the life of the beneficial interest using the effective yield method.

~~125.~~128. In 2009, the Working Group adopted a substantively-revised SSAP No. 43 (effective September 30, 2009). The focus of the substantive revisions was to revise the valuation and impairment requirements based on the cash flows expected to be collected for the securities, rather than fair value. Although the focus of the revisions was inclusion of impairment guidance based on whether an entity has an intent to sell, whether an entity does not have the intent and ability to hold a security, and when there is a non-interest related decline if there is no intent to sell and the entity has the intent and ability to hold, the revisions resulted in a significant rewrite of the guidance in SSAP No. 43, including the guidance for beneficial interests. This guidance expanded the prior scope inclusion from "beneficial interests from the sale of LBSS," to include "purchased beneficial interests in securitized financial assets."

~~126.~~129. In agenda item 2010-12, Clarify Definitions of Loan-Backed and Structured Securities, the Working Group received a regulator-sponsored, nonsubstantive Form A with a proposal to revise the definitions of a loan-backed and structured security (LBSS). As a result of this proposal, the definition was revised to eliminate the reference to "securitized loans" and instead refer to "securitized assets." These revisions were adopted with an effective date of January 1, 2011.

a. Although the agenda item simply identifies that this item was exposed in August 2010, and then adopted after a single exposure in October 2010, with an effective date of January 1, 2011, there were significant comments received during the exposure period. In short summary, these comments highlighted that the scope of the changes were intended to move fixed-income assets that had been accounted for as bonds under SSAP No. 26 to SSAP No. 43 as LBSS. Particularly, the comments noted concerns with the movement of equipment trust certificates and credit tenant loans from the accounting provisions of SSAP No. 26 to the accounting rules of SSAP No. 43. These comments stated that "instruments with radically different sources of cash flows and risk characteristics utilize trust structures, and not all should be classified as loan-backed." There were no changes incorporated to the proposed guidance as a result of these comments, and the revisions were adopted as exposed.

~~127.~~130. In 2019, revisions to the definition and scope section were also adopted to clarify the identification of affiliate/related party transactions (agenda item 2019-03) as well as to explicitly capture mortgage-referenced securities issued from a government sponsored enterprise in scope of SSAP No. 43 (agenda item 2018-17). The inclusion of mortgage-referenced securities was a distinct departure from the "trust" structure required in determining inclusion within scope of SSAP No. 43, but was incorporated as

the securities (with the referenced pool of assets), functions similarly to the securities held in trust and the referenced pool of assets can be assessed for the underlying credit risk

~~128.~~131. Between the adoption of agenda item 2010-12 and the items adopted in 2019, there were several revisions to SSAP No. 43, but those revisions did not impact the definition / scope of the statement. Those revisions included changes to incorporate price-point NAIC designations, guidance for interim financials for RMBC/CMBS, clarification of disclosures, updating Q/A guidance, and guidance for prepayment fees.

~~129.~~132. Definition of loan-backed and structured securities in the "As of March 2020" AP&P Manual:

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

3. Structured securities are defined as loan-backed securities which have been divided into two or more classes for which the payment of interest and/or principal of any class of securities has been allocated in a manner which is not proportional to payments received by the issuer from the underlying assets.

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

a. In determining whether a loan-backed structure is a related party investment, consideration shall be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security. For example, although a loan-backed security may be acquired from a non-related issuer, if the assets held in trust predominantly[4] reflect assets issued by affiliates of the insurance reporting entity, and the insurance reporting entity only has direct recourse to the assets held in trust, the transaction shall be considered an affiliated investment, and the transaction shall also subject to the accounting and reporting provisions in *SSAP No. 25—Affiliates and Other Related Parties*.

5. Mortgage-referenced securities do not meet the definition of a loan-backed or structured security but are explicitly captured in scope of this statement. In order to qualify as a mortgage-

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

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

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

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

a. Loan-backed and structured securities acquired at origination,

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

c. Loan-backed and structured securities for which it is probable, either known at acquisition or identified during the holding period[7], that the reporting entity will be unable to collect all contractually required payments receivable, and

d. Transferor's beneficial interests in securitization transactions that are accounted for as sales under SSAP No. 103R and purchased beneficial interests in securitized financial assets[8].

Benefits of Reporting in Scope of SSAP No. 43 – Before the Principles-Based Definition

~~130.~~133. There are a variety of benefits for reporting investments as bonds on Schedule D-1. Also, with regards to bifurcated impairment, capturing an investment in scope of SSAP No. 43 may be more advantageous than capturing in scope of *SSAP No. 26—Bonds*. These benefits include:

a. Capturing an investment in scope of SSAP No. 26 or SSAP No. 43 results with reporting the investment on Schedule D-1, Long-Term Bonds. By reporting on this bond schedule, the investment is generally not subject to investment limitations, the asset is admitted and

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

[6] As discussed in paragraph 4.a. of this statement, a SSAP No. 43 security may still be considered a related party transaction even if the asset trustee or security issuer is a non-related party.

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

[8] The accounting requirements related to these types of securities included in paragraphs 22-25 shall be determined at acquisition or initial transfer.

the investment has the benefit of lower risk-based capital (RBC) charges based on NAIC designation. (Moving held equity instruments from Schedule BA into a SSAP No. 43 trust has been particularly noted as providing "regulatory capital relief.")

b. Capturing an investment in scope of SSAP No. 26 or SSAP No. 43 may result in amortized cost reporting and a delay in recognizing decreases in value or other-than-temporary impairments than if the assets held in trust were reported separately on the statutory financial statements.

i. Under the SSAP No. 43 bifurcated impairment model, an entity is not required to recognize an OTTI or deviate from an amortized cost measurement as long as the entity can assert that they have the intent and ability to hold the SSAP No. 43 security to recover the amortized cost basis and there is no non-interest related decline. (This has been a key factor in the PPN design, as a high-quality bond is placed in trust (along with other assets), and the bond – over several years – will single-handedly satisfy the contractual requirements of the 43 issued security, preventing any recognition of OTTI or a reduction of NAIC designation even when the other securities held in trust could completely default to zero.)

ii. The SSAP No. 43 bifurcated impairment can be considered an advantage over SSAP No. 26 as under SSAP No. 43, if there is an intent and ability to hold the asset, a reporting entity only has to recognize an OTTI for the portion of the non-interest related loss. Under SSAP No. 26, if there is any assessed OTTI (despite if interest or credit related), a reporting entity must recognize an OTTI down to the then-current fair value for the security.

iii. Prior to the principles-based bond project, guidance in SSAP No. 43 did not differentiate between different types of tranches or payment streams for the issued securities. This is easiest to illustrate through the "equity" tranche of a SSAP No. 43 investment but could be a factor if payments are provided sequentially. (Sequential payments are used to pay the senior notes first, until paid in full, before payments are allocated to junior notes.) For the "equity" tranche, which is a term that refers to the junior-most layer of issued SSAP No. 43 securities, this tranche is the first-loss position and only receives payment after all other layers have been satisfied. Without prior guidance in SSAP No. 43 for this layer, entities were able to classify these residual tranches as "bonds" on Schedule D-1, which did not properly reflect the nature of those investments.

c. SSAP No. 43 permits admittance of the security without any verification to the assets held in trust. As such, if a reporting entity was to derecognize a joint venture or LLC from Schedule BA and reacquire through the ownership of a SSAP No. 43 security, the reporting entity would be permitted to admit the security without any verification of the joint venture or LLC held in trust. Under *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, assets must have audited support (audited U.S. GAAP financials, audited reconciliation to U.S. GAAP, audited IFRS financials or audited U.S. tax basis equity) in order to be admitted in the statutory financial statements.

Key Issues with Scope / Definition Application of SSAP No. 43 – Before the Principles-Based Definition

~~131.~~134. With the existing guidance in SSAP No. 43, there are no restrictions to the assets that can be placed in trust and used to support securities issued from the trust structure. Although these structural designs are referred to as "securitizations" and reported as debt instruments, these investment structures

may not reflect actual securitizations in which cash flows from multiple contractual debt obligations held in trust are used to pay principal and interest payments on the trust-issued security. The assets being securitized may include assets that are not cash flow producing, creating reliance on an underlying collateral valuation risk. Or, there may be no economic substance to the use of the securitization structure, such that the insurer is in the same economic position as owning the underlying assets directly. As a result, there is a regulatory concern that assets being represented as bonds may contain unidentifiable risks that regulators would not traditionally associate with bond risk.

135. As an additional issue of the existing guidance, questions have been raised on whether securities captured in scope of SSAP No. 43 would be "asset-backed securities" as defined by the Code of Federal Regulations (17 CFR 229.1101(c)). These questions have arisen as an SEC identified nationally recognized statistical rating organization (NRSRO) must be specifically approved to provide ratings of "asset-backed securities." Since the CFR definition is different than what is permitted in scope of SSAP No. 43, a rating from an NRSRO approved as a credit rating provider (CRP) that may not be approved by the SEC for "asset-backed securities" could provide a valid rating for a SSAP No. 43 instrument permitted as "filing exempt" if that asset was not an "asset-backed security." This has caused questions as regulators have identified designations given by CRPs not SEC approved to provide "ABS" designations and have questioned the use of these CRP ratings in determining the NAIC designation.

Issue Paper Exhibits:

Staff Note: Although not captured, the final issue paper retained for historical purposes will include the following Exhibits reflecting the adopted guidance to initially reflect the principles-based bond definition.

Exhibit 1 – SSAP No. 26—Bonds

Exhibit 2 – SSAP No. 43—Asset-Backed Securities

Exhibit 3 – SSAP No. 21—Other Admitted Assets

Exhibit 4 – Revisions to Other SSAPs

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Hearing/10 - Bond IP - 6-25-24.docx

PRINCIPLES-BASED BOND DEFINITION
IMPLEMENTATION QUESTIONS AND ANSWERS

Last Updated: August 7, 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.

Note: Additional Q&A topics are anticipated and will be subsequently exposed.

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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.

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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 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.

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6. 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]

6.1 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. 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]

7.1 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.

7.2 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 intended 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. Any unintended language that conflicts with statements in the SSAP should be disregarded.

7.3 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.

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

8.1 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.

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

Issue: Bond Definition – Debt Securities Issued by Funds

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 clarify guidance in the principles-based bond definition on the treatment on debt securities issued by funds, particularly to eliminate inconsistent application between similar funds and to better align with the recently adopted definition of residual tranches. In the adopted bond definition, bonds issued by business development corporations (BDCs), closed-end funds (CEFs), or similar operating entities are provided as examples of issuer credit obligations (ICOs) when they are registered under the Investment Company Act of 1940 (1940 Act). It has been noted that this guidance is inconsistent with the stated intent of having the bond definition be principles-based as the registration of the fund appears to be the basis of classification as an ICO vs ABS, rather than based on principles. It has been noted that with the current guidance, two funds with issued debt that are virtually identical can have separate SSAP classification of the debt securities (resulting with different accounting/reporting) simply based on whether the fund is registered. Additionally, it would lead to debt securities being classified inconsistently with their equity counterparts. In concept, there should be consistency between the classification of a debt security as an asset-backed security, and the equity of that structure being classified as a residual interest. Using SEC-registration as currently adopted would result in misalignment of these concepts.

The changes captured within this agenda item propose to revise the principles-based bond definition guidance to clarify that debt securities issued by funds representing operating entities qualify as ICOs. This would allow consistent treatment of similar funds regardless of SEC registration status. Guidance is also proposed to assist with distinguishing whether a fund represents an operating entity or a securitization vehicle.

The original guidance, and the reference to the SEC registration, was an easy approach to determine whether a debt security from a fund qualified as an ICO. This is because SEC registered funds have leverage limits on how much debt can be issued. Although debt securities issued from SEC registered CEFs and BDCs are still permitted as ICOs, the proposed edits permit debt securities from non-registered funds to qualify as ICO if the funds are functioning as operating entities and are not issuing securities for the primary purpose of raising debt capital.

Existing Authoritative Literature:

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

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:

   a. U.S. Treasury securities, including U.S. Treasury Inflation-Indexed Securities; (INT 01-25).

   b. U.S. government agency securities.

c. Municipal securities issued by the municipality or supported by cash flows generated by a municipally-owned asset or entity that provides goods or services (e.g., airport, toll roads, etc.).

d. Corporate bonds issued by operating entities, including Yankee bonds and zero-coupon bonds.

e. Corporate bonds issued by holding companies that own operating entities.

f. Project finance bonds issued by operating entities.

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.

h. Bonds issued by real estate investment trusts (REITs) or similar property trusts.

i. Bonds issued by business development corporations, closed-end funds, or similar operating entities, in each case registered under the 1940 Act.

j. Convertible bonds issued by operating entities, including mandatory convertible bonds as defined in paragraph 20.b.

Issue Paper – Exposure Draft As of 2023 Summer National Meeting

32. Whether an issuer of debt represents an operating entity or ABS Issuer is expected to be clear in most instances, but certain instances may be less clear. Ultimately, for an issuer credit obligation, it comes down to whether support for repayment consists of direct or indirect recourse to an operating entity or entities. In addition to "traditional bond" structures previously included in SSAP No. 26R, examples of issuer credit obligations include:

a. Investments in the form of securities for which repayment is fully supported by an underlying contractual obligation of a single operating entity. (e.g., CTLs, ETCs, other lease backed securities, Funding Agreement Backed Notes (FABNs), etc.). For purposes of applying this principle 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.

b. Bonds issued by real estate investment trusts (REITS) or similar property trusts.

c. Bonds issued by business development corporations, closed-end funds or similar operating entities, in each case registered under the 1940 Act. With this inclusion, it is important to highlight that the intent is specific to bonds issued from SEC-registered entities. The reference to "similar entities" is not intended to capture items issued from collateralized fund obligations (CFOs) or other such structures. Although some may consider CFOs to be similar to closed-end funds, that assessment is not supported for classification as an issuer credit obligation. Instruments considered to reflect CFOs (and other like structures) are required to be assessed as asset-backed securities for inclusion on Schedule D-1.

d. Project finance debt issued by operating entities. These investments reflect financing of a single asset or "operation" (such as a toll road or power generation facility) that collateralizes a debt issuance and the cash flows produced by the asset/operation service the debt, where the issuer may also represent an operating entity. These designs have characteristics of both issuer credit operations, as the operation constitutes a stand-alone business, as well as characteristics of ABS, as they are formed for the purpose of raising debt capital backed by the cash flows from collateral held by a bankruptcy-remote entity. When viewed holistically, these issuing entities are typically used to facilitate the financing of an operating component of a project sponsor or municipality.

Although the use of a bankruptcy-remote entity (e.g., SPV) facilitates the efficient raising of debt as a source of financing, the primary purpose is to finance an operating project. Therefore, when the issuing entity represents a stand-alone business producing its own operating revenues and expenses, where the primary purpose is to finance an operating project, the issuing entity shall be considered an operating entity despite certain characteristics that resemble ABS issuances.

i. It is important to highlight that the guidance for project finance is strictly for instruments issued by operating entities, similar to other instruments that qualify as issuer credit obligations under the principles-based bond definition. Consistent with other concepts, the naming convention (e.g., referring to an instrument as project finance) or the presence or absence of an SPV/trust structure are not definitive components in determining whether an investment qualifies for reporting on Schedule D-1, or is classified as an issuer credit obligation or ABS. Instruments (even if identified as "project finance") that do not qualify as issuer credit obligations as they not issued by operating entities, shall be assessed for qualification for reporting on Schedule D-1 as ABS. If the instruments do not qualify for reporting as ABS, they shall not be reported on Schedule D-1.

e. U.S. Treasury Inflation-Protected Securities (TIPs): The inclusion of U.S. TIPs specifically as an issuer credit obligation intends to highlight a specific exception to the determination as a creditor relationship as the variation is due to plain-vanilla inflation adjustment mechanisms. Although U.S. TIPs are specific as issuer credit obligations, Under the bond definition encompassing both issuer credit obligations and asset-backed securities, in order for a debt instrument to represent a creditor relationship, 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 (e.g., 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 variables are precluded from bond treatment as they do not reflect creditor relationships. Although US TIPS are indexed to the consumer price index and grows with inflation, these securities shall be captured as issuer credit obligations on Schedule D-1.

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):

- *SSAP No. 26R—Bonds* and *SSAP No. 43R—Asset-Backed Securities*, reflecting new guidance to incorporate a principles-based bond definition were adopted during the 2023 Summer National Meeting. This guidance is effective Jan. 1, 2025. The corresponding Issue Paper has been updated as discussions occurred and has not yet been finalized as discussions involving SSAP No. 21R for the debt securities that do not qualify as bonds is not yet adopted.

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 include this agenda item on their maintenance agenda as a SAP clarification and expose revisions to *SSAP No. 26R—Bonds* incorporating the principles-based bond definition to clarify that debt securities issued by funds that represent operating entities are permitted as issuer credit obligations. These revisions would be in effect pursuant to the effective date of the revised SSAP No. 26R guidance, which is Jan. 1, 2025. The edits revise paragraph 7.i and incorporate a new paragraph 12 to the SSAP No. 26R guidance.

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This agenda item also proposes revisions to the draft Issue Paper (paragraph 32c) to update the guidance previously included addressing 1940 Act registered BDCs and CEFs as issuer credit obligations.

Proposed Revisions to *SSAP No. 26R—Bonds* (Effective Jan. 1, 2025)

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:

   a. U.S. Treasury securities, including U.S. Treasury Inflation-Indexed Securities;(INT 01-25).

   b. U.S. government agency securities.

   c. Municipal securities issued by the municipality or supported by cash flows generated by a municipally-owned asset or entity that provides goods or services (e.g., airport, toll roads, etc.).

   d. Corporate bonds issued by operating entities, including Yankee bonds and zero-coupon bonds.

   e. Corporate bonds, issued by holding companies that own operating entities.

   f. Project finance bonds issued by operating entities.

   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.

   h. Bonds issued by real estate investment trusts (REITs) or similar property trusts.

   i. Bonds issued by funds representing operating entities as described in paragraph 12.~~Bonds issued by business development corporations, closed-end funds, or similar operating entities, in each case registered under the 1940 Act.~~

   j. Convertible bonds issued by operating entities, including mandatory convertible bonds as defined in paragraph 20.b.

8. An asset[1]-backed security is a bond issued by an entity (an "ABS Issuer") created for the primary purpose of raising debt capital backed by financial assets[2] or cash generating non-financial assets owned by the

[1] The underlying collateral supporting an asset-backed security shall meet the definition of an asset by the ABS Issuer. Certain forms of collateral, such as rights to future cash flows, may not be recognized as assets by the selling entity but may be recognized as assets when sold to an ABS Issuer. These assets are permitted as the collateral supporting an asset-backed security, although they may not represent an asset that can be liquidated to provide payment toward the issued debt obligations (i.e., if the future cash flows do not materialize). The limited ability to liquidate the underlying collateral supporting an asset-backed security does not impact the structural determination of whether an issued security meets the definition of an asset-backed security but may impact the recoverability of the investment, as well as the consideration of whether there is sufficient credit enhancement.

[2] *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* defines a financial asset as cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right (a) to receive cash or another financial instrument from a second entity or (b) to exchange other financial instruments on potentially favorable terms with the second entity. As a point of clarity, for the purposes of this standard, financial assets do not include assets for which the realization of the benefits conveyed by the above rights

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[3]. 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.

9. The assets owned by the ABS Issuer are either financial assets or cash-generating non-financial assets. Cash-generating non-financial assets are defined as assets that are expected to generate a meaningful level of cash flows toward repayment of the bond through use, licensing, leasing, servicing or management fees, or other similar cash flow generation. For the avoidance of doubt, there must be a meaningful level of cash flows to service the debt, other than through the sale or refinancing of the underlying assets held by the ABS Issuer. Reliance on cash flows from the sale or refinancing of cash generating non-financial assets does not preclude a security from being classified as an asset-backed security so long as the conditions in this paragraph are met.

   a. *Meaningful Level of Cash Flows*: Determining what constitutes a "meaningful" level of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral pursuant to paragraph 9 is specific to each transaction, determined at origination, and shall consider the following factors:

      i. The price volatility in the principal market for the underlying collateral;
      ii. The liquidity in the principal market for the underlying collateral;
      iii. The diversification characteristics of the underlying collateral (i.e., types of collateral, geographic location(s), source(s) of cash flows within the structure, etc.);
      iv. The overcollateralization of the underlying collateral relative to the debt obligation; and
      v. The variability of cash flows, from sources other than sale or refinancing, expected to be generated from the underlying collateral.

      The factors for price variability and the variability of cash flows are directly related to the "meaningful" requirement. That is, as price volatility or variability of cash flows increase, the required percentage of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral must also increase. The factors for liquidity, diversification and overcollateralization are inversely related to the "meaningful" concept. That is, as liquidity, diversification or overcollateralization increase, the required percentage of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral may decrease.

   b. As a practical expedient to determining whether a cash generating non-financial asset is expected to produce meaningful cash flows, a reporting entity may consider an asset for which less than 50% of the original principal relies on sale or refinancing to meet the meaningful criteria. In applying this practical expedient, only contractual cash flows of the non-financial

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depends on the completion of a performance obligation (e.g., leases, mortgage servicing rights, royalty rights, etc.). These assets represent non-financial assets, or a means through which non-financial assets produce cash flows, until the performance obligation has been satisfied.

[3] Dedicated cash flows from an operating entity can form the underlying defined collateral in an asset-backed security. This dynamic, perhaps noted in a whole-business securitization, still reflects an asset-backed security and is not an issuer credit obligation.

assets may be considered. This practical expedient should not be construed to mean that assets cannot meet the meaningful criteria if they rely on sale or refinancing to service greater than 50% of the original principal or if they rely on cash flows that are not contracted at origination. Rather, such instances would require a complete analysis of the considerations described within the meaningful level of cash flows definition in paragraph 9.

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.

    a. *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 required to be in a different economic position is specific to each transaction; determined at origination; and refers to the level of credit enhancement a market participant (i.e., knowledgeable investor transacting at arm's length) would conclude is substantive.

    b. The first loss position may be issued as part of a securitization in the form of a debt or equity interest, or it may be retained by the sponsor and not issued as part of the securitization. If the first loss position (or a more senior position(s), if the first loss position(s) lacks contractual payments along with a substantive credit enhancement) is issued as part of the securitization, and does not have contractual principal and interest payments along with substantive credit enhancement and is held by a reporting entity, the investment(s) does not qualify for reporting as a bond and shall be reported on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value consistent with the treatment for residuals. (These items are further addressed in *SSAP No. 21R—Other Admitted Assets*.)

11. Whether an issuer of debt represents an operating entity or ABS Issuer is unambiguous in most instances, but certain instances may be less clear. For example, an entity may operate a single asset such as a toll road or power generation facility (e.g., project finance) which serves to collateralize a debt issuance, and the cash flows produced by the operation of the assets are pledged to service the debt. In many such instances, the entity is structured as a bankruptcy-remote entity that is separate from the municipality or project sponsor. Such entities have characteristics of operating entities as the operation of the asset constitutes a stand-alone business. They also have many common characteristics of ABS Issuers as they are formed for the purpose of raising debt capital backed by the cash flows from collateral held by a bankruptcy-remote entity. When viewed more holistically, these issuing entities are typically being used to facilitate the financing of an operating component of a project sponsor or municipality. The use of a bankruptcy-remote entity facilitates the efficient raising of debt to finance the operating project, but the primary purpose is to finance an operating project. Therefore, structures in which the issuing entity represents a stand-alone business producing its own operating revenues and expenses, where the primary purpose is to finance an operating project, shall be considered operating entities despite certain characteristics they may share with ABS Issuers.

12. Likewise, distinguishing between a fund that represents an operating entity and a securitization vehicle that represents an ABS Issuer can involve similar ambiguity. Both types of entities may hold only passive investments and issue debt securities for which ultimate recourse upon default is to those investments. However, a clear distinction can generally be made by evaluating the substance of the entity and its primary purpose:

    a. A fund representing an operating entity has a primary purpose of raising equity capital and generating returns to its equity investors. Marginal amounts of debt may be issued to fund operations or produce levered returns to equity holders. However, this is in service to meeting the fund's primary equity-investor objective. For 1940-Act registered closed-end funds (CEFs) and business development corporations (BDCs), debt securities issued from the fund in accordance with permitted leverage ratios represent debt issued by operating entities and qualify as issuer credit obligations.

    b. In contrast, an ABS Issuer has a primary purpose of raising debt capital and its structural terms and features serve to support this purpose. Perhaps most distinctively, in addition to the characteristics detailed in Paragraph 8, the contractual terms of the structure generally define how each cash flow generated by the collateral is to be applied. There is generally little discretion afforded to the manager/servicer of the vehicle and any discretion that is allowed is narrowly defined in the contractual agreements. This hardwiring of debtholder protections allows for the issuance of higher amounts of leverage than would be possible for a fund representing an operating entity, further supporting the entity's primary purpose of raising debt capital.

~~12.~~13. The definition of a creditor relationship, per paragraph 6, does not include equity/fund investments (such as mutual funds or exchanged-traded funds), or securities that possess equity-like characteristics or that represent an ownership interests in the issuer. However, as identified in paragraph 2, exchange traded funds (ETFs), which qualify for bond treatment, as identified in Part Three of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and included in the 'SVO-Identified Bond ETF List' published on the SVO's webpage are provided special statutory accounting treatment and are included within the scope of this statement. These investments shall follow the guidance within this statement, as if they were issuer credit obligations, unless different treatment is specifically identified in paragraphs 32-38.

~~13.~~14. Investments within the scope of this statement issued by a related party, or acquired through a related party transaction, are also subject to the provisions, admittance assessments and disclosure requirements of *SSAP No. 25—Affiliates and Other Related Parties.*

~~14.~~15. Investments within the scope of this statement meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement and SSAP No. 25.

Proposed Revisions to Draft Issue Paper:

32. Whether an issuer of debt represents an operating entity or ABS Issuer is expected to be clear in most instances, but certain instances may be less clear. Ultimately, for an issuer credit obligation, it comes down to whether support for repayment consists of direct or indirect recourse to an operating entity or entities. In addition to "traditional bond" structures previously included in SSAP No. 26R, examples of issuer credit obligations include:

    a. Investments in the form of securities for which repayment is fully supported by an underlying contractual obligation of a single operating entity. (e.g., CTLs, ETCs, other lease backed securities, Funding Agreement Backed Notes (FABNs), etc.). For purposes of applying this principle 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.

b. Bonds issued by real estate investment trusts (REITS) or similar property trusts.

c. Bonds issued by funds representing operating entities. Determining whether a fund represents an operating entity can generally be made by evaluating the substance of the entity and its primary purpose. A fund representing an operating entity has the primary purpose of raising equity capital and generating returns to its equity investors. Marginal amounts of debt may be issued to fund operations or produce levered returns to equity holders. These debt issuances occur in accordance with the fund's primary equity-investor objective. Debt securities issued by closed-end funds and business development corps registered under the 1940 Act are permitted automatic qualification as issuer credit obligations as those funds are subject to strict limits or reporting components on the leverage (debt issuance) within the fund. ~~Bonds issued by business development corporations, closed-end funds or similar operating entities, in each case registered under the 1940 Act. With this inclusion, it is important to highlight that the intent is specific to bonds issued from SEC-registered entities. The reference to "similar entities" is not intended to capture items issued from collateralized fund obligations (CFOs) or other such structures.~~ In contrast, an ABS Issuer has a primary purpose of raising debt capital and its structural terms and features serve to support this purpose. More distinctively, the contractual terms of the structure generally define how each cash flow generated by the collateral is to be applied. For these structures, there is little or no discretion afforded to the manager/servicer of the vehicle and any discretion that is allowed is narrowly defined in the contractual agreements. The hardwiring of debtholder protections allows for the issuance of higher amounts of debt securities to be issued than what would be possible for a fund representing an operating entity. These features support the entity's primary purpose of raising debt capital. Although some may consider CFOs to be similar to closed-end funds, that assessment is not supported for classification as an issuer credit obligation. Instruments considered to reflect CFOs (and other like structures) are required to be assessed as asset-backed securities for inclusion on Schedule D-1.

d. Project finance debt issued by operating entities. These investments reflect financing of a single asset or "operation" (such as a toll road or power generation facility) that collateralizes a debt issuance and the cash flows produced by the asset/operation service the debt, where the issuer may also represent an operating entity. These designs have characteristics of both issuer credit operations, as the operation constitutes a stand-alone business, as well as characteristics of ABS, as they are formed for the purpose of raising debt capital backed by the cash flows from collateral held by a bankruptcy-remote entity. When viewed holistically, these issuing entities are typically used to facilitate the financing of an operating component of a project sponsor or municipality. Although the use of a bankruptcy-remote entity (e.g., SPV) facilitates the efficient raising of debt as a source of financing, the primary purpose is to finance an operating project. Therefore, when the issuing entity represents a stand-alone business producing its own operating revenues and expenses, where the primary purpose is to finance an operating project, the issuing entity shall be considered an operating entity despite certain characteristics that resemble ABS issuances.

i. It is important to highlight that the guidance for project finance is strictly for instruments issued by operating entities, similar to other instruments that qualify as issuer credit obligations under the principles-based bond definition. Consistent with other concepts, the naming convention (e.g., referring to an instrument as project finance) or the presence or absence of an SPV/trust structure are not definitive components in determining whether an investment qualifies for reporting on Schedule D-1, or is classified as an issuer credit obligation or ABS. Instruments (even if identified as "project finance") that do not qualify as issuer credit obligations as they not issued by operating entities, shall be assessed for

qualification for reporting on Schedule D-1 as ABS. If the instruments do not qualify for reporting as ABS, they shall not be reported on Schedule D-1.

e. U.S. Treasury Inflation-Protected Securities (TIPs): The inclusion of U.S. TIPs specifically as an issuer credit obligation intends to highlight a specific exception to the determination as a creditor relationship as the variation is due to plain-vanilla inflation adjustment mechanisms. Although U.S. TIPs are specific as issuer credit obligations, Under the bond definition encompassing both issuer credit obligations and asset-backed securities, in order for a debt instrument to represent a creditor relationship, 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 (e.g., 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 variables are precluded from bond treatment as they do not reflect creditor relationships. Although US TIPS are indexed to the consumer price index and grows with inflation, these securities shall be captured as issuer credit obligations on Schedule D-1.

Status:
On January 10, 2024, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed this agenda item with the proposed revisions, as illustrated above, to clarify the guidance for debt securities issued by funds. These revisions permit debt securities issued by funds to be classified as issuer credit obligations if the fund represents an operating entity regardless of SEC-registration status. This item was exposed with a comment deadline of February 9, 2024.

On March 16, 2024, the Statutory Accounting Principles (E) Working Group re-exposed this item with a request for regulators and industry to provide comment on the proposed language that assists with clarifying the scope of guidance and to 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.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Hearing/12 - 24-01 - PBBD - SEC Funds.docx

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

Issue: Conforming Repurchase Agreements

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 in response to the January 2024 referral received from the Life Risk-Based Capital (E) Working Group in response to the American Council of Life Insurers (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 their 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. Pursuant to the Statutory Accounting Principles (E) Working Group referral response dated Feb. 8, 2024, it was identified that the statutory accounting and reporting for securities lending and repurchase agreements are currently different. As a result, the SAPWG requested that the LRBCWG defer consideration of the proposal until the SAPWG has time to assess the differences and consider converging revisions (if deemed appropriate) before modifying the RBC formula.

This agenda item identifies initial statutory differences between securities lending and repurchase agreements as well as other items that should be reviewed for potential clarification on the "conforming agreement" securities lending concept currently captured in the general interrogatories. These items are summarized as follows:

- Documentation of Securities Lending Collateral: Securities lending collateral is detailed in Schedule DL: Securities Lending Collateral Asset for 1) collateral that an entity has received and reinvested and 2) collateral received that the entity has not reinvested but for which the entity has the ability to sell or repledge. This schedule currently does not include repurchase agreement collateral. As detailed within the ACLI proposal, the ACLI identifies that repurchase agreements and securities lending transactions are similar forms of short-term collateralized funding for life insurers, with counterparties reflecting the key difference between the two funding structures. With these similarities, consistent reporting of the collateral may be appropriate to ensure financial regulators receive comparable information regardless of the legal form of the agreement. Furthermore, a review of year-end 2022 data identified that securities associated with securities lending transactions are declining, whereas securities associated with repurchase agreements are increasing.

- Blanks Reporting Revisions: Blanks reporting revisions will be required to incorporate a new general interrogatory to capture repurchase collateral from conforming programs and for that data to be pulled directly into the RBC formula. Additionally, the current guidance on what reflects a "conforming program" for securities lending is captured in the RBC instructions. To ensure consistency in reporting, consideration should occur on incorporating the guidance into the annual statement instructions. This would ensure that financial statement preparers, who may not have the RBC instructions, have the guidelines to properly assess whether a program should be classified as conforming or nonconforming.

- Assessment of Conforming Provisions: From a review of year-end 2022 financial statements, very few reporting entities reported any securities lending collateral as part of a nonconforming program. Although the instructions identify what is permitted as "acceptable collateral," from a review of the collateral reported on Schedule DL, reporting entities are classifying programs as conforming even though the reported

Schedule DL collateral is outside the parameters of acceptable collateral. From initial assessments, it appears that there may be interpretation differences on whether the "acceptable collateral" requirement encompasses only the collateral received from the counterparty and not what the reporting entity currently holds due to reinvestment of the original collateral. From this information, clarification of the intent of the guidelines and what is conforming or nonconforming is proposed to be considered. It is also noted that the provisions to separate conforming and nonconforming programs in the RBC formula was incorporated before the great financial crisis, and significant changes to the accounting and reporting (Schedule DL) were incorporated because of how securities lending transactions impacted certain reporting entities during the crisis. For example, prior to Schedule DL, most of the security lending collateral was off-balance sheet, and now only collateral that an entity cannot sell or repledge is off-balance sheet. From a review of the detail, reporting entities are combining any off-balance sheet (which is limited) with what is captured on Schedule DL for inclusion in the "conforming program" securities lending general interrogatory.

Existing Authoritative Literature:

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

The guidance in SSAP No. 103R provides guidance for sales and secured borrowings and is extensive. Only the guidance for secured borrowings is included below. Most securities lending and repurchase transactions are accounted for as secured borrowings and not sales. Also, the guidance below includes information for repurchase and reverse repurchase agreements but does not include the guidance for repurchase financings or dollar-repurchase agreements. Lastly, the guidance in SSAP No. 103R was structured to mirror the issuance of U.S. GAAP guidance in FAS 166, so has the broad concepts, followed by disclosures, and then specific application guidance. For ease of review, the quoted segments below have been grouped first with the guidance followed by disclosures.

Secured Borrowing

14. If a transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset does not meet the conditions for a sale in paragraph 8, or if a transfer of a portion of an entire financial asset does not meet the definition of a participating interest (paragraph 7), the transferor and transferee shall account for the transfer as a secured borrowing with pledge of collateral (paragraph 19). The transferor shall continue to report the transferred financial assets in its statement of financial position with no change in their measurement (that is, basis of accounting).

Secured Borrowings and Collateral

19. A debtor may grant a security interest in certain assets to a lender (the secured party) to serve as collateral for its obligation under a borrowing, with or without recourse to other assets of the debtor. An obligor under other kinds of current or potential obligations, for example, interest rate swaps, also may grant a security interest in certain assets to a secured party. If collateral is transferred to the secured party, the custodial arrangement is commonly referred to as a pledge. Secured parties sometimes are permitted to sell or repledge (or otherwise transfer) collateral held under a pledge. The same relationships occur, under different names, in transfers documented as sales that are accounted for as secured borrowings (paragraph 14). The accounting for noncash[1] collateral by the debtor (or obligor) and the secured party depends on whether the secured party or its agent has the right to sell or repledge the collateral and on whether the debtor has defaulted. (Paragraphs 85-121 provide application guidance for securities lending, securities borrowing and repurchase agreements.)

a. If the secured party (transferee) or its agent has the right by contract or custom to sell or repledge the collateral, then the debtor (transferor) shall report that asset in its balance sheet.

[1] Cash "collateral," sometimes used, for example, in securities lending transactions, shall be derecognized by the payer and recognized by the recipient, not as collateral, but rather as proceeds of either a sale or a borrowing.

b. If the secured party (transferee) sells collateral pledged to it, it shall recognize the proceeds from the sale and its obligation to return the collateral. The sale of the collateral is a transfer subject to the provisions of this statement.

c. If the debtor (transferor) defaults under the terms of the secured contract and is no longer entitled to redeem the pledged asset, it shall derecognize the pledged asset, and the secured party (transferee) shall recognize the collateral as its asset initially measured at fair value or, if it has already sold the collateral, derecognize its obligation to return the collateral.

d. Except as provided in paragraph 19.c., the debtor (transferor) shall continue to carry the collateral as its asset, and the secured party (transferee) shall not recognize the pledged asset.

20. Reporting entities may enter into certain transactions that require the granting of a security interest in certain assets to another party to serve as collateral for their performance under a contract. If the assets pledged are recorded as admitted assets under *SSAP No. 4—Assets and Nonadmitted Assets* and *INT 01-31: Assets Pledged as Collateral* and are not impaired under the provisions of *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*, the pledging entity records the collateral as an admitted asset until committing a contract default that has not been cured in accordance with the contract provisions. At the time of an uncured default, the provisions of paragraph 19 shall be used to determine the appropriate accounting treatment for the collateral. If the secured party utilizes collateral to offset all or a portion of the liability owed by the pledging entity as a result of the default, then the collateral amount utilized to offset the liability shall be removed from the balance sheet. At the same time, the amount of the liability that was offset shall be removed from the balance sheet since that obligation has been satisfied through the secured party's utilization of that collateral. To the extent that an uncured default remains without the secured party utilizing the collateral to offset the obligation, the pledging insurer shall only record an admitted asset for the amount of collateral that it can redeem.

Securities Lending Transactions

85. Securities lending transactions are generally initiated by broker-dealers and other financial institutions that need specific securities to cover a short sale or a customer's failure to deliver securities sold. Securities lending transactions typically extend less than one year. Transferees (borrowers) of securities generally are required to provide collateral to the transferor (lender) of securities, commonly cash but sometimes other securities or standby letters of credit, with a value slightly higher than that of the securities borrowed. If the collateral is cash, the transferor typically earns a return by investing that cash at rates higher than the rate paid or rebated to the transferee. If the collateral is other than cash, the transferor typically receives a fee. Securities custodians or other agents commonly carry out securities lending activities on behalf of clients. Because of the protection of collateral (typically valued daily and adjusted frequently for changes in the market price of the securities transferred) and the short terms of the transactions, most securities lending transactions in themselves do not impose significant credit risks on either party. Other risks arise from what the parties to the transaction do with the assets they receive. For example, investments made with cash collateral impose market and credit risks on the transferor.

86. If the criteria conditions in paragraph 8 (sales criteria) are met, securities lending transactions shall be accounted for:

a. By the transferor as a sale of the "loaned" securities for proceeds consisting of the cash collateral[2] and a forward repurchase commitment.

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[2] If the "collateral" in a transaction that meets the criteria in paragraph 8 is a financial asset that the holder or its agent is permitted by contract or custom to sell or repledge, that financial asset is proceeds of the sale of the "loaned" securities. To the extent that the "collateral" consists of letters of credit or other financial instruments that the holder or its agent is not permitted by contract or custom to sell or repledge, a securities lending transaction does not satisfy the sale criteria and is accounted for as a loan of securities by the transferor to the transferee.

b. By the transferee as a purchase of the "borrowed" securities in exchange for the collateral and a forward resale commitment. During the term of that agreement, the transferor has surrendered control over the securities transferred and the transferee has obtained control over those securities with the ability to sell or transfer them at will. In that case, creditors of the transferor have a claim only to the "collateral" and the forward repurchase commitment.

87. Many securities lending transactions are accompanied by an agreement that entitles and obligates the transferor to repurchase or redeem the transferred financial assets before their maturity under which the transferor maintains effective control over those financial assets (paragraphs 51-52). Those transactions shall be accounted for as secured borrowings, in which cash (or securities that the holder or its agent is permitted by contract or custom to sell or repledge) received as collateral is considered the amount borrowed, the securities loaned are considered pledged as collateral against the cash or securities borrowed and reclassified as set forth in paragraph 19.a., and any rebate paid to the transferee of securities is interest on the cash or securities the transferor is considered to have borrowed.

88. The transferor of securities being "loaned" accounts for cash received in the same way whether the transfer is accounted for as a sale or a secured borrowing. The cash received shall be recognized as the transferor's asset – as shall investments made with that cash, even if made by agents or in pools with other securities lenders – along with the obligation to return the cash. If securities that may be sold or repledged are received, the transferor of the securities being "loaned" accounts for those securities in the same way as it would account for cash received.

89. The transferor of securities being "loaned" accounts for collateral received in the same way whether the transfer is accounted for as a sale or a secured borrowing. The collateral received shall be recognized as the transferor's asset – as shall investments made with that collateral, even if made by agents or in pools with other securities lenders – along with the obligation to return the collateral. If securities that may be sold or repledged are received by the transferor or its agent, the transferor of the securities being "loaned" accounts for those securities in the same way as it would account for collateral received. Collateral which may be sold or repledged by the transferor or its agent is reflected on balance sheet, along with the obligation to return the asset3. Collateral received which may not be sold or repledged by the transferor or its agent is off balance sheet4. For collateral on the balance sheet, the reporting is determined by the administration of the program.

a. Securities lending programs where the collateral received by the reporting entity's unaffiliated agent that can be sold or repledged is reported on the balance sheet. The collateral received and reinvestment of that collateral by the reporting entity's unaffiliated agent shall be reflected as a one-line entry on the balance sheet (Securities Lending Collateral) and a detailed schedule will be required each quarter and at year-end to list the description of the collateral asset. This description shall include the NAIC designation, fair value; book adjusted carrying value and maturity date. A separate liability shall also be established to record the obligation to return the collateral (Collateral from Securities Lending Activities).

b. Securities lending programs where the collateral received by the reporting entity that can be sold or repledged is reported on the balance sheet. If the reporting entity is the administrator of the program, then, the collateral received and any reinvestment of that collateral is reported with the invested assets of the reporting entity based on the type of investment (i.e. bond, common stock, etc.). A separate liability shall also be established to record the obligation to return the collateral (Collateral from Securities Lending Activities).

[3] If cash is received by the transferor or its agent and reinvested or repledged it is reported on balance sheet. It is explicitly intended that when the lender bears reinvestment risk, that collateral is on balance sheet.

[4] An example of collateral which is off balance sheet is when securities are received by the transferor or its agent in which the collateral must be held and returned, without the ability to transfer or repledge the collateral. This would involve limited situations in which the transferor or agent is prohibited from reinvesting the collateral.

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c. Securities lending programs where the collateral received by the reporting entity's affiliated agent can report using either one-line reporting (paragraph 89.a.) or investment schedule reporting (paragraph 89.b.).

90. Reinvestment of the collateral by the reporting entity or its agent shall follow the same impairment guidance as other similar invested assets reported on the balance sheet. Any fees received by the transferor for loaning the securities shall be recorded as miscellaneous investment income.

Securities Lending Transactions – Collateral Requirements[5]

91. The reporting entity shall receive collateral having a fair value as of the transaction date at least equal to 102 percent of the fair value of the loaned securities at that date. If at any time the fair value of the collateral received from the counterparty is less than 100 percent of the fair value of the loaned securities, the counterparty shall be obligated to deliver additional collateral by the end of the next business day, the fair value of which, together with the fair value of all collateral then held in connection with the transaction at least equals 102 percent of the fair value of the loaned securities. If the collateral received from the counterparty is less than 100 percent at the reporting date, the difference between the actual collateral and 100 percent will be nonadmitted. Collateral value is measured and compared to the loaned securities in aggregate by counterparty.

92. In the event that foreign securities are loaned and the denomination of the currency of the collateral is other than the denomination of the currency of the loaned foreign securities, the amount of collateral shall be at least equal to 105 percent of the fair value of the loaned securities at that date. If at any time the fair value of the collateral received from the counterparty is less than 102 percent of the fair value of the loaned securities, the reporting entity must obtain additional collateral by the end of the next business day, the fair value of which together with the fair value of all collateral then held in connection with the transaction at least equals 105 percent of the fair value of the loaned securities. If the collateral received from the counterparty is less than 100 percent at the reporting date, the difference between the actual collateral and 100 percent will be nonadmitted. Collateral value is measured and compared to the loaned securities in aggregate by counterparty.

Securities Borrowing Transactions – Sale Criteria is Not Met (Secured Borrowing)

93. In addition to being the transferor of securities being loaned and receiving collateral under a securities lending arrangement, reporting entities may be a transferee of borrowed securities, and provide collateral under a securities borrowing arrangement.

94. A transferee that sells borrowed securities shall recognize the proceeds from the sale of the securities and an obligation, at fair value, to return the borrowed securities to the transferor. If cash proceeds from the sale of borrowed securities are invested into other assets, or if non-cash proceeds are received from the sale, the assets acquired shall be shown as assets on the reporting entity's (transferee's) financial statements and accounted and reported in accordance with the SSAP for the type of assets acquired. For all instances in which the transferee sells borrowed securities, the reporting entity shall designate restricted assets equivalent to the fair value of the obligation to return the borrowed securities to the transferor.

95. A reporting entity transferee that borrows securities captured under this section (sale criteria is not met) and uses the borrowed securities to settle a short sale transaction shall eliminate the contra-asset recognized under the short sale (paragraph 83) and establish a liability to return the borrowed security. The liability to return the borrowed security shall remain on the books until the reporting entity acquires the security to return to the transferor. The accounting/reporting for the short sale and the secured borrowing transaction shall be separately reflected within the financial statements. As such, use of the borrowed asset for the short sale would be similar to recognizing "proceeds" from selling a borrowed asset, as such, if the borrowed asset is used to settle a short sale, the reporting entity shall recognize the borrowed asset and the obligation to return the asset under the secured borrowing agreement until the asset has been returned under the secured borrowing transaction. and recognize an obligation, at fair value, to return the borrowed securities.

[5] The collateral requirements are required for determining admitted assets under statutory accounting, but the receipt of collateral is not a factor in determining whether the transferor has effective control over the loaned assets in accordance with paragraph 51.

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Repurchase Agreements and "Wash Sales"

96. Government securities dealers, banks, other financial institutions, and corporate investors commonly use repurchase agreements to obtain or use short-term funds. Under those agreements, the transferor ("repo party") transfers a security to a transferee ("repo counterparty" or "reverse party") in exchange for cash[6] and concurrently agrees to reacquire that security at a future date for an amount equal to the cash exchanged plus a stipulated "interest" factor. Repurchase agreements, reverse repurchase agreements and dollar repurchase agreements meet the definition of assets as defined in SSAP No. 4—Assets and Nonadmitted Assets and are admitted assets to the extent they conform to the requirements of this statement.

97. Repurchase agreements can be affected in a variety of ways. Some repurchase agreements are similar to securities lending transactions in that the transferee or its agent has the right to sell or repledge the securities to a third party during the term of the repurchase agreement. In other repurchase agreements, the transferee does not have the right to sell or repledge the securities during the term of the repurchase agreement. For example, in a tri-party repurchase agreement, the transferor transfers securities to an independent third-party custodian that holds the securities during the term of the repurchase agreement. Also, many repurchase agreements are for short terms, often overnight, or have indefinite terms that allow either party to terminate the arrangement on short notice. However, other repurchase agreements are for longer terms, sometimes until the maturity of the transferred financial asset. Some repurchase agreements call for repurchase of securities that need not be identical to the securities transferred.

98. If the conditions in paragraph 8 are met, the transferor shall account for the repurchase agreement as a sale of financial assets and a forward repurchase commitment, and the transferee shall account for the agreement as a purchase of financial assets and a forward resale commitment. Other transfers that are accompanied by an agreement to repurchase the transferred financial assets that may be accounted for as sales include transfers with agreements to repurchase at maturity. (Repurchase financing is addressed in paragraphs 105-110.)

99. Furthermore, "wash sales" that previously were not recognized if the same financial asset was purchased within 30 days before or after the sale shall be accounted for as sales under this statement. Unless there is a concurrent contract to repurchase or redeem the transferred financial assets from the transferee, the transferor does not maintain effective control over the transferred financial assets.

100. As with securities lending transactions, under many agreements to repurchase transferred financial assets before their maturity the transferor maintains effective control over those financial assets. Repurchase agreements that do not meet all the conditions in paragraph 8 shall be treated as secured borrowings. Fixed-coupon and dollar-roll repurchase agreements, and other contracts under which the securities to be repurchased need not be the same as the securities sold, qualify as borrowings if the return of substantially the same (paragraph 52) securities as those concurrently transferred is assured. Therefore, those transactions shall be accounted for as secured borrowings by both parties to the transfer.

101. If a transferor has transferred securities to an independent third-party custodian, or to a transferee, under conditions that preclude the transferee from selling or repledging the assets during the term of the repurchase agreement (as in most tri-party repurchase agreements), the transferor has not surrendered control over those assets.

Repurchase Agreements

102. Repurchase agreements are defined as agreements under which a reporting entity sells securities and simultaneously agrees to repurchase the same or substantially the same securities at a stated price on a specified date. For securities to be substantially the same, the criteria defined in paragraph 52 must be met, and for mortgage-backed securities excluding mortgage pass-through securities, the projected cash flows of the securities must be substantially the same under multiple scenario prepayment assumptions.

[6] Instead of cash, other securities or letters of credit sometimes are exchanged. Those transactions are accounted for in the same manner as securities lending transactions (paragraphs 85-92).

103. For repurchase agreements that are accounted for as collateralized borrowings in accordance with paragraph 100 of this statement, the underlying securities shall continue to be accounted for as an investment owned by the reporting entity. The proceeds from the sale of the securities shall be recorded as a liability, and the difference between the proceeds and the amount at which the securities will be subsequently reacquired shall be reported as interest expense, calculated on the straight-line method or the scientific interest (constant yield) method, over the term of the agreement.

104. Reporting entities generally take possession of the underlying collateral under repurchase agreements and in many cases may obtain additional collateral when the estimated fair value of such securities falls below their current contract value. However, to the extent that the current fair value of the collateral is less than the recorded amount, the shortfall shall reduce the admitted asset value of the repurchase agreement.

Reverse Repurchase Agreements

111. Reverse repurchase agreements are defined as agreements under which a reporting entity purchases securities and simultaneously agrees to resell the same or substantially the same securities at a stated price on a specified date. For securities to be substantially the same, the criteria defined in paragraph 52 must be met, and for mortgage-backed securities excluding mortgage pass-through securities, the projected cash flows of the securities must be substantially the same under multiple scenario prepayment assumptions.

112. For reverse repurchase agreements that are accounted for as collateralized lendings in accordance with paragraph 100 of this statement, the underlying securities shall not be accounted for as investments owned by the reporting entity. The amount paid for the securities shall be reported as a short-term investment, and the difference between the amount paid and the amount at which the securities will be subsequently resold shall be reported as interest income, calculated on the straight-line method or the scientific interest (constant yield) method, over the term of the agreement.

Collateral Requirements – Repurchase and Reverse Repurchase Agreements[7]

113. The collateral requirements for repurchase and reverse repurchase agreements are as follows:

Repurchase Transaction

a. The reporting entity shall receive collateral having a fair value as of the transaction date at least equal to 95 percent of the fair value of the securities transferred by the reporting entity in the transaction as of that date. If at any time the fair value of the collateral received from the counterparty is less than 95 percent of the fair value of the securities so transferred, the counterparty shall be obligated to deliver additional collateral by the end of the next business day the fair value of which, together with the fair value of all collateral then held in connection with the transaction, at least equals 95 percent of the fair value of the transferred securities. If the collateral is less than 95 percent at the reporting date, the difference between the actual collateral and 95 percent will be nonadmitted.

Reverse Repurchase Transaction

b. The reporting entity shall receive as collateral transferred securities having a fair value at least equal to 102 percent of the purchase price paid by the reporting entity for the securities. If at any time the fair value of the collateral is less than 100 percent of the purchase price paid by the reporting entity, the counterparty shall be obligated to provide additional collateral, the fair value of which, together with fair value of all collateral then held in connection with the transaction, at least equals 102 percent of the purchase price.

Disclosures

(Disclosures are detailed in paragraph 28 of SSAP No. 103R. Only relevant subparagraphs are reflected.)

[7] The collateral requirements are required for determining admitted assets under statutory accounting, but the receipt of collateral is not a factor in determining whether the transferor has effective control over the loaned assets in accordance with paragraph 50.

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28. A reporting entity shall disclose the following[8]:

a. For Repurchase and Reverse Repurchase Agreements:

i. If the entity has entered into repurchase or reverse repurchase agreements, information regarding the company policy or strategies for engaging in repo programs, policy for requiring collateral, as well as whether transactions have been accounted for as secured borrowings or as sale transactions. This disclosure shall include the terms of reverse repurchase agreements whose amounts are included in borrowing money. The following information shall be disclosed by type of agreement:

(a) Whether repo agreements are bilateral and/or tri-party trades;

(b) Maturity time frame divided by the following categories: open or continuous term contracts for which no maturity date is specified, overnight, 2 days to 1 week, from 1 week to 1 month, greater than 1 month to 3 months, greater than 3 months to 1 year, and greater than 1 year[9];

(c) Aggregate narrative disclosure of the fair value of securities sold and/or acquired that resulted in default. (This disclosure is not intended to capture "failed trades", which are defined as instances in which the trade did not occur as a result of an error and was timely corrected. Rather, this shall capture situations in which the non-defaulting party exercised their right to terminate after the defaulting party failed to execute.)

ii. For repurchase transactions accounted for as secured borrowings[10], the maximum amount and end balance as of each reporting period (quarterly and annual) for the following:

(a) Fair value of securities sold. (Book adjusted carrying value shall be provided as an end balance only.) This information is required in the aggregate, and by type of security categorized by NAIC designation, with identification of nonadmitted assets. Although legally sold as a secured borrowing, these assets are still reported by the insurer and shall be coded as restricted pursuant to the annual statement instructions, disclosed in accordance with *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures*, reported in the general interrogatories, and included in any other statutory schedules or disclosure requirements requesting information for restricted assets.

(b) Cash collateral and the fair value of security collateral (if any) received. This information is required in the aggregate and by type of security categorized by NAIC designation with identification of collateral securities received that do not qualify as admitted assets.

(1) For collateral received, aggregate allocation of the collateral by the remaining contractual maturity of the repurchase agreements (gross): overnight and continuous, up to 30 days, 30-90 days, greater than 90

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[8] All repurchase and reverse repurchase transactions (collectively referred to as "repos"), and securities borrowing and securities lending transactions shall be reported gross for disclosure purposes and when detailed on the respective investment schedules. However, repurchase and reverse repurchase transactions, and securities borrowing and securities lending transactions may be reported net in the financial statements (pages 2 and 3 of the statutory financial statements) in accordance with *SSAP No. 64—Offsetting and Netting of Assets and Liabilities* when a valid right to offset exists. When these transactions are offset in accordance with SSAP No. 64 and reported net in the financial statements, the disclosure requirements in SSAP No. 64, paragraph 6, shall be followed.

[9] Only short-term repo agreements (with a stated short-term maturity date) are allowed as admitted assets. Long-term repo agreements (agreements with maturity dates in excess of 365 days) are nonadmitted.

[10] For secured borrowing repurchase transactions, the insurance reporting entity is selling a security, and receiving collateral (generally cash) in an exchange that does not qualify as a sale.

days. This disclosure shall also include a discussion of the potential risks associated with the agreements and related collateral received, including the impact arising changes in the fair value of the collateral received and/or the provided security and how those risks are managed.

(2) For cash collateral received that has been reinvested, the total reinvested cash and the aggregate amortized cost and fair value of the invested asset acquired with the cash collateral. This disclosure shall be reported by the maturity date of the invested asset: under 30 days, 60 days, 90 days, 120 days, 180 days, less than 1 year, 1-2 years, 2-3 years and greater than 3 years. To the extent that the maturity dates of the liability (collateral to be returned) does not match the invested assets, the reporting entity shall explain the additional sources of liquidity to manage those mismatches.

(c) Liability recognized to return cash collateral, and the liability recognized to return securities received as collateral as required pursuant to the terms of the secured borrowing transaction.

iii. For reverse repurchase transactions accounted for as secured borrowings[11], the maximum amount and end balance as of each reporting period (quarterly and annual) for the following:

(a) Fair value of securities acquired. This information shall be reported in the aggregate, and by type of security categorized by NAIC designation, with identification of whether acquired assets would not qualify as admitted assets.

(b) Cash collateral and the fair value of security collateral (if any) provided. (If security collateral was provided, book adjusted carrying value shall be provided as an end balance only.) Disclosure shall identify the book adjusted carrying value of any nonadmitted securities provided as collateral. For collateral pledged, the aggregate allocation of the collateral by the remaining contractual maturity of the reverse-repurchase agreements (gross): overnight and continuous, up to 30 days, 30-90 days, greater than 90 days. This disclosure shall also include a discussion of the potential risks associated with the agreements and related collateral pledged, including obligations arising from a decline in the fair value of the collateral pledged and how those risks are managed.

(c) Recognized receivable for the return of collateral. (Generally cash collateral, but including securities provided as collateral as applicable under the terms of the secured borrowing transaction. Receivables are not recognized for securities provided as collateral if those securities are still reported as assets of the reporting entity.)

(d) Recognized liability to return securities acquired under the reverse-repurchase agreement as required pursuant to the secured borrowing transaction. (Generally, a liability is required if the acquired securities are sold.)

iv. For repurchase transactions accounted for as a sale[12], the maximum amount and end balance as of each reporting period (quarterly and annual) for the following:

[11] For secured borrowing reverse repurchase transactions, the insurance reporting entity is buying a security and providing collateral (generally cash) in an exchange that does not qualify as a sale.

[12] For sale repurchase transactions, the insurance reporting entity sold a security and received "proceeds" in exchange. With a sale transaction, the insurer removes the asset from their financial statements and recognizes the proceeds from the sale. This transaction requires recognition of a forward repurchase commitment.

(a) Fair value of securities sold (derecognized from the financial statements). (Book adjusted carrying value shall be provided as an end balance only, reflecting the amount derecognized from the sale transaction.) This information is required in the aggregate, and by type of security categorized by NAIC designation, with information on the book adjusted carrying value of nonadmitted assets sold.

(b) Cash and the fair value of securities (if any) received as proceeds and recognized in the financial statements. This information is required in the aggregate and by type of security categorized by NAIC designation, with identification of received assets nonadmitted in the financial statements. All securities received shall be coded as restricted pursuant to the annual statement instructions, disclosed in accordance with SSAP No. 1, reported in the general interrogatories, and included in any other statutory schedules or disclosure requirements requesting information for restricted assets.

(c) The forward repurchase commitment recognized to return the cash or securities received. Amount reported shall reflect the stated repurchase price under the repurchase transaction.

v. For reverse repurchase transactions accounted for as sale[13], the maximum amount and end balance as of each reporting period (quarterly and annual):

(a) Fair value of securities acquired and recognized on the financial statements. (Book adjusted carrying value shall be provided as an end balance only.) This information shall be reported in the aggregate, and by type of security categorized by NAIC designation. The disclosure also requires the book adjusted carrying value of nonadmitted assets acquired.

(b) Cash collateral and the fair value of security collateral (if any) provided. (If security collateral was provided, book adjusted carrying value shall be provided as an end balance only.) Disclosure shall also identify whether any nonadmitted assets were provided as collateral (derecognized from the financial statements).

(c) The forward resale commitment recognized (stated repurchase price) to sell the acquired securities.

b. Collateral:

i. If the entity has entered into securities lending transactions, its policy for requiring collateral or other security and the fair value of the loaned security;

ii. If the entity has pledged any of its assets as collateral that are not reclassified and separately reported in the statement of financial position pursuant to paragraph 19.a., the carrying amounts and classifications of both those assets and associated liabilities as of the date of the latest statement of financial position presented, including qualitative information about the relationship(s) between those assets and associated liabilities. For example, if assets are restricted solely to satisfy a specific obligation, the carrying amounts of those assets and associated liabilities, including a description of the nature of restrictions placed on the assets, shall be disclosed.

iii. If the entity or its agent has accepted collateral that it is permitted by contract or custom to sell or repledge, the fair value as of the date of each statement of financial position presented of that collateral and of the portion of that collateral that it has sold or repledged,

[13] For sale reverse repurchase transactions, the insurance reporting entity has purchased a security and provided "proceeds" in exchange. With a sale transaction, the insurer reports the acquired asset in their financial statements and removes the proceeds provided. This transaction requires recognition of a forward resale commitment.

and information about the sources and uses of that collateral. Additionally, the reporting entity shall disclose the aggregate amount of contractually obligated open collateral positions (aggregate amount of securities at current fair value or cash received for which the borrower may request the return of on demand) and the aggregate amount of contractually obligated collateral positions under 30-day, 60-day, 90-day, and greater than 90-day terms.

iv. If the entity has accepted collateral that it is not permitted by contract or custom to sell or repledge, provide detail on these transactions, including the terms of the contract, and the current fair value of the collateral.

v. For all securities lending transactions, disclose collateral for transactions that extend beyond one year from the reporting date; and

vi. For securities lending transactions administered by an affiliated agent in which "one-line" reporting (paragraph 89.a.) of the reinvested collateral per paragraph 89.c. is optional, at the discretion of the reporting entity, disclose the aggregate value of the reinvested collateral which is "one line" reported and the aggregate value of items which are reported in the investment schedules (paragraph 89.b.). Identify the rationale between the items which are one line reported and those that are investment schedule reported and if the treatment has changed from the prior period and

vii. For securities lending transactions, include separately, the amount of any loaned securities within the separate account and if the policy and procedures for the separate account differ from the general account.

c. The reporting entity shall provide the following information by type of program (securities lending or dollar repurchase agreement) with respect to the reinvestment of the cash collateral and any securities which it or its agent receives as collateral that can be sold or repledged.

i. The aggregate amount of the reinvested cash collateral (amortized cost and fair value). Reinvested cash collateral shall be broken down by the maturity date of the invested asset – under 30 days, 60 days, 90 days, 120 days, 180 days, less than 1 year, 1-2 years, 2-3 years and greater than 3 years.

ii. To the extent that the maturity dates of the liability (collateral to be returned) does not match the invested assets, the reporting entity shall explain the additional sources of liquidity to manage those mismatches.

Blanks/Notes Reporting – Securities Lending: *(Only data-captured notes included)*

- **Schedule DL – Part 1: Securities Lending Collateral Assets:** This schedule includes collateral currently held as part of a securities lending program administered by the reporting entity's agent that can be sold or repledged. This is currently held collateral, meaning original collateral if still in original form received or the new invested asset resulting from the disposal and/or reinvestment of the original collateral. This collateral reported on DL - Part 1 is not reported on the specific investment schedules, but is captured on the assets page, line 10.

- **Schedule DL – Part 2: Securities Lending Collateral Assets:** This schedule includes collateral currently held as part of a securities lending program administered by the reporting entity that can be sold or repledged. This is currently held collateral, meaning original collateral if still in original form received or the new invested asset resulting from the disposal and/or reinvestment of the original collateral. This collateral reported on DL -Part 2 should be reported on the specific investment schedules.

- **Note 5E(3):** Aggregate fair value of securities or cash received that a borrower may request on demand (open positions) and the amount of obligated positions under 30-day, 60-day, 90-day and greater than 90-day terms.

- **Note 5E(5):** Aggregated amount of the reinvested cash collateral (amortized cost and fair value) divided by the maturity date of the invested asset – under prescribed timeframes.

- **Note 5E(7):** Collateral for transactions that extend beyond one year from the reporting date.

Notes Disclosure – Repurchase Transactions:

- **Note 5F – Repurchase Agreement Transactions Accounted for as Secured Borrowings:** This note disclosure includes items noted below, but it does not include details of current collateral held.
  - Fair value of aggregate securities sold and by type of security / NAIC designation.
  - Cash collateral and fair value of security collateral received in aggregate and by type of security / NAIC designation.
  - Aggregate allocation of collateral by remaining contractual maturity.
  - Total of reinvested cash collateral with amortized cost and fair value of the asset acquired with the cash collateral by maturity date of the invested asset.
  - Liability to return cash collateral and liability to return securities received as collateral pursuant to the terms of the secured borrowing transaction.

Blanks – General Interrogatories:
Note – Lines 25.04 and 25.05 include the securities lending conforming and nonconforming programs. All other restricted assets, including repurchase agreements, are detailed in lines 26.21-26.32.

INVESTMENT

25.01 Were all the stocks, bonds and other securities owned December 31 of current year, over which the reporting entity has exclusive control, in the actual possession of the reporting entity on said date? (other than securities lending programs addressed in 25.03) Yes [ ] No [ ]

25.02 If no, give full and complete information, relating thereto ....

25.03 For securities lending programs, provide a description of the program including value for collateral and amount of loaned securities, and whether collateral is carried on or off-balance sheet. (an alternative is to reference Note 17 where this information is also provided) ....

....

25.04 For the reporting entity's securities lending program, report amount of collateral for conforming programs as outlined in the Risk-Based Capital Instructions. $ ________

25.05 For the reporting entity's securities lending program, report amount of collateral for other programs. $ ________

25.06 Does your securities lending program require 102% (domestic securities) and 105% (foreign securities) from the counterparty at the outset of the contract? Yes [ ] No [ ] N/A [ ]

25.07 Does the reporting entity non-admit when the collateral received from the counterparty falls below 100%? Yes [ ] No [ ] N/A [ ]

25.08 Does the reporting entity or the reporting entity's securities lending agent utilize the Master Securities Lending Agreement (MSLA) to conduct securities lending? Yes [ ] No [ ] N/A [ ]

25.09 For the reporting entity's securities lending program, state the amount of the following as of December 31 of the current year:

25.091 Total fair value of reinvested collateral assets reported on Schedule DL, Parts 1 and 2 $ ________

25.092 Total book/adjusted carrying value of reinvested collateral assets reported on Schedule DL, Parts 1 and 2 $ ________

25.093 Total payable for securities lending reported on the liability page $ ________

26.1 Were any of the stocks, bonds or other assets of the reporting entity owned at December 31 of the current year not exclusively under the control of the reporting entity or has the reporting entity sold or transferred any assets subject to a put option contract that is currently in force? (Exclude securities subject to Interrogatory 21.1 and 25.03). Yes [ ] No [ ]

26.2 If yes, state the amount thereof at December 31 of the current year:

26.21 Subject to repurchase agreements $ ________
26.22 Subject to reverse repurchase agreements $ ________
26.23 Subject to dollar repurchase agreements $ ________
26.24 Subject to reverse dollar repurchase agreements $ ________
26.25 Placed under option agreements $ ________
26.26 Letter stock or securities restricted as to sale – excluding FHLB Capital Stock $ ________
26.27 FHLB Capital Stock $ ________
26.28 On deposit with states $ ________
26.29 On deposit with other regulatory bodies $ ________
26.30 Pledged as collateral – excluding collateral pledged to an FHLB $ ________
26.31 Pledged as collateral to FHLB – including assets backing funding agreements $ ________
26.32 Other $ ________

26.3 For category (26.26) provide the following:

1 Nature of Restriction	2 Description	3 Amount

RBC Instructions – Securities Lending Conforming Agreements:

- **LR017: Off-Balance Sheet and Other Items Instructions:**

  Line (1) Securities lending programs that have all of the following elements are eligible for a lower off-balance sheet charge:

  1. A written plan adopted by the Board of Directors that outlines the extent to which the insurer can engage in securities lending activities and how cash collateral received will be invested.

  2. Written operational procedures to monitor and control the risks associated with securities lending. Safeguards to be addressed should, at a minimum, provide assurance of the following:

     a. Documented investment guidelines, including, where applicable, those between lender and investment manager with established procedure for review of compliance.

     b. Investment guidelines for cash collateral that clearly delineate liquidity, diversification, credit quality, and average life/duration requirements.

     c. Approved borrower lists and loan limits to allow for adequate diversification.

     d. Holding excess collateral with margin percentages in line with industry standards, which are currently 102% (or 105% for cross currency loans).

     e. Daily mark-to-market of lent securities and obtaining additional collateral needed to ensure that collateral at all times exceeds the value of the loans to maintain margin of 102% of market.

     f. Not subject to any automatic stay in bankruptcy and may be closed out and terminated immediately upon the bankruptcy of any party.

  3. A binding securities lending agreement (standard "Master Lending Agreement" from Securities Industry and Financial Markets Association) is in writing between the insurer, or its agent on behalf of the insurer, and the borrowers.

  4. Acceptable collateral is defined as cash, cash equivalents, direct obligations of, or securities that are fully guaranteed as to principal and interest by, the government of the United States or any agency of the United States, or by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation and NAIC 1-designated securities. Affiliate-issued collateral would not be deemed acceptable. In all cases the collateral held must be permitted investments in the state of domicile for the respective insurer.

  Collateral included in General Interrogatories, Part 1, Line 24.04 of the annual statement should be included on Line (1).

  Line (2) Collateral from all other securities lending programs should be reported General Interrogatories, Part 1, Line 24.05 and included in Line (2).

Staff Note: From a review 2022 financials and comparing the information on Schedule DL, collateral reported with NAIC designations below NAIC 1 and not within the other permitted parameters detailed as acceptable collateral under number 4 above is being reported as part of a "conforming program" Also, these RBC instructions are detailed within the "Off-Balance Sheet" RBC schedule, but the majority of security lending collateral is captured on balance sheet, either in the direct investment schedules or on line 10 of the asset page. There is no other location in the general interrogatory to report securities lending collateral, so if

the intent was for the "conforming/non-conforming" provisions to only include off-balance sheet collateral, revisions would be required to separately capture the restricted asset risk for securities lending collateral reporting on balance sheet.

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

- The Working Group directed a referral response to the Life Risk-Based Capital (E) Working Group on February 20, 2024, requesting time to assess accounting and reporting differences between securities lending and repurchase agreements before moving forward with RBC factor changes for repurchase agreements. This agenda is in response to the initial LRBCWG referral.

- Agenda item 2023-26 developed in response to *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative*, proposes new disclosures for repos and reverse repos, including on counterparty risk arising from these transactions.

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 recommend that the Working Group move this item to the active listing of the maintenance agenda categorized as a SAP clarification with direction to work with industry in determining current application and interpretation differences on the reporting of securities lending collateral and repurchase agreement collateral.

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

Status:
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed this agenda item and directed NAIC staff to work with industry in determining current application/interpretation differences on the reporting of securities lending collateral and repurchase agreement collateral for possible consistency revisions.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Hearing/13 - 24-04 - Conforming Repos.docx

Discussion of Security Lending / Repo Reporting
Includes Restricted Assets Reporting & RBC Impacts

Overview: Fundamentally, securities lending and repurchase/reverse repurchase (Repo) transactions perform similar functions and are entered for short-term collateralized funding/lending. Although some articles identify that the type of collateral exchanged (security or cash) is a key difference, from discussions with industry cash or securities can be used as collateral under either a security lending or repo agreement. Industry has identified that the counterparty is a key difference between the transactions.

Although similar in function, the accounting and reporting for securities lending and repurchase transactions are different under statutory accounting even when both are accounted for under the "secured borrowing" approach. (All scenarios below focus on secured borrowing accounting, and not as a "sale," as that is the more prevalent accounting approach.)

This memo intends to document the current accounting guidance and identify how NAIC staff believe accounting and reporting should be reflected. The Working Group is requesting comments on this memo, particularly within the established notes. Subsequently, NAIC staff plan to propose statutory accounting and reporting changes to reflect a consistent approach between securities lending and repurchase transactions.

The guidance for securities lending / borrowings and repo agreements are *in SAP No. 103—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. Although other aspects of the SSAP are applicable, focused guidance for these transactions are in the following paragraphs:

- Securities Lending: Paragraphs 85-92.
- Securities Borrowing: Paragraphs 93-95
- Repurchase Agreements: Paragraphs 102-104 & 113
- Reverse Repurchase Agreements: Paragraphs 111-113

Broad concepts for secured borrowing are in paragraph 19. The concepts for securities lending differ from this guidance with the requirement to recognize items on balance sheet with the ability to sell/repledge collateral. Disclosure guidelines for these transactions are in paragraph 28.

The "conforming" securities lending guidelines are captured in the RBC instructions. The full detail of the requirements is included as an appendix to this memo, but collateral requirements include:

- Cash and cash equivalents
- Direct obligations of, or securities that are fully guaranteed as to principal and interest by, the government of the United States, or any agency of the United States, or by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation.
- NAIC 1 Designated Securities
- Affiliated-issued collateral is not deemed acceptable.
- In all cases, collateral held must be permitted investments in the state of domicile for the respective insurer.

Securities Lending – Reporting Entity Lends a Security and Receives Collateral in Exchange:

A security lending transaction involves the temporary transfer of securities from one party (security lender) to another party (security borrower) and with the lender receiving collateral from the borrower to protect against the risk of loss. The lender receives a fee for the use of the security. Under statutory accounting guidance, the accounting for security lending depends on whether the reporting entity has the ability to pledge or sell the collateral received.

1. Lending Entity Cannot Sell / Repledge Security Collateral Received:

a) Reporting entity lends a security under a secured borrowing agreement. The reporting entity retains the lent security on books and codes it as a restricted asset.

b) Reporting entity lender does not recognize security collateral received as an asset and does not recognize an obligation to return the collateral.

c) If the fair value of the collateral received drops below 100% of the fair value of the loaned security, then the reporting entity (lender) is to nonadmit a portion of loaned security (which is still reported on the books). The amount nonadmitted should be the difference between the collateral and the security reported on the books. (This calculation is done at any point in time – so for a lent $100 bond, if the fair value of the bond declines to $90, then the collateral comparison would be done to the current FV of the bond, and not the FV at the time the security was lent. So, if collateral was received at $102, and declined to $90 (matching the bond), nonadmittance would not be required.) The comparison is also completed in aggregate by counterparty, so if the collateral for one security was to appreciate in value, and the collateral for another was to decline, as long as the combined collateral value continued to represent 100% of the fair value of the loaned securities, additional collateral would not be required.

The Restricted Asset / RBC Impact is as follows:

d) The retained asset lent to the counterparty should be identified as a restricted asset. This loaned asset shall be captured on general interrogatory (GI) line 25.04 or GI line 25.05 based on whether the security lending arrangement is considered to be a 'conforming' security lending program. Amounts reported on these lines flow to LR017 (Off-Balance Sheet and Other Items), lines 1 and 2. Items captured in GI line 25.04 (conforming) receive a 0.0020 RBC charge. Items captured in GI line 25.05 (nonconforming) receive a 0.0126 RBC charge. There is no current disclosure on the type of collateral received for these off-balance sheet programs. As such, regulators cannot verify from the financial statements whether the program complies with the "conforming" program requirements. However, as the collateral cannot be sold/repledged, if the collateral complies with the conforming requirements, there would be no change to that assessment over the duration of the transaction. ***(Note 1)***

e) As the collateral asset is not recognized on book of the lender, there is no RBC asset (C-1) charge. As the collateral asset is not recognized, there is no restricted asset reporting or RBC restricted asset charge. The restricted asset charge is placed on the asset that is lent but still retained on the books as discussed above in paragraph 1d. ***(Note 2)***

<u>Note 1:</u> Should the type of collateral received in these programs be captured in a financial statement disclosure to allow for regulator verification of the "conforming" program guidelines? Additionally, it has been noted that the admittance calculation focuses solely on the fair value comparison of the collateral received to the security lent. However, there is no current guidance that assesses admittance based on the quality/type of collateral received. Under the current guidance, residuals or low-quality assets could be received and there is no documentation of this type of collateral for certain sec lending and repo programs. Even if these programs would not qualify as conforming, there is a question on whether admittance restrictions should exist based on the collateral received from the counterparty.

<u>Note 2:</u> NAIC staff believes there is inconsistent application of the current guidance as there is a disconnect in language between RBC and the Blanks on whether the collateral received or the lent asset is identified as a restricted asset. The blanks instructions in GI 25.04 and GI 25.05 identify the "Amount of Collateral." The lines in RBC identify "Loaned to Others." This inconsistency in terminology likely causes confusion on whether the amount reported should be the lent security or the collateral received in exchange. NAIC staff suggest clarifying terminology for consistency purposes, clarifying that the loaned asset retained on book should be the amount reported as restricted that flows through all schedules.

2. Lending Entity Can Sell / Repledge Collateral Received – (Also Applies to Cash Collateral)

a) Reporting entity lends a security under a secured borrowing agreement. The reporting entity retains the lent security on books and codes it as a restricted asset.

b) Reporting entity lender recognizes collateral received from the counterparty on its book and recognizes a liability to return the collateral. (This collateral is reported on Schedule DL.) If security collateral is captured directly on the investment schedules, the collateral is **<u>not</u>** coded as a restricted asset. *(See paragraph 2f.)*

c) If the fair value of the collateral received drops below 100% of the fair value of the loaned security, then the reporting entity is to nonadmit a portion of loaned security (which is still reported on the books). The amount nonadmitted should be the difference between the collateral and the security reported on the books. (This calculation is done at any point in time – so for a lent $100 bond, if the fair value of the bond declines to $90, then the collateral comparison would be done to the current FV of the bond, and not the FV at the time the security was lent. So, if collateral was received at $102, and declined to $90 (matching the bond), nonadmittance would not be required.) The comparison is also completed in aggregate by counterparty, so if the collateral for one security was to appreciate in value, and the collateral for another was to decline, as long as the combined collateral value continued to represent 100% of the fair value of the loaned securities, additional collateral would not be required. ***(Note 3 & Note 4)***

The Restricted Asset / RBC Impact is as follows:

d) The retained asset lent to the counterparty should be identified as a restricted asset. This loaned asset shall be captured on GI line 25.04 or GI line 25.05 based on whether the

security lending agreement is considered to be a 'conforming' security lending program. Amounts reported on these lines flow to LR017 (Off-Balance Sheet and Other Items), lines 1 and 2. Items captured in GI line 25.04 (conforming) receive a 0.0020 RBC charge. Items captured in GI line 25.05 (nonconforming) receive a 0.0126 RBC charge. ***(Note 5)***

e) The current collateral recognized on the balance sheet is subject to the corresponding asset (C-1) RBC charge. (This occurs directly from the investment schedule, or indirectly from Schedule DL if the program is administered by a third-party administrator.) The RBC charge depends on the form of the collateral. (This recognition occurs regardless of whether the original collateral is reinvested.)

f) The collateral reported on book as it can be sold/repledged, is not coded as a restricted asset as there is an offsetting liability recognized for the obligation to return the collateral. Identifying both the lent security and the on-book collateral as restricted assets, particularly with the offsetting liability to return the collateral would result in a double-counting of restricted asset charges for the same transaction.

g) On day 1, both the collateral asset received and liability to return are recognized at fair value. Subsequently, the asset is measured pursuant to the applicable SSAP and the liability to return shall be adjusted as needed to reflect the current fair value of the collateral originally received. If the collateral received is reinvested, the resulting asset shall be accounted for pursuant to the applicable SSAP. As the measurement method for the collateral asset on book may not reflect fair value, this may result in a disconnect between the collateral asset and liability to return reported, but the reporting entity's liability to return the collateral shall always reflect the full obligation (fair value) to return collateral originally received.

<u>Note 3</u>: As the collateral can be sold/repledged, there is a question on the application of the admittance provisions in paragraphs 91-92 of SSAP No. 103. That guidance is focused on the fair value of the original collateral received in comparison to the fair value of the security lent. Once the collateral has been reinvested, the reporting entity is responsible for the reinvestment risk and the counterparty is not responsible for fair value changes of the reinvested security. Although a position could be taken that the fair value of the collateral originally received should continue to be compared to the fair value of the lent security to determine if more collateral needs to be provided, with the current financial statement reporting, this information is not captured to allow assessments once the collateral has been reinvested allowing regulators to verify the admittance provisions.

<u>Note 4</u>: With regards to the admittance calculation, there is also a question on application when the original collateral still covers 100% of the BACV of the loaned security but does not meet the requirement for 100% of the loaned security's fair value. As an example, if the loaned security at amortized cost has a BACV of $90, but had a fair value of $100 when loaned, the guidance in paragraph 91 requires collateral of $102 at the onset of the transaction. If the original collateral was to decrease in fair value to $98, it would no longer comply with the guidance in paragraph 91 and nonadmittance of the loaned security for $2 is expected under the guidance ($100 - $98). However, as the loaned security is reported at BACV of $90, the collateral still covers the full reported value of the loaned security. If the counterparty was to default, the reporting entity would eliminate the loaned security ($90) and the liability to return the collateral ($98) from the books and retain the collateral

asset as their own. This transaction would result in an $8 gain for the reporting entity. If the loaned security had been nonadmitted by $2 prior to the default due to the FV decline of the collateral, there would have been a surplus hit of $2 for the nonadmittance. Upon the counterparty default, in addition to the $8 gain, there would have then been a surplus bump of $2 with the elimination of the nonadmitted asset. *(It is noted that if the fair value for the collateral asset had been retained, the reporting entity would have had a greater gain, but they are still fully covered based on how the loaned asset is reported.)* NAIC staff requests confirmation of the admittance guidance and its application from regulators, particularly when the fair value of the collateral continues to cover the BACV of the loaned security.

Note 5: As the collateral received can be sold/repledged, there is a question on the application of the "conforming security lending" collateral requirements. From a broad review of financial statements, collateral reported on Schedule DL was identified as outside of the conforming parameters, but the security lending program was identified as "conforming" with the lower RBC charge. NAIC staff recommend clarification on the application of the "conforming" requirements. Particularly, if the intent is to permit a lower RBC charge due to the liquidity / stability of certain types of collateral, then it may be appropriate to require the collateral to always comply with the "conforming" provisions regardless of if it has been reinvested by the reporting entity.

3. Securities Borrowing – Entity Borrows a Security and Provides Collateral in Exchange

a) Reporting entity borrower retains security collateral provided to counterparty on book and codes it as a restricted asset. (If providing cash in exchange for the borrowed security, then the cash is derecognized with a receivable for the return.) ***(Note 6)***

b) Reporting entity borrower does not recognize the borrowed security on their books, unless the reporting entity sells the borrowed security or the counterparty defaults. If the reporting entity sells the borrowed security, the cash received or reinvested asset is recognized with an obligation (liability) to return the borrowed security. Pursuant to paragraph 94 of SSAP No. 103, assets equivalent to the fair value of the borrowed security shall be coded as a restricted asset. Specific guidance exists in SSAP No. 103 for when borrowed securities are used to settle a short-sale. (A counterparty default would always result with an unwinding of the transaction with each party reporting the asset they have in their possession as their resulting asset.) ***(Note 7 & 8)***

The Restricted Asset / RBC Impact is as follows:

c) The retained asset (provided as collateral to a counterparty) is still on the reporting entity's investment schedules and should continue to receive the RBC asset C-1 charge. It should also be coded as a restricted asset. Due to the reporting lines available, it could be coded as "collateral held under securities lending agreements" or as an "other" restricted asset and captured in GI 26.32. If captured as a collateral within a security lending agreement, would be captured on GI line 25.04 or GI line 25.05 based on whether it is from a 'conforming' security lending program. Amounts reported on these lines flow to LR017 (Off-Balance Sheet and Other Items), lines 1 and 2. Items captured in GI line 25.04 (conforming) receive a 0.0020 RBC charge. Items captured in GI line 25.05

(nonconforming) receive a 0.0126 RBC charge. If reported as an “other” restricted asset, it would be captured on GI 26.32 with a 0.0126 RBC charge.

d) There would be no RBC impact for the borrowed security unless it is sold. At that time, the reinvested asset would be recognized and subject to an RBC asset C-1 charge. This asset (or an equivalent of other assets) would be identified as restricted. This is likely “collateral held under security lending agreement” and reported based on conforming /nonconforming in GI line 25.04 (0.0020 factor) or 25.05 (0.0126 factor).

Note 6: A security borrowing transaction is the flipside of the security lending transaction, with the reporting entity operating on the opposite side as borrower instead of lender. With this dynamic, it is presumed that the same restricted asset categories, and whether it is a conforming program, would be determinants in reporting the restricted asset and in the resulting RBC charge. NAIC staff requests confirmation of this assessment. (A security borrowing is the transaction, and it is accounted for as a “secured borrowing” – this terminology can be confusing when discussing the design.)

Note 7: The guidance for a security borrowing could result with restricted asset reporting for both the collateral provided (if not cash collateral) as well as for the reinvested borrowed securities that the reporting entity has sold. NAIC staff notes that this could be a double hit of restricted asset charges and recommends comments on paragraph 94 of SSAP No. 103 on the elimination of the restricted asset requirement for the assets received from the sale of the borrowed security. It is noted that the reporting entity would already have a liability recognized to return the borrowed security to the counterparty.

Note 8: For security borrowing transactions, it is identified that both a receivable and payable from the counterparty could be recognized. A receivable - if cash was originally provided as collateral for the return of the cash - and a payable - if the reporting entity sold the borrowed security for the obligation to return the security. This dynamic could result in a netting of the transactions under SSAP No. 64. If netted, then the regulators would not be able to identify these aspects within the financial statements, but the provisions that permit netting under SSAP No. 64 (legal right to offset) may be present.

Repurchase Agreements

Repurchase agreements, by definition, are agreements in which a reporting entity sells a security and simultaneously agrees to repurchase the security or a substantially similar security at a stated date and price. Repurchase agreements are functionally similar to securities lending. These transactions are generally captured as "secured borrowings" due to the requirement to repurchase the security transferred but could qualify as "sale" transactions. As very few (if any) are captured as sales under statutory accounting, this assessment will only focus on those captured as "secured borrowings."

Reporting entities can operate on both sides of repurchase agreements. If the reporting entity is selling a security and receiving cash (cash taker), it is considered a repurchase agreement. If the reporting entity is buying a security and providing cash (cash provider) it is considered a reverse repurchase agreement. SSAP No. 103 is explicit that only short-term repo agreements (with a stated short-term maturity date of 365 days or less) are allowed as admitted assets. Long-term repo agreements (with maturity dates in excess of 365 days) are nonadmitted.

There is no current concept for a "conforming repurchase agreement" and incorporating this concept, allowing for a lower RBC charge, was the request of the ACLI to the Life RBC Working Group.

4. **Repurchase Agreement – Reporting Entity Sells Security and Receives Cash / Collateral**

a) Reporting entity (cash taker) retains sold security on book and codes it as a restricted asset. This would remain an asset of the reporting entity unless the reporting entity defaults under the terms of the secured borrowing agreement. If that occurs, the reporting entity would derecognize the asset and eliminate the obligation to return the cash collateral per subparagraph (b).

b) Reporting entity recognizes cash received and obligation to return cash. (If security collateral is received, it is off-balance sheet unless that collateral is sold by the reporting entity. If sold, the reporting entity recognizes the proceeds from the sale and the obligation to return the collateral to the repo counterparty.) This process for security collateral received under a repurchase agreement is different from securities lending. Under security lending, if collateral received can be sold or repledged, even if it is not sold or repledged, the collateral is reported on balance sheet with an obligation to return. The disclosure guidance for repurchase agreements varies significantly from securities lending transactions as Schedule DL does not apply to repurchase agreements. As such, for repurchase agreements, there is no detail that identifies collateral held when the collateral can be sold/repledged. ***(Note 9)***

c) For repurchase agreements the reporting entity should receive proceeds (collateral) with a fair value of at least 95% of the fair value of the sold security. So, if the security has a FV of $100, proceeds (collateral) of $95 is required. If the FV of the proceeds (collateral) is not sufficient, then nonadmittance of the "sold" security for the amount of the shortfall is required. So, if only 93% collateral was received, the security "sold" but still reporting on-book would only be admitted for $98 with nonadmittance of $2. ***(Note 10)***

The Restricted Asset / RBC Impact is as follows:

a) The retained asset (sold to the counterparty) is still on the investment schedule and should continue to receive the RBC asset (C-1) charge. It should also be coded as a restricted asset as "subject to repurchase agreements" and captured in GI 26.21. This would then be captured in LR017 on line 3, "subject to repurchase agreements" and would receive a 0.0126 RBC charge. Under SSAP No. 103, repo agreements must be short-term to be admitted. If the repo agreement extends beyond 365 days, then the asset sold (retained on the book) would be identified as a nonadmitted asset.

b) The cash proceeds (collateral) would be recorded as cash and flow through on Schedule E - Part 1 - Cash to LR012 with a .0039 RBC charge. If the cash is used to acquire another security, then the acquired security would be reported on the investment schedules and flow through to RBC accordingly based on the investment.

Note 9: Due to the similarities in overall function between securities lending and repurchase agreements, NAIC staff supports consistent accounting, reporting and disclosures. NAIC staff recommends expanding Schedule DL to capture repurchase agreements, and a reassessment of the repurchase agreement disclosures to determine whether the level of detail should be retained.

Note 10: The same concept issues exist for the nonadmittance of reported securities under repo transactions than what exist under the securities lending transactions. Under current guidance, if the fair value of the sold security was to increase, more proceeds (collateral) is required or the sold security is subject to nonadmittance. If collateral was reinvested, the comparison would have to be based on the original collateral received and not the reinvested collateral. Also, there is the question on nonadmittance when the collateral received still covers the BACV of the sold security.

Reverse Repurchase Agreement – Reporting Entity Buys Security and Provides Cash / Collateral

a) Reporting entity (cash provider) acquires security from counterparty but does not report the security on their investment schedule. (The reporting entity would recognize the asset if the counterparty defaulted on the agreement.) ***(Note 11)***

    i. If the reporting entity sells the acquired security, the reporting entity would recognize the cash proceeds from the sale and an obligation to return the security to the counterparty. If the cash proceeds are reinvested, then the acquired investment would be on the applicable investment schedule.

b) Reporting entity derecognizes the cash provided to acquire the security and recognizes a receivable for the cash return. This is captured as a short-term investment on Schedule E-2. If the reverse repo agreement was long-term, it shall be nonadmitted.

    i. If the reporting entity provides security in exchange for the security (instead of cash), the security would remain on the reporting entity's investment schedules, coded as a restricted asset.

c) For reverse repurchase agreements the reporting entity should receive securities with a fair value of at least 102% of the purchase price (cash or securities transferred). So, if the cost of the transaction is $100, the reporting entity should receive securities worth $102. ***(Note 12)***

The Restricted Asset / RBC Impact is as follows:

d) The acquired asset is not reported unless the counterparty defaults or unless the reporting entity sells the acquired assets. Unless one of these things occurs, there is no RBC impact for the acquired asset under a reverse repo. (If those transactions occur, then the RBC is determined by the resulting security reported on the investment schedule.)

e) The receivable for the return of the cash collateral would be recorded as a short-term investment on Schedule E – Part 2 and flow through to LR012 with a .0039 RBC charge. This receivable would also be coded as restricted as an "asset subject to a reverse repurchase agreement" on GI 26.23. This would flow to LR017 line 6 and would receive a 0.0126 RBC charge. ***Note 13***

Note 11: The SSAP No. 103 guidance for reverse repo transactions does not have an explicit nonadmittance component if the % threshold is not met. Clarification on what should occur if the adequate collateral is not received / retained is recommended. Additionally, it has been noted that there is no current guidance that assesses admittance based on the quality/type of collateral received. Under the current guidance, residuals or low-quality assets could be received and there is no documentation of this type of collateral for certain sec lending and repo programs. Even if these programs would not qualify as conforming, there is a question on whether admittance restrictions should exist based on the collateral received from the counterparty.

Note 12: SAP does not currently capture details on securities acquired upon the sale of the asset acquired under a reverse repo. The note disclosures only detail aggregate amounts.

Note 13: The guidance does not explicitly indicate that the short-term receivable recorded for reverse repurchase transactions should be coded as a restricted asset and taken to GI 26.23. However, as the restricted asset note detailed in SSAP No. 1 and GI 26.23 both capture "assets subject to reverse repurchase agreements," this reference can only refer to the short-term receivable as there is no other asset reported on the books from the transaction. Assessment may be warranted on identification of restricted assets on reverse repurchase transactions.

Appendix A – "Conforming" Securities Lending Guidance from RBC Instructions

Line (1) Securities lending programs that have all of the following elements are eligible for a lower off-balance sheet charge:

1. A written plan adopted by the Board of Directors that outlines the extent to which the insurer can engage in securities lending activities and how cash collateral received will be invested.

2. Written operational procedures to monitor and control the risks associated with securities lending. Safeguards to be addressed should, at a minimum, provide assurance of the following:

    a. Documented investment guidelines, including, where applicable, those between lender and investment manager with established procedure for review of compliance.

    b. Investment guidelines for cash collateral that clearly delineate liquidity, diversification, credit quality, and average life/duration requirements.

    c. Approved borrower lists and loan limits to allow for adequate diversification.

    d. Holding excess collateral with margin percentages in line with industry standards, which are currently 102% (or 105% for cross currency loans).

    e. Daily mark-to-market of lent securities and obtaining additional collateral needed to ensure that collateral at all times exceeds the value of the loans to maintain margin of 102% of market.

    f. Not subject to any automatic stay in bankruptcy and may be closed out and terminated immediately upon the bankruptcy of any party.

3. A binding securities lending agreement (standard "Master Lending Agreement" from Securities Industry and Financial Markets Association) is in writing between the insurer, or its agent on behalf of the insurer, and the borrowers.

4. Acceptable collateral is defined as cash, cash equivalents, direct obligations of, or securities that are fully guaranteed as to principal and interest by, the government of the United States or any agency of the United States, or by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation and NAIC 1-designated securities. Affiliate-issued collateral would not be deemed acceptable. In all cases the collateral held must be permitted investments in the state of domicile for the respective insurer.

Collateral included in General Interrogatories, Part 1, Line 25.04 of the annual statement should be included on Line (1).

Attachment 15
Ref #2024-06

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

Issue: Risk Transfer Analysis on Combination Reinsurance Contracts

Check (applicable entity):

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

Description of Issue:
This agenda item is to address a December 2023, referral by the Valuation Analysis (E) Working Group (VAWG) regarding reinsurance risk transfer and reserve credit for a particular form of reinsurance being observed by regulators in the life industry. The referral noted that:

> VAWG has identified that issues arise when evaluating reinsurance for risk transfer in accordance with *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*, when treaties involve more than one type of reinsurance, and there is interdependence of the types of reinsurance, including but not limited to an experience refund that is based on the aggregate experience. In such cases, VAWG regulators find that these types of reinsurance must be evaluated together and cannot be evaluated separately for the purpose of risk transfer. For example, where a treaty includes coinsurance and YRT with an aggregate experience refund and the inability to independently recapture the separate types of reinsurance, it is not adequate to separately review the coinsurance and YRT pieces of the transaction for risk transfer. The treaty as a whole is non- proportional. This complexity is not immediately apparent to the regulatory reviewer, and it is important that this issue be raised broadly, so that individual state regulators are aware. Individual regulators are encouraged to contact VAWG if they would like additional perspective when reviewing such treaties.
>
> Generally, VAWG regulators observe that some companies are reporting an overstated reserve credit due to a bifurcated risk transfer analysis. Specifically, some companies reported a proportional reserve credit for a coinsurance component, despite in aggregate the reinsurer only being exposed to loss in tail scenarios. From an actuarial perspective, there is consensus among VAWG members that it is not appropriate for a ceding company to take a proportional reserve credit that reflects the transfer of all actuarial risks when not all actuarial risks are transferred.
>
> VAWG recommends that SAPWG discuss this issue, to 1) increase familiarity with the issue and 2) consider whether any clarifications to risk transfer requirements is appropriate

SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance contains guidance for life and health reinsurance agreements. Additionally, SSAP No. 61R refers to Appendix *A-791, Life and Health Reinsurance Agreements* for risk transfer criteria applicable to all forms of life and health reinsurance other than Yearly Renewable Term (YRT) agreements and certain non-proportional contracts such as stop loss and catastrophe reinsurance. YRT agreements are required to comply with specific parts of A-791. Furthermore, contracts that do not meet the conditions for reinsurance accounting in SSAP No. 61R, including the applicable parts of A-791, receive deposit accounting.

As noted in the referral above, regulators have observed reinsurance transactions that combine both coinsurance and YRT, typically applicable to different underlying policies, but that are interdependent. There exists an aggregate experience refund and recapture provisions that allow for recapture by the cedant, but only if both components are recaptured simultaneously.

VAWG observed that some insurers have assessed these components under A-791 as if they were separate agreements, concluding that the requirements for risk transfer are met for each. Reserve credit was then taken on each component; a proportional credit for the quota share on the coinsured policies, and a YRT credit for the YRT component. Note that YRT contracts ordinarily cover a percentage of the one-year mortality risk for the net amount at risk on a policy. A simple way to describe net amount at risk is the difference between the policy reserve held and the face value of the policy.

The concern raised by regulators is that the substance of this interdependent agreement design is more akin to the risk transferred under a nonproportional reinsurance agreement. This is because in aggregate, proportionate amounts of the risk are not transferred. The agreements are designed to compensate the cedant for aggregate experience only in tail scenarios, which is accomplished through the design of the aggregate experience refund. In most reasonably expected scenarios, the net effect of the reinsurance is such that the cedant pays a financing charge to the reinsurer for a designated period of time until an expected recapture date and no additional net funds exchange hands. As a result, taking a full proportional reserve credit on the coinsured component is not reflective of the actual risk being transferred. SSAP No. 61R, paragraph 36 notes that the reinsurance credit is only for the risk reinsured. As noted in the referral, there was consensus among VAWG members that it is not appropriate for a ceding company to take a proportional reserve credit that reflects the transfer of all actuarial risks when not all actuarial risks are transferred. NAIC staff agrees with the VAWG consensus and proposes to incorporate a version of existing guidance from SSAP No. 62R that addresses this point. The inclusion of this guidance is intended to require risk transfer to be analyzed for the entire contract when multiple interdependent types of reinsurance are present.

SSAP No. 62R—Property and Casualty Reinsurance Exhibit A – Implementation Questions and Answers, question 10 provides guidance on interdependent contract features. This agenda item proposes to incorporate key aspects of the SSAP No. 62R, Exhibit A question 10 into SSAP No. 61R to provide more clarity on evaluation of risk transfer on contracts with interdependent features. The answer requires that features of the contracts(s) that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in determining if a particular contract transfers risk. The *SSAP No. 62R—Property and Casualty Reinsurance Exhibit A – Implementation Questions and Answers* question 10 provides the following:

> 10A: A contract is not defined, but is essentially a question of substance. It may be difficult in some circumstances to determine the boundaries of a contract. **For example, the profit-sharing provisions of one contract may refer to experience on other contracts and, therefore, raise the question of whether, in substance, one contract rather than several contracts exist.**
>
> The inconsistency that could result from varying interpretations of the term *contract* is limited by requiring that features of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. Therefore, if agreements with the reinsurer or related reinsurers, in the aggregate, do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured.

As historical background, the guidance for SSAP No. 62R, Exhibit A, question 10, originated from *GAAP EITF Topic D-34, Accounting for Reinsurance: Questions and Answers about FASB Statement No. 113* (EITF D-34) 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 to *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* as illustrated below. The proposed revisions incorporate guidance to SSAP No. 61R which is consistent with the guidance currently in SSAP No. 62R, Exhibit A Implementation Questions and Answers, question 10 and also add reference to A-791, paragraph 6 guidance in the YRT guidance paragraph. (See Authoritative Literature). FASB Statement No. 113 was adopted with modification in both SSAP No. 62R and SSAP No. 61R. Topic 944 Reinsurance Contracts in the current FASB Codification Implementation Guide continues to include the guidance from EITF D-34

The example reinsurance contract that VAWG observed contained yearly renewable term reinsurance. Per SSAP No. 61R, paragraph 19, only certain parts of *A-791 Life and Health Reinsurance Agreements* apply to YRT contracts. Specifically, YRT contracts only have to pass A-791, paragraphs 2.b., 2.c., 2.d., 2.h., 2.i., 2.j. or 2.k. to result in reinsurance accounting. In addition, paragraph 3 of A-791 on deferral of gain on cession of prior year blocks of business also applies. As described above, YRT contracts do not transfer all of the risk inherent in the contract as they typically only cover a percentage of the net amount at risk for typically one year. Note that the reinsurance accounting credit from a YRT contract per the guidance in SSAP No. 61R, paragraph 37 is computed as the one-year term mean reserve on the amount of insurance ceded. Therefore, a YRT credit is typically less than what a proportional coinsurance contract which transfers all significant risks would typically provide.

The VAWG reinsurance contract example also included coinsurance contracts which must pass all of A-791 to receive reinsurance accounting. The example contract contained a shared experience refund between the two contract types. This interdependent feature is a key element. NAIC staff agrees with VAWG that an interdependent reinsurance payment in a contract requires a single risk transfer assessment. However, the combined interdependent contract when assessed in aggregate would likely cause it to either not meet the conditions for reinsurance accounting or would result in a smaller reinsurance credit than VAWG observed some entities taking.

A-791, paragraph 2e contains the guidance which limits the amounts paid to the reinsurer to the income realized on the underlying reinsured policy and paragraph 2f contains the guidance on transferring all the significant risk of the business reinsured. Adding YRT coverage with coinsurance would likely result in a "fail" of the criteria in A-791 because not all of the significant risks of the underlying reinsured policies would be likely to be passed to the reinsurer (thus failing the criteria in A-791, paragraph 2f). Combining YRT and coinsurance in the same contract could also cause that contract to fail A-791 if the reinsurance contract charged more than the income on the underlying policy.

In addition, A-791, paragraph 6 requires 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. This paragraph does not currently apply to YRT but is being recommended to apply.

Existing Authoritative Literature:

- ***SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance***

Types of Reinsurance Arrangements

11. Once an entity has decided to reinsure amounts in excess of its desired retention, it may proceed in one of several basic arrangements—coinsurance, modified coinsurance, yearly renewable term or non-proportional. Such contracts may have funds withheld.

Coinsurance

12. In this arrangement, the risks are reinsured on the same plan as that of the original policy. The direct writer and the reinsurer share in the risk in the same manner. The ceding entity pays the reinsurer a proportional part of the premiums collected from the insured. In return, the reinsurer reimburses the ceding entity for the proportional part of the death or accident and health claim payments and other benefits provided by the policy, including nonforfeiture values, policy dividends, experience rating refunds, commissions, premium taxes, and other direct expenses agreed to in the contract. The reinsurer must also establish the required reserves for the portion of the policy it has assumed. A single policy can be coinsured with more than one entity or under more than one reinsurance contract with the same entity as long as the combined total of reinsurance and the retention of the ceding entity is not more than 100% of the risk.

13. In coinsurance of participating policies, the reinsurer may reimburse the ceding entity for its portion of the dividends paid to the policyholder. In determining its schedule of dividends, the ceding entity takes into account the experience on the business as written. If the reinsurer reimburses dividends it will typically accept the ceding entity's schedule but may require input into the schedule. Changes to the schedule may

have to be agreed to by the reinsurer. Coinsurance of all or a portion of a block of business also is used in situations where a severe strain is placed on the direct writing entity's surplus in the first policy year. For example, the premium received by the direct writer during the first policy year usually is insufficient to pay the high first-year commissions and other costs of issue and to establish the initial reserve. In such an example, coinsurance relieves some of the surplus strain of adding large amounts of new insurance.

Modified Coinsurance

14. The "modified coinsurance" or "modco" arrangement is a variation of coinsurance. The ceding entity has transferred all or a portion of the net policy liabilities on the reinsured policies to the reinsurer, and the reinsurer is required to indemnify the ceding entity for the same amount. The assets necessary to support the reserves for the original policies are maintained by the ceding entity instead of the reinsurer. This is accomplished by designating in the contract the transfer of the net policy liabilities to the assuming entity and an immediate transfer back to the extent of the modco deposit. Under modified coinsurance, the assuming entity shall transfer to the ceding entity the increase in the reserve on the reinsured portion. This transaction reflects the reinsurer's risk with respect to the reinsured business and its obligation to maintain the reserves supporting such obligation. In some cases, a policy may be reinsured partially on a coinsurance arrangement and partially on a modified coinsurance arrangement. This may be accomplished through the use of two contracts or in a single contract.

Yearly Renewable Term (YRT)

15. Under this arrangement of reinsurance, the ceding entity transfers the net amount at risk on the portion reinsured to the reinsurer and pays a one-year term premium. The "net amount at risk"—as defined in the contract—is usually the amount of insurance provided by the policy in excess of the ceding entity's reserve on it.

Non-Proportional

16. Other forms of reinsurance are also available, such as catastrophe and stop loss coverage. These arrangements provide for financial protection to the ceding entity for aggregate losses rather than providing indemnification for an individual policy basis as described in the preceding three reinsurance arrangements. Catastrophic and stop loss reinsurance are written on an annual basis to protect the ceding entity from excessive aggregate losses. Usually, the coverage does not extend over the life of the underlying policy nor is there any requirement on the ceding entity to renew the arrangement.

Transfer of Risk

17. **Reinsurance agreements must transfer risk from the ceding entity to the reinsurer in order to receive the reinsurance accounting treatment discussed in this statement.** If the terms of the agreement violate the risk transfer criteria contained herein, **(i.e., limits or diminishes the transfer of risk by the ceding entity to the reinsurer), the agreement shall follow the guidance for Deposit Accounting. In addition, any contractual feature that delays timely reimbursement violates the conditions of reinsurance accounting.**

18. This paragraph applies to all life, deposit-type and accident and health reinsurance agreements except for yearly renewable term reinsurance agreements and non-proportional reinsurance agreements such as stop loss and catastrophe reinsurance. All reinsurance agreements covering products that transfer significant risk shall follow the guidance for reinsurance accounting contained in this statement. All reinsurance contracts covering products that do not provide for sufficient transfer of risk shall follow the guidance for Deposit Accounting.

19. **Yearly renewable term (**YRT) reinsurance agreements that transfer a proportionate share of mortality or morbidity risk inherent in the business being reinsured and do not contain any of the conditions described in **Appendix A-791, paragraphs 2.b., 2.c., 2.d., 2.h., 2.i., 2.j. or 2.k.,** shall follow the guidance for reinsurance accounting, including paragraphs 55-57 of this statement that apply to indemnity reinsurance. Contracts that fail to meet the requirements for reinsurance accounting shall follow the guidance for Deposit Accounting. For all treaties entered into on or after January 1, 2003, the deferral guidance in paragraph 3 of A-791 shall also apply to YRT agreements. Since YRT agreements only transfer

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the mortality or morbidity risks to the reinsurer, the recognition of income shall be reflected on a net of tax basis, as gains emerge based on the mortality or morbidity experience.

20. For non-proportional reinsurance agreements such as stop loss and catastrophe reinsurance agreements, contract terms shall be evaluated to assess whether they transfer significant risk to the reinsurer. For example, prepayment schedules and accumulating retentions from multiple years are contractual features inherently designed to delay the timing of reimbursement to the ceding entity limits the risk to the reinsurer. Regardless of what a particular feature might be called, any feature that can delay timely reimbursement violates the conditions for reinsurance accounting. Transfer of insurance risk requires that the reinsurer's payment to the ceding entity depend on and directly vary with the amount and timing of claims settled under the reinsured contracts. Contractual features that can delay timely reimbursement prevent this condition from being met. Reinsurance accounting shall apply to all non-proportional agreements that transfer significant risk and do not contain any provisions that protect the reinsurer from incurring a loss. Contracts that fail to meet the requirements for reinsurance accounting shall follow the guidance for Deposit

Credits for Ceded Reinsurance

36. The credit taken by the ceding entity under the coinsurance arrangement is calculated using the same methodology and assumptions used in determining its policy and claim reserves. It is, of course, only for the percentage of the risk that was reinsured. Under modified coinsurance, the reserve credit is reduced by the modco deposit retained by the ceding entity. If the entity reinsures on a yearly renewable term basis, it is itself buying insurance for the portion of the ceded amount at risk. The amount of yearly renewable term reinsurance that is required on a given policy generally decreases each year as the entity's reserve increases. The net amount at risk may increase, however, on interest sensitive products such as universal life. The amount at risk on accident and health yearly renewal term reinsurance will remain level and the reinsurance premium will increase each year.

37. The reserve credit taken by the ceding entity is reported as a reduction to the reserves and not as an asset of the entity. **The ceding entity's reserve credit and assuming entity's reserve for yearly renewable term reinsurance shall be computed as the one year term mean reserve on the amount of insurance ceded. The ceding entity must use the same mortality and interest bases which were used for valuing the original policy before reinsurance.** The credit may also be computed on a pro rata basis if the result is not materially different from the credit computed on the mean reserve basis. For all types of reinsurance, the ceding entity also takes credit for other amounts due from the reinsurer such as unpaid claims and claims incurred but not reported. If contemplated by the reinsurance contract, recognition of related assets and liabilities must occur (policy loans, due and deferred premiums, etc.).

38. Non-proportional reinsurance is entered into on an annual basis to limit the claims experience of the ceding entity and thereby protect its financial integrity. When the period of the arrangement exceeds one year, the contract must be carefully reviewed to determine if the end result more closely follows proportional reinsurance. **No reserve credit is taken for non-proportional reinsurance unless the aggregate attachment point has in fact been penetrated. In order for an entity to reflect reserve credits on a prospective basis, the entity will need to demonstrate that the present value of expected recoveries using realistic assumptions, to be realized from the reinsurer are in excess of the present value of the reinsurance premiums guaranteed to be paid by the ceding entity under the terms of the contrac**t. Because non-proportional reinsurance aggregates experience, and does not indemnify the ceding entity for each policy loss, the use of statutory assumptions underlying the insured policies is inappropriate for determining any reserve credit to be taken by the ceding entity. Historical experience, pricing assumptions and asset shares shall be considered in determining if the reinsurer may be reasonably expected to pay any claims. The reserve credit taken shall only reflect these reasonable expectations. **This treatment of non-proportional reinsurance is similar to the way property and casualty (P&C) reinsurance is considered. This is because these modes of reinsurance more closely follow P&C indemnification principles than life insurance formula basis, and because these coverages are very similar to excess insurance on P&C products. In determining the appropriate reserve credit, the probability of a loss penetrating to the reinsurer's level of coverage (using reasonable assumptions) must be multiplied by the expected amount of recovery.** This is the same as reserve credits on coinsurance where the probability of a claim (i.e., mortality) is multiplied by the expected return (i.e., death

benefit). In that the coverage is for aggregate experience, the mortality assumptions underlying any one policy risk are inappropriate to analyze the appropriate credits for non-proportional coverage.

- **SSAP No. 61R, adopts FAS 113 with modifications.**

Relevant Literature

86. This statement adopts with modification *FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*. The statutory accounting principles established by this statement differ substantially from GAAP, reflecting much more detailed guidance, as follows:

a. Reserve credits taken by ceding companies as a result of reinsurance contracts are netted against the ceding entity's policy and claim reserves and unpaid claims;

b. First year and renewal ceding commissions on indemnity reinsurance of new business are recognized as income. Ceding commissions on ceded in-force business are included in the calculation of initial gain or loss;

c. As discussed in SSAP No. 50, statutory accounting defines deposit-type contracts as those contracts which do not include any mortality or morbidity risk. GAAP defines investment contracts as those that do not subject the insurance enterprise to significant policyholder mortality or morbidity risk. (The distinction is any mortality or morbidity risk for statutory purposes vs. significant mortality or morbidity risk for GAAP purposes.) Therefore, a contract may be considered an investment contract for GAAP purposes, and that same contract may be considered other than deposit-type for statutory purposes. A reinsurance treaty covering contracts that have insignificant mortality or morbidity risk (i.e., contracts classified as other than deposit-type contracts for statutory purposes, but investment contracts for GAAP purposes) that does not transfer that mortality or morbidity risk, but does transfer all of the significant risk inherent in the business being reinsured (e.g., lapse, credit quality, reinvestment or disintermediation risk) qualifies for reinsurance accounting for statutory reporting purposes, but would not qualify for reinsurance accounting treatment for GAAP purposes;

d. Initial gains on indemnity reinsurance of in-force blocks of business have unique accounting treatment. A portion of the initial gain (equal to the tax effect of the initial gain in surplus) is reported as commissions and expense allowances on reinsurance ceded in the statement of operations. The remainder of the initial gain is reported on a net-of-tax basis as a write-in for gain or loss in surplus in the Capital and Surplus Account. In subsequent years, the ceding entity recognizes income on the reinsurance ceded line for the net-of-tax profits that emerged on the reinsured block of business with a corresponding decrease in the write-in for gain or loss in surplus;

e. This statement prohibits recognition of a gain or loss in connection with the sale, transfer or reinsurance of an in-force block of business between affiliated entities in a non-economic transaction. Any difference between the assets transferred by the ceding entity and the liabilities, including unamortized IMR, shall be deferred and amortized under the interest method;

f. This statement requires that a liability be established through a provision reducing surplus for unsecured reinsurance recoverables from unauthorized reinsurers;

g. This statement prescribes offsetting certain reinsurance premiums.

87. This statement incorporates Appendices A-785 and A-791.

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- **SSAP No. 61R, Glossary Excerpts:**

Net Amount at Risk
The excess of the death benefit of a policy over the policy reserve. It is the amount which must come from surplus in the event of a death claim.

Non-Proportional Reinsurance
Reinsurance that is not secured on individual lives for specific individual amounts of reinsurance, but rather reinsurance that protects the ceding entity's overall experience on its entire portfolio of business, or at least a broad as noted in paragraph 19 of SSAP No. 61 segment of it. The most common forms of non-proportional reinsurance are stop loss reinsurance and catastrophe reinsurance.

Non-proportional reinsurance is a form of casualty insurance. Usually neither the premium nor continuance of coverage is guaranteed beyond a specified term.

Pool
A method of allocating reinsurance among several reinsurers. Using this method, each reinsurer receives a specified percentage of risk ceded into the pool. Percentages may vary by reinsurer.

Proportional Reinsurance
Reinsurance on a particular life for a specified amount or share generally, though not necessarily, secured at the time the policy is issued to the insured. The continuation of coverage guarantees for the reinsurance generally parallel those in the life insurance coverage reinsured. Most life reinsurance conducted in the United States is done so on a proportional basis.

Yearly Renewable Term (YRT)
A form of life reinsurance under which the mortality or morbidity risks, but not the permanent plan reserves, are transferred to the reinsurer for a premium that varies each year with the amount at risk and the ages of the insureds. The amount of reinsurance, which may change annually, is generally the amount of insurance provided by the policy in excess of the primary insurer's reserve.

- ***SSAP No. 62R—Property and Casualty Reinsurance* Exhibit A – Implementation Questions and Answers**

10. Q: For purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract?

- A: A contract is not defined, but is essentially a question of substance. It may be difficult in some circumstances to determine the boundaries of a contract. For example, the profit-sharing provisions of one contract may refer to experience on other contracts and, therefore, raise the question of whether, in substance, one contract rather than several contracts exist.

The inconsistency that could result from varying interpretations of the term *contract* is limited by requiring that features of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. Therefore, if agreements with the reinsurer or related reinsurers, in the aggregate, do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured.

The original GAAP source of the above in SSAP No. 62R is *EITF D-34* *Accounting for Reinsurance: Questions and Answers about FASB Statement No. 113*, ***question 13***

13. Q—For purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract?

A—Statement 113 does not define what constitutes a "contract," which is essentially a question of substance. It may be difficult in some circumstances to determine the boundaries of a contract. For

example, the profit-sharing provisions of one contract may refer to experience on other contracts and, therefore, raise the question of whether, in substance, one contract rather than several contracts exist.

Statement 113 limits the inconsistency that could result from varying interpretations of the term contract by requiring that features of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. Therefore, if agreements with the reinsurer or related reinsurers, in the aggregate, do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured.

Certain guidance relevant to determining the boundaries of a contract is provided in the accounting literature. As described in paragraph 8 of Statement 113, provisions of other related contracts may be considered part of the subject contract under certain circumstances. Likewise, paragraphs 59 and 60 of Statement 113 indicate that the Board did not intend for different kinds of exposures combined in a program of reinsurance to be evaluated for risk transfer and accounted for together, because that would allow contracts that do not meet the conditions for reinsurance accounting to be accounted for as reinsurance by being designated as part of a program. In addition, Question 12 above refers to the fact that an amendment of a contract may create a new contract. [Revised 12/98.]

The legal form and substance of a reinsurance contract generally will be the same, so that the risks reinsured under a single legal document would constitute a single contract for accounting purposes. However, that may not always be the case. Accordingly, careful judgment may be required to determine the boundaries of a contract for accounting purposes. [Revised 12/98.]

If an agreement with a reinsurer consists of both risk transfer and nonrisk transfer coverages that have been combined into a single legal document, those coverages must be considered separately for accounting purposes. [Revised 12/98.]

Topic 944 Reinsurance Contracts in the current FASB Codification Implementation Guide continues to include the guidance from EITF D-34

Reinsurance Contracts
Implementation Guidance

What Constitutes a Contract

944-20-55-27
This implementation guidance discusses, for purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract, which is essentially a question of substance. It may be difficult in some circumstances to determine the boundaries of a contract.

944-20-55-28
For instance, the profit-sharing provisions of one contract may refer to experience on other contracts and, therefore, raise the question of whether, in substance, one contract rather than several contracts exist.

944-20-55-29
The guidance in the Financial Services—Insurance Topic on reinsurance limits the inconsistency that could result from varying interpretations of the term contract by requiring that features of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. Therefore, if agreements with the reinsurer or related reinsurers, in the aggregate, do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured.

944-20-55-30
Certain guidance relevant to determining the boundaries of a contract is provided in the accounting literature.

944-20-55-31
Paragraph 944-20-15-40 states that provisions of other related contracts may be considered part of the subject contract under certain circumstances.

944-20-55-32
Different kinds of exposures combined in a program of reinsurance shall not be evaluated for risk transfer and accounted for together, because that would allow contracts that do not meet the conditions for reinsurance accounting to be accounted for as reinsurance by being designated as part of a program.

944-20-55-33
In addition, paragraph 944-20-15-65 refers to the fact that an amendment of a contract may create a new contract.

944-20-55-34
The legal form and substance of a reinsurance contract generally will be the same, so that the risks reinsured under a single legal document would constitute a single contract for accounting purposes. However, that may not always be the case. Accordingly, careful judgment may be required to determine the boundaries of a contract for accounting purposes.

944-20-55-35
Paragraph 944-20-15-56 states that, if an agreement with a reinsurer consists of both risk transfer and nonrisk transfer coverages that have been combined into a single legal document, those coverages shall be considered separately for accounting purposes.

- ***A-791 Life and Health Reinsurance Agreements***

A-791, paragraph 1, provides the following:

1. This Appendix shall not apply to assumption reinsurance, yearly renewable term reinsurance or certain nonproportional reinsurance such as stop loss or catastrophe reinsurance.

Q – Aside from assumption reinsurance, what other types of reinsurance are exempt from the accounting requirements?

A – Yearly renewable term (YRT) and c**ertain nonproportional reinsurance arrangements, such as stop loss and catastrophe reinsurance are exempt** because these do not normally provide significant surplus relief and therefore are outside the scope of this Appendix. If a catastrophe arrangement takes a reserve credit for actual losses beyond the attachment point or the unearned premium reserve (UPR) of the current year's premium, there will most likely be no regulatory concern.

Similarly, if a YRT treaty provides incidental reserve credits for the ceding insurer's net amount at risk for the year with no other allowance to enhance surplus, there will most likely be no regulatory concern. For purposes of this exemption, a treaty labeled as YRT does not meet the intended definition of YRT if the surplus relief in the first year is greater than that provided by a YRT treaty with zero first year reinsurance premium and no additional allowance from the reinsurer.

Additional pertinent information applicable to all YRT treaties and to non-proportional reinsurance arrangements is contained in paragraphs 19 and 20 of SSAP No. 61R.

A-791, paragraph 2e contains the guidance which limits the reinsurance to the amount realized on the reinsured policy.

2. No insurer shall, for reinsurance ceded, reduce any liability or establish any asset in any statutory financial statement if, by the terms of the reinsurance agreement, in substance or effect, any of the following conditions exist:

e. The reinsurance agreement involves the possible payment by the ceding insurer to the reinsurer of amounts other than from income realized from the reinsured policies. For example, it is improper for a ceding company to pay reinsurance premiums, or other fees or charges to a reinsurer which are greater than the direct premiums collected by the ceding company;

A-791, paragraph 2f contains the guidance on transferring all of the significant risk of the business reinsured.

2. No insurer shall, for reinsurance ceded, reduce any liability or establish any asset in any statutory financial statement if, by the terms of the reinsurance agreement, in substance or effect, any of the following conditions exist:

f. The treaty does not transfer all of the significant risk inherent in the business being reinsured. The following table identifies for a representative sampling of products or type of business, the risks which are considered to be significant. For products not specifically included, the risks determined to be significant shall be consistent with this table.

Risk categories:

i. Morbidity

ii. Mortality

iii. Lapse

This is the risk that a policy will voluntarily terminate prior to the recoupment of a statutory surplus strain experienced at issue of the policy.

iv. Credit Quality

This is the risk that invested assets supporting the reinsured business will decrease in value. The main hazards are that assets will default or that there will be a decrease in earning power. It excludes market value declines due to changes in interest rate.

v. Reinvestment

This is the risk that interest rates will fall and funds reinvested (coupon payments or monies received upon asset maturity or call) will therefore earn less than expected. If asset durations are less than liability durations, the mismatch will increase.

vi. Disintermediation

This is the risk that interest rates rise and policy loans and surrenders increase or maturing contracts do not renew at anticipated rates of renewal. If asset durations are greater than the liability durations, the mismatch will increase. Policyholders will move their funds into new products offering higher rates. The company may have to sell assets at a loss to provide for these withdrawals.

+ - Significant   0 - Insignificant

RISK CATEGORY

	i.	ii.	iii.	iv.	v.	vi.
Health Insurance - other than LTC/LTD*	+	0	+	0	0	0

Health Insurance - LTC/LTD*	+	0	+	+	+	0
Immediate Annuities	0	+	0	+	+	0
Single Premium Deferred Annuities	0	0	+	+	+	+
Flexible Premium Deferred Annuities	0	0	+	+	+	+
Guaranteed Interest Contracts	0	0	0	+	+	+
Other Annuity Deposit Business	0	0	+	+	+	+
Single Premium Whole Life	0	+	+	+	+	+
Traditional Non-Par Permanent	0	+	+	+	+	+
Traditional Non-Par Term	0	+	+	0	0	0
Traditional Par Permanent	0	+	+	+	+	+
Traditional Par Term	0	+	+	0	0	0
Adjustable Premium Permanent	0	+	+	+	+	+
Indeterminate Premium Permanent	0	+	+	+	+	+
Universal Life Flexible Premium	0	+	+	+	+	+
Universal Life Fixed Premium	0	+	+	+	+	+
Universal Life Fixed Premium dump-in premiums allowed	0	+	+	+	+	+

*LTC = Long Term Care Insurance
LTD = Long Term Disability Insurance

6. The reinsurance agreement shall contain provisions which provide that:

   a. **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**; and

   b. Any change or modification to the agreement shall be null and void unless made by amendment to the agreement and signed by both parties.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): The referral from VAWG was formally received by the Working Group on January 10, 2024 and NAIC staff was directed to draft an agenda item for discussion.

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

Convergence with International Financial Reporting Standards (IFRS): None

Staff Review Completed by: Robin Marcotte – NAIC Staff - February 2024

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 to *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* as illustrated below. The proposed revisions incorporate guidance to SSAP No. 61R which is consistent with the guidance currently in SSAP No. 62R, Exhibit A Implementation Questions and Answers, question 10 and also add reference to A-791, paragraph 6 guidance in the YRT guidance paragraph.

As described in the summary of issues, NAIC staff agrees that risk transfer analysis of a reinsurance contract or contracts with interdependent features that directly or indirectly compensate the reinsurer, requires that all parts of the contract be evaluated in aggregate. Appendix A-791, paragraph 6 already contains guidance that the agreement must constitute the entire agreement. While NAIC staff agrees with the concern that VAWG raised regarding some entities taking too large of a reinsurance credit, the existing guidance in SSAP No. 61R regarding risk transfer requires that reporting entities should not take reinsurance credit for

amounts greater than the risk ceded should be sufficient to address those concerns. However, NAIC staff would be willing to develop a more extensive implementation guidance or other revisions if desired.

Status:
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed revisions to incorporate guidance to *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* that is consistent with the guidance currently in *SSAP No. 62R—Property and Casualty Reinsurance*, Exhibit A Implementation Questions and Answers, question 10. This guidance requires risk transfer to be evaluated in aggregate for contracts with interrelated contract features such as experience rating refunds. The revisions also adds a reference in *Appendix A-791 Life and Health Reinsurance Agreements* (A-791), paragraph 6 regarding the entirety of the contract. In addition, the Working Group directed NAIC staff to notify the Valuation Analysis (E) Working Group, the Life Actuarial (A) Task Force and the Reinsurance (E) Task Force of the exposure.

Proposed Revisions SSAP No. 61R:

Transfer of Risk

17. Reinsurance **agreements must transfer risk from the ceding entity to the reinsurer in order to receive the reinsurance accounting treatment discussed in this statement.** If the terms of the agreement violate the risk transfer criteria contained herein, **(i.e., limits or diminishes the transfer of risk by the ceding entity to the reinsurer), the agreement shall follow the guidance for Deposit Accounting. In addition, any contractual feature that delays timely reimbursement violates the conditions of reinsurance accounting.**

~~17.~~18. For purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract is essentially a question of substance. It may be difficult in some circumstances to determine the boundaries of a contract. For instance, the profit-sharing provisions of one contract may refer to experience on other contracts and, therefore, raise the question of whether, in substance, one contract rather than several contracts exist. The inconsistency that could result from varying interpretations of the term contract is limited by requiring that features of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. Therefore, if agreements with the reinsurer or related reinsurers in the aggregate do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured.

~~18.~~19. This paragraph applies to all life, deposit-type and accident and health reinsurance agreements except for yearly renewable term reinsurance agreements and non-proportional reinsurance agreements such as stop loss and catastrophe reinsurance. All reinsurance agreements covering products that transfer significant risk shall follow the guidance for reinsurance accounting contained in this statement. All reinsurance contracts covering products that do not provide for sufficient transfer of risk shall follow the guidance for Deposit Accounting.

~~19.~~20. **Yearly renewable term (**YRT) reinsurance agreements that transfer a proportionate share of mortality or morbidity risk inherent in the business being reinsured and do not contain any of the conditions described in **Appendix A-791, paragraphs 2.b., 2.c., 2.d., 2.h., 2.i., 2.j. or 2.k.,** shall follow the guidance for reinsurance accounting, including paragraphs 55-57 of this statement that apply to indemnity reinsurance. Contracts that fail to meet the requirements for reinsurance accounting shall follow the guidance for Deposit Accounting. For all treaties entered into on or after January 1, 2003, the deferral guidance in paragraph 3 of A-791 shall also apply to YRT agreements. YRT agreements shall follow the requirements of A-791, paragraph 6, regarding the entire agreement and the effective date of agreements. Since YRT agreements only transfer the mortality or morbidity risks to the reinsurer, the recognition of income shall be reflected on a net of tax basis, as gains emerge based on the mortality or morbidity experience.

20. For non-proportional reinsurance agreements such as stop loss and catastrophe reinsurance agreements, contract terms shall be evaluated to assess whether they transfer significant risk to the reinsurer. For example, prepayment schedules and accumulating retentions from multiple years are contractual features inherently designed to delay the timing of reimbursement to the ceding entity limits the risk to the reinsurer. Regardless of what a particular feature might be called, any feature that can delay timely reimbursement violates the conditions for reinsurance accounting. Transfer of insurance risk requires that the reinsurer's payment to the ceding entity depend on and directly vary with the amount and timing of claims settled under the reinsured contracts. Contractual features that can delay timely reimbursement prevent this condition from being met. Reinsurance accounting shall apply to all non-proportional agreements that transfer significant risk and do not contain any provisions that protect the reinsurer from incurring a loss. Contracts that fail to meet the requirements for reinsurance accounting shall follow the guidance for Deposit Accounting.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Hearing/15 - 24-06 - RT YRT-Combo contracts.docx

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

Issue: Reporting of Funds Withheld and Modco Assets

Check (applicable entity):

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

Description of Issue: During 2023, as a result of rising interest rates, the Statutory Accounting Principles (E) Working Group addressed the issue of net negative (disallowed) interest maintenance reserve for statutory accounting with *Interpretation (INT) 23-01 Net Negative (Disallowed) Interest Maintenance Reserve*, as a short-term solution. Later in 2023, the IMR Ad Hoc Group was formed to find a more permanent solution to address IMR for statutory accounting. During the IMR Ad Hoc Group's review process and discussions, it was noted that there were issues with identifying assets that are subject to funds withheld or modified coinsurance (modco) arrangements within the financial statements and reporting schedules. The intent of this agenda item is to make it easier to identify assets that are subject to a funds withheld or modco arrangements through updated reporting in the financials. This agenda item does not intend to change statutory accounting for these arrangements.

Funds withheld and modco arrangements are defined in the glossary to *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*:

- Funds withheld assets - "*Assets that would normally be paid over to a reinsurer but are withheld by the ceding entity to permit statutory credit for nonadmitted reinsurance, to reduce a potential credit risk, or to retain control over investments. Under certain conditions, the reinsurer may withhold funds from the ceding entity*."

- Modco arrangements - "*Indemnity life insurance that differs from coinsurance only in that the reserves are retained by the ceding entity, which represents a prepayment of all or a portion of the reinsurer's future obligation. Periodically an adjustment is made to the mean reserve on deposit with the ceding entity. This is usually done quarterly but may be done more frequently. If the reserve increases, the increase in mean reserve less interest on the mean reserve held at the end of the previous accounting period is paid by the reinsurer to the ceding entity. If the mean reserve decreases, the decrease and interest are paid by the ceding entity to the reinsurer. The appropriate interest rate is defined in the treaty*."

Although this issue of clarity of reporting of funds withheld and modco assets was raised as part of the IMR project, which is focused on life insurance, funds withheld also exist for property/casualty insurance, so this agenda item proposes to add this updated reporting to all the annual statement blanks.

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 and Title annual statement blanks. The new part would be similar in structure to Schedule DL and would include all assets held under a funds withheld arrangement and would include a separate signifier for modco assets.

Existing Authoritative Literature:
Funds withheld and modco arrangements are noted in *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*. Funds withheld are also discussed in *SSAP No. 62R—Property and Casualty Reinsurance* and Appendix A-785 Credit for Reinsurance.

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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 recommend that the Working Group move this item to the active listing of the maintenance agenda categorized as a SAP clarification and expose the recommendation 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 and Title annual statement blanks, that is similar in structure to Schedule DL and would include all assets held under a funds withheld arrangement and would include a separate signifier for modco assets.

Staff Review Completed by: Jake Stultz, NAIC Staff—February 2024

Status:
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed a project which proposes 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, which is similar in structure to Schedule DL and would include all assets held under a funds withheld arrangement and would include a separate signifier for modified coinsurance assets.

Summer 2024 Updated Staff Recommendation:

NAIC staff recommend that the Working Group expose the draft of the new reporting schedules (included in Exhibit 1 of this Form A), which 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 and Title annual statement blanks and direct NAIC staff to continue working with interest parties on this proposal.

The Life RBC formula reflects a reduction in RBC charges for modco and funds withheld assets. This reduction is by asset type and often by asset designation. The fair value of the assets withheld is also reported in the reinsurance Schedules S and F as collateral. Accordingly, to accomplish both things, asset-by-asset identification is necessary. Therefore, some of the submitted comments regarding not being able to identify assets withheld which are not held in trust would indicate a disconnect. <u>Comments are requested regarding if the assets cannot be identified, then how are the numbers determined for the life risk-based capital charge reductions reported and the collateral fair value.</u>

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Hearing/16 - 24-07 - Modco Reporting.docx

Exhibit 1, Draft Schedule S, Part 8 and Schedule F, Part 7, Instructions and Blanks

Life/Fraternal & Health Instructions

SCHEDULE S – PART 8

FUNDS WITHHELD AS OF DECEMBER 31, CURRENT YEAR

This section should include data on all modified coinsurance (MODCO) and other reinsurance transactions with funds withheld as of December 31, current year.

If a reporting entity's detail lines report any of the following required categories, it shall report the subtotal amount of the corresponding category, with the specified subtotal line number appearing in the same manner and location as the pre-printed total line and number:

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Category	Line Number
General Account	
Issuer Credit Obligations	
NAIC Designation 1	0199999
NAIC Designation 2	0299999
NAIC Designation 3	0399999
NAIC Designation 4	0499999
NAIC Designation 5	0599999
NAIC Designation 6	0699999
Asset-Backed Securities	
NAIC Designation 1	0799999
NAIC Designation 2	0899999
NAIC Designation 3	0999999
NAIC Designation 4	1099999
NAIC Designation 5	1199999
NAIC Designation 6	1299999
Unaffiliated Preferred Stock	
NAIC Designation 1	1399999
NAIC Designation 2	1499999
NAIC Designation 3	1599999
NAIC Designation 4	1699999
NAIC Designation 5	1799999
NAIC Designation 6	1899999
Unaffiliated Common Stock	1999999
Mortgages	2099999
Real Estate	2199999
Other Long-Term Investments	2299999
Total General Account	2599999
Separate Account	
Issuer Credit Obligations	
NAIC Designation 1	2199999
NAIC Designation 2	2299999
NAIC Designation 3	2399999
NAIC Designation 4	2499999
NAIC Designation 5	2599999
NAIC Designation 6	2699999
Asset-Backed Securities	
NAIC Designation 1	2799999
NAIC Designation 2	2899999
NAIC Designation 3	2999999
NAIC Designation 4	3099999
NAIC Designation 5	3199999
NAIC Designation 6	3299999
Unaffiliated Preferred Stock	
NAIC Designation 1	3399999
NAIC Designation 2	3499999
NAIC Designation 3	3599999
NAIC Designation 4	3699999
NAIC Designation 5	3799999
NAIC Designation 6	3899999
Unaffiliated Common Stock	3999999
Mortgages	4099999
Real Estate	4199999
Other Long-Term Investments	4299999
Total General Account	4599999

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Column 1 – CUSIP Identification

CUSIP numbers for all purchased publicly issued securities are available from the broker's confirmation or the certificate. For private placement securities, the NAIC has created a special number called a PPN to be assigned by the Standard & Poor's CUSIP Bureau. For foreign securities, use a CINS that is assigned by the Standard & Poor's CUSIP Bureau: *www.cusip.com/cusip/index.htm*.

For Lines 0199999 through 2699999, if no valid CUSIP, CINS or PPN number exists, then the CUSIP field should be zero-filled and a valid ISIN security number should be reported in (Column 11).

The CUSIP reported for this column should be determined in a manner consistent with the instructions of other schedules for the lines shown below:

Lines 0019999999 through 2509999999 .... Schedule D, Part 1, Column 1
Lines 4019999999 through 4509999999 .... Schedule D, Part 2, Section 1, Column 1
Lines 5019999999 through 5989999999 .... Schedule D, Part 2, Section 2, Column 1
Line 9409999999 .... Schedule BA, Part 1, Column 1
Line 9709999999 .... Schedule E, Part 2, Column 1

The CUSIP number should be zero-filled for the following lines:

Real Estate (Schedule A type) 9209999999
Mortgage Loans on Real Estate (Schedule B type).. 9309999999
Short-Term Invested Assets (Schedule DA, Part 1 type)... 9509999999
Cash (Schedule E, Part 1 type)... 9609999999
Other Assets 9809999999

Column 2 – Description

Give a complete and accurate description of all bonds and preferred and common stocks as listed in the *Valuations of Securities*.

For SVO-Identified Bond Exchange Traded Funds, enter the name of the fund as it appears on the NAIC SVO-Identified bonds ETF listing as of December 31 of the current year.

For Certificate of Deposit Account Registry Service (CDARs) or other similar services that have a maturity of greater than one year, individually list the various banking institutions that are financially responsible for honoring certificates of deposit.

Column 3 – MODCO (Yes/No)

If the funds withheld include Modified Coinsurance (MODCO) enter Yes.

Column 4 – Restricted Asset Code

If assets are not under the exclusive control of the company as shown in the General Interrogatories, they are to be identified by placing one of the codes (**identified in the Investment Schedules General Instructions**) in this column.

Column 5 – NAIC Designation, NAIC Designation Modifier and SVO Administrative Symbol

The NAIC Designation, NAIC Designation Modifier and SVO Administrative Symbol reported for this column should be determined in a manner consistent with the instructions of other schedules for the lines shown below:

Lines 0019999999 through 0509999999 ...... Schedule D, Part 1, Section 1, Column 4
Lines 1019999999 through 1909999999 ...... Schedule D, Part 1, Section 2, Column 4
Lines 4019999999 through 4509999999 ...... Schedule D, Part 2, Section 1, Column 19
Lines 5019999999 through 5989999999 ...... Schedule D, Part 2, Section 2, Column 17
Line 9409999999 .... Schedule BA, Part 1, Column 7
Line 9509999999 .... Schedule DA, Part 1, Column 22
Line 9709999999 .... Schedule E, Part 2, Column 11

For Lines 9209999999, 9309999999, 9609999999 and 9809999999, the column should be left blank.

The NAIC Designation, Designation Modifier and SVO Administrative Symbol will be shown as one column on the printed but will be three sub-columns in the data table.

On the printed page the sub-columns should be displayed with a "." between the NAIC Designation and the NAIC Designation Modifier with a space between the NAIC Designation Modifier and the SVO Administrative Symbol (e.g., "1.A YE").

Column 6 – Fair Value

The value reported for this column should be determined in a manner consistent with the fair value column instructions of other schedules for the lines shown below:

Lines 0019999999 through 0509999999 ...... Schedule D, Part 1, Section 1, Column 7
Lines 1019999999 through 1909999999 ...... Schedule D, Part 1, Section 2, Column 7
Lines 4019999999 through 4509999999 ...... Schedule D, Part 2, Section 1, Column 9
Lines 5019999999 through 5989999999 ...... Schedule D, Part 2, Section 2, Column 7
Line 9209999999 .... Schedule A, Part 1, Column 10
Line 9309999999 .... FV of the underlying collateral Schedule B, Part 1
Line 9409999999 .... Schedule BA, Part 1, Column 11

For those lines where the same type of investment is reported on other schedules but do not have a fair value column, report the amount consistent with instructions for the following:

Line 9509999999 .... Report B/ACV, Schedule DA, Part 1, Column 6
Line 9609999999 .... Report Balance, Schedule E Part 1, Column 6
Line 9709999999 .... Report B/ACV, Schedule E Part 2, Column 7

Column 7 – Book/Adjusted Carrying Value

The value reported for this column should be determined in a manner consistent with the instructions of other schedules for the lines shown below:

Lines 0019999999 through 0509999999 ...... Schedule D, Part 1, Section 1, Column 8
Lines 1019999999 through 1909999999 ...... Schedule D, Part 1, Section 2, Column 8
Lines 4019999999 through 4509999999 ...... Schedule D, Part 2, Section 1, Column 7
Lines 5019999999 through 5989999999 ...... Schedule D, Part 2, Section 2, Column 5
Line 9209999999 .... Schedule A, Part 1, Column 9
Line 9309999999 .... Schedule B, Part 1, Column 8

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Line 9409999999 .... Schedule BA, Part 1, Column 12
Line 9509999999 .... Schedule DA, Part 1, Column 6
Line 9609999999 .... Report Balance, Schedule E, Part 1, Column 6
Line 9709999999 .... Schedule E, Part 2, Column 7

Column 8 – Modified Coinsurance (MODCO)

Report the modified coinsurance funds withheld amount.

**** Columns 9 through 13 will be electronic only. ****

Column 9 – Investments Involving Related Parties

Required for all investments involving related parties including, but not limited to, those captured as affiliate investments. This disclosure intends to capture information on investments held that reflect interactions involving related parties, regardless of whether the related party meets the affiliate definition, or the reporting entity has received domiciliary state approval to disclaim control/affiliation.

Enter one of the following codes to identify the role of the related party in the investment.

1. Direct loan or direct investment (excluding securitizations) in a related party, for which the related party represents a direct credit exposure.

2. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which 50% or more of the underlying collateral represents investments in or direct credit exposure to related parties.

3. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies involving a relationship with a related party as sponsor, originator, manager, servicer or other similar influential role and for which less than 50% (including 0%) of the underlying collateral represents investments in or direct credit exposure to related parties.

4. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies in which the structure reflects an in-substance related party transaction but does not involve a relationship with a related party as sponsor, originator, manager, servicer or other similar influential role.

5. The investment is identified as related party, but the role of the related party represents a different arrangement than the options provided in choices 1-4.

6. The investment does not involve a related party.

The code reported for this column should be determined in a manner consistent with the instructions of other schedules for the lines shown below:

Lines 0019999999 through 0509999999 .... Schedule D, Part 1, Section 1, Column 21
Lines 1019999999 through 1909999999 .... Schedule D, Part 1, Section 2, Column 22
Lines 4019999999 through 4509999999 .... Schedule D, Part 2, Section 1, Column 21
Lines 5019999999 through 5989999999 .... Schedule D, Part 2, Section 2, Column 18
Line 9309999999 .... Schedule B, Part 1, Column 16
Line 9409999999 .... Schedule BA, Part 1, Column 21
Line 9509999999 .... Schedule DA, Part 1, Column 20
Line 9709999999 .... Schedule E, Part 2, Column 10

The column should be left blank for the following lines:

Real Estate (Schedule A type) 9209999999
Cash (Schedule E, Part 1 type)... 9609999999
Other Assets 9809999999

Column 10 – Investment Characteristics

If an investment has one or more of the following characteristics, then list the appropriate number(s) separated by commas. If none of the characteristics apply, then leave the column blank.

1. Investment terms permit interest to be received in a form other than cash.

2. Investment terms permit payment of interest to be deferred without being considered past due.

3. Interest due and accrued has been written off as uncollectible and/or nonadmitted.

4. Investment has a current year or prior year recognized other-than-temporary impairment.

5. Investment is an interest-only strip

6. Investment is a principal-only strip

7. Investment reflects a To-Be-Announced (TBA) security that will qualify as an issuer credit obligation or asset-backed security at the time the reporting entity takes possession of the issued security.

Column 11 – Maturity Date

The maturity date reported for this column should be determined in a manner consistent with the instructions of other schedules for the lines shown below:

Lines 0019999999 through 0509999999 ...... Schedule D, Part 1, Column 19
Lines 1019999999 through 1909999999 ...... Schedule D, Part 2, Column 19
Line 9509999999 .... Schedule DA, Part 1, Column 5
Line 9709999999 .... Schedule E, Part 2, Column 6

The following lines are considered assets with no maturity date and should be left blank:

4019999999 through 4509999999 .... Preferred Stock (Schedule D, Part 2, Section 1 type)
5019999999 through 5989999999 .... Common Stock (Schedule D, Part 2, Section 2 type)
9209999999 .... Real Estate (Schedule A type)
9309999999 .... Mortgage Loans on Real Estate (Schedule B type)
9409999999 .... Other Invested Assets (Schedule BA type)
9809999999 .... Other Assets

Column 12 – Fair Value Hierarchy Level and Method Used to Obtain Fair Value Code

Report the fair value level that represents the inputs used to determine fair value. Whenever possible, the reported fair value shall reflect Level 1, followed by Level 2, and then Level 3. In all situations fair value shall be determined in accordance with *SSAP No. 100R – Fair Value.*

The following is a listing of valid fair value level indicators to show the fair value hierarchy level.

“1” for Level 1

“2” for Level 2

“3” for Level 3

The following is a listing of the valid method indicators to show the method used by the reporting entity to determine the Rate Used to Obtain Fair Value.

“a” for securities where the rate is determined by a pricing service.

“b” for securities where the rate is determined by a stock exchange.

“c” for securities where the rate is determined by a broker or custodian. The reporting entity should obtain and maintain the pricing policy for any broker or custodian used as a pricing source. In addition, the broker must either be approved by the reporting entity as a counterparty for buying and selling securities or be an underwriter of the security being valued.

“d” for securities where the rate is determined by the reporting entity or a third party contracted by the reporting entity. The reporting entity is required to maintain a record of the pricing methodology used.

“e” for securities where the rate is determined by the unit price published in the NAIC *Valuation of Securities*.

Enter a combination of hierarchy and method indicator. The fair value hierarchy level indicator would be listed first and the method used to determine fair value indicator would be listed next. For example, use “1b” to report Level 1 for the fair value hierarchy level and stock exchange for the method used to determine fair value.

The guidance in *SSAP No. 100R—Fair Value* allows the use of net asset value per share (NAV) instead of fair value for certain investments. If NAV is used instead of fair value leave blank.

Column 13 – Source Used to Obtain Fair Value

For Method Code “a,” identify the specific pricing service used.

For Method Code “b,” identify the specific stock exchange used.

The listing of most **stock exchange codes can be found in the Investment Schedules General Instructions.**

For Method Code “c,” identify the specific broker or custodian used.

For Method Code “d,” leave blank.

For Method Code “e,” leave blank.

If net asset value (NAV) is used instead of fair value, the reporting entity should use “NAV” to indicate net asset value used instead of fair value.

Column 14 – ISIN Identification

The International Securities Identification Numbering (ISIN) system is an international standard set up by the International Organization for Standardization (ISO). It is used for numbering specific securities, such as stocks, bonds, options and futures. ISIN numbers are administered by a National Numbering Agency (NNA) in each of their respective countries, and they work just like serial numbers for those securities. Record the ISIN number only if no valid CUSIP, CINS or PPN exists to report in Column 1.

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The ISIN reported for this column should be determined in a manner consistent with the instructions of other schedules for the lines shown below:

Lines 0019999999 through 0509999999 .... Schedule D, Part 1, Section 1, Column 35
Lines 1019999999 through 1909999999 .... Schedule D, Part 1, Section 2, Column 37
Lines 4019999999 through 4509999999 .... Schedule D, Part 2, Section 1, Column 27
Lines 5019999999 through 5989999999 .... Schedule D, Part 2, Section 2, Column 25

The ISIN number should be zero-filled for the following lines:

Real Estate (Schedule A type) 9209999999
Mortgage Loans on Real Estate (Schedule B type)... 9309999999
Other Invested Assets (Schedule BA type) 9409999999
Short-Term Invested Assets (Schedule DA, Part 1 type) 9509999999
Cash (Schedule E, Part 1 type).. 9609999999
Cash Equivalents (Schedule E, Part 2 type) 9709999999
Other Assets 9809999999

Property/Casualty Instructions

SCHEDULE F – PART 7

FUNDS WITHHELD AS OF DECEMBER 31, CURRENT YEAR

This section should include data on all modified coinsurance (MODCO) and other reinsurance transactions with funds withheld as of December 31, current year.

If a reporting entity's detail lines report any of the following required categories, it shall report the subtotal amount of the corresponding category, with the specified subtotal line number appearing in the same manner and location as the pre-printed total line and number:

Category	Line Number
General Account	
Issuer Credit Obligations	
NAIC Designation 1	0199999
NAIC Designation 2	0299999
NAIC Designation 3	0399999
NAIC Designation 4	0499999
NAIC Designation 5	0599999
NAIC Designation 6	0699999
Asset-Backed Securities	
NAIC Designation 1	0799999
NAIC Designation 2	0899999
NAIC Designation 3	0999999
NAIC Designation 4	1099999
NAIC Designation 5	1199999
NAIC Designation 6	1299999
Unaffiliated Preferred Stock	
NAIC Designation 1	1399999
NAIC Designation 2	1499999
NAIC Designation 3	1599999
NAIC Designation 4	1699999
NAIC Designation 5	1799999
NAIC Designation 6	1899999
Unaffiliated Common Stock	1999999
Mortgages	2099999
Real Estate	2199999
Other Long-Term Investments	2299999
Total General Account	2599999
Separate Account	
Issuer Credit Obligations	
NAIC Designation 1	2199999
NAIC Designation 2	2299999
NAIC Designation 3	2399999
NAIC Designation 4	2499999
NAIC Designation 5	2599999
NAIC Designation 6	2699999
Asset-Backed Securities	
NAIC Designation 1	2799999
NAIC Designation 2	2899999
NAIC Designation 3	2999999
NAIC Designation 4	3099999
NAIC Designation 5	3199999
NAIC Designation 6	3299999
Unaffiliated Preferred Stock	
NAIC Designation 1	3399999
NAIC Designation 2	3499999
NAIC Designation 3	3599999
NAIC Designation 4	3699999
NAIC Designation 5	3799999
NAIC Designation 6	3899999
Unaffiliated Common Stock	3999999
Mortgages	4099999
Real Estate	4199999
Other Long-Term Investments	4299999
Total General Account	4599999

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Column 1 – CUSIP Identification

CUSIP numbers for all purchased publicly issued securities are available from the broker's confirmation or the certificate. For private placement securities, the NAIC has created a special number called a PPN to be assigned by the Standard & Poor's CUSIP Bureau. For foreign securities, use a CINS that is assigned by the Standard & Poor's CUSIP Bureau: *www.cusip.com/cusip/index.htm*.

For Lines 0199999 through 2699999, if no valid CUSIP, CINS or PPN number exists, then the CUSIP field should be zero-filled and a valid ISIN security number should be reported in (Column 11).

The CUSIP reported for this column should be determined in a manner consistent with the instructions of other schedules for the lines shown below:

Lines 0019999999 through 2509999999 .... Schedule D, Part 1, Column 1
Lines 4019999999 through 4509999999 .... Schedule D, Part 2, Section 1, Column 1
Lines 5019999999 through 5989999999 .... Schedule D, Part 2, Section 2, Column 1
Line 9409999999 .... Schedule BA, Part 1, Column 1
Line 9709999999 .... Schedule E, Part 2, Column 1

The CUSIP number should be zero-filled for the following lines:

Real Estate (Schedule A type) 9209999999
Mortgage Loans on Real Estate (Schedule B type)... 9309999999
Short-Term Invested Assets (Schedule DA, Part 1 type).. 9509999999
Cash (Schedule E, Part 1 type)... 9609999999
Other Assets 9809999999

Column 2 – Description

Give a complete and accurate description of all bonds and preferred and common stocks as listed in the *Valuations of Securities*.

For SVO-Identified Bond Exchange Traded Funds, enter the name of the fund as it appears on the NAIC SVO-Identified bonds ETF listing as of December 31 of the current year.

For Certificate of Deposit Account Registry Service (CDARs) or other similar services that have a maturity of greater than one year, individually list the various banking institutions that are financially responsible for honoring certificates of deposit.

Column 3 – MODCO (Yes/No)

If the funds withheld include Modified Coinsurance (MODCO) enter Yes.

Column 4 – Restricted Asset Code

If assets are not under the exclusive control of the company as shown in the General Interrogatories, they are to be identified by placing one of the codes (**identified in the Investment Schedules General Instructions**) in this column.

Column 5 – NAIC Designation, NAIC Designation Modifier and SVO Administrative Symbol

The NAIC Designation, NAIC Designation Modifier and SVO Administrative Symbol reported for this column should be determined in a manner consistent with the instructions of other schedules for the lines shown below:

Lines 0019999999 through 0509999999 ...... Schedule D, Part 1, Section 1, Column 4
Lines 1019999999 through 1909999999 ...... Schedule D, Part 1, Section 2, Column 4
Lines 4019999999 through 4509999999 ...... Schedule D, Part 2, Section 1, Column 19
Lines 5019999999 through 5989999999 ...... Schedule D, Part 2, Section 2, Column 17
Line 9409999999 .... Schedule BA, Part 1, Column 7
Line 9509999999 .... Schedule DA, Part 1, Column 22
Line 9709999999 .... Schedule E, Part 2, Column 11

For Lines 9209999999, 9309999999, 9609999999 and 9809999999, the column should be left blank.

The NAIC Designation, Designation Modifier and SVO Administrative Symbol will be shown as one column on the printed but will be three sub-columns in the data table.

On the printed page the sub-columns should be displayed with a "." between the NAIC Designation and the NAIC Designation Modifier with a space between the NAIC Designation Modifier and the SVO Administrative Symbol (e.g., "1.A YE").

Column 6 – Fair Value

The value reported for this column should be determined in a manner consistent with the fair value column instructions of other schedules for the lines shown below:

Lines 0019999999 through 0509999999 ...... Schedule D, Part 1, Section 1, Column 7
Lines 1019999999 through 1909999999 ...... Schedule D, Part 1, Section 2, Column 7
Lines 4019999999 through 4509999999 ...... Schedule D, Part 2, Section 1, Column 9
Lines 5019999999 through 5989999999 ...... Schedule D, Part 2, Section 2, Column 7
Line 9209999999 .... Schedule A, Part 1, Column 10
Line 9309999999 .... FV of the underlying collateral Schedule B, Part 1
Line 9409999999 .... Schedule BA, Part 1, Column 11

For those lines where the same type of investment is reported on other schedules but do not have a fair value column, report the amount consistent with instructions for the following:

Line 9509999999 .... Report B/ACV, Schedule DA, Part 1, Column 6
Line 9609999999 .... Report Balance, Schedule E Part 1, Column 6
Line 9709999999 .... Report B/ACV, Schedule E Part 2, Column 7

Column 7 – Book/Adjusted Carrying Value

The value reported for this column should be determined in a manner consistent with the instructions of other schedules for the lines shown below:

Lines 0019999999 through 0509999999 ...... Schedule D, Part 1, Section 1, Column 8
Lines 1019999999 through 1909999999 ...... Schedule D, Part 1, Section 2, Column 8
Lines 4019999999 through 4509999999 ...... Schedule D, Part 2, Section 1, Column 7
Lines 5019999999 through 5989999999 ...... Schedule D, Part 2, Section 2, Column 5
Line 9209999999 .... Schedule A, Part 1, Column 9
Line 9309999999 .... Schedule B, Part 1, Column 8

Line 9409999999 .... Schedule BA, Part 1, Column 12
Line 9509999999 .... Schedule DA, Part 1, Column 6
Line 9609999999 .... Report Balance, Schedule E, Part 1, Column 6
Line 9709999999 .... Schedule E, Part 2, Column 7

Column 8 – Modified Coinsurance (MODCO)

Report the modified coinsurance funds withheld amount.

**** Columns 9 through 13 will be electronic only. ****

Column 9 – Investments Involving Related Parties

Required for all investments involving related parties including, but not limited to, those captured as affiliate investments. This disclosure intends to capture information on investments held that reflect interactions involving related parties, regardless of whether the related party meets the affiliate definition, or the reporting entity has received domiciliary state approval to disclaim control/affiliation.

Enter one of the following codes to identify the role of the related party in the investment.

1. Direct loan or direct investment (excluding securitizations) in a related party, for which the related party represents a direct credit exposure.

2. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which 50% or more of the underlying collateral represents investments in or direct credit exposure to related parties.

3. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies involving a relationship with a related party as sponsor, originator, manager, servicer or other similar influential role and for which less than 50% (including 0%) of the underlying collateral represents investments in or direct credit exposure to related parties.

4. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies in which the structure reflects an in-substance related party transaction but does not involve a relationship with a related party as sponsor, originator, manager, servicer or other similar influential role.

5. The investment is identified as related party, but the role of the related party represents a different arrangement than the options provided in choices 1-4.

6. The investment does not involve a related party.

The code reported for this column should be determined in a manner consistent with the instructions of other schedules for the lines shown below:

Lines 0019999999 through 0509999999 .... Schedule D, Part 1, Section 1, Column 21
Lines 1019999999 through 1909999999 .... Schedule D, Part 1, Section 2, Column 22
Lines 4019999999 through 4509999999 .... Schedule D, Part 2, Section 1, Column 21
Lines 5019999999 through 5989999999 .... Schedule D, Part 2, Section 2, Column 18
Line 9309999999 .... Schedule B, Part 1, Column 16
Line 9409999999 .... Schedule BA, Part 1, Column 21
Line 9509999999 .... Schedule DA, Part 1, Column 20
Line 9709999999 .... Schedule E, Part 2, Column 10

The column should be left blank for the following lines:

Real Estate (Schedule A type) 9209999999
Cash (Schedule E, Part 1 type)... 9609999999
Other Assets 9809999999

Column 10 – Investment Characteristics

If an investment has one or more of the following characteristics, then list the appropriate number(s) separated by commas. If none of the characteristics apply, then leave the column blank.

1. Investment terms permit interest to be received in a form other than cash.

2. Investment terms permit payment of interest to be deferred without being considered past due.

3. Interest due and accrued has been written off as uncollectible and/or nonadmitted.

4. Investment has a current year or prior year recognized other-than-temporary impairment.

5. Investment is an interest-only strip

6. Investment is a principal-only strip

7. Investment reflects a To-Be-Announced (TBA) security that will qualify as an issuer credit obligation or asset-backed security at the time the reporting entity takes possession of the issued security.

Column 11 – Maturity Date

The maturity date reported for this column should be determined in a manner consistent with the instructions of other schedules for the lines shown below:

Lines 0019999999 through 0509999999 ...... Schedule D, Part 1, Column 19
Lines 1019999999 through 1909999999 ...... Schedule D, Part 2, Column 19
Line 9509999999 .... Schedule DA, Part 1, Column 5
Line 9709999999 .... Schedule E, Part 2, Column 6

The following lines are considered assets with no maturity date and should be left blank:

4019999999 through 4509999999 .... Preferred Stock (Schedule D, Part 2, Section 1 type)
5019999999 through 5989999999 .... Common Stock (Schedule D, Part 2, Section 2 type)
9209999999 .... Real Estate (Schedule A type)
9309999999 .... Mortgage Loans on Real Estate (Schedule B type)
9409999999 .... Other Invested Assets (Schedule BA type)
9809999999 .... Other Assets

Column 12 – Fair Value Hierarchy Level and Method Used to Obtain Fair Value Code

Report the fair value level that represents the inputs used to determine fair value. Whenever possible, the reported fair value shall reflect Level 1, followed by Level 2, and then Level 3. In all situations fair value shall be determined in accordance with *SSAP No. 100R – Fair Value.*

The following is a listing of valid fair value level indicators to show the fair value hierarchy level.

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"1" for Level 1

"2" for Level 2

"3" for Level 3

The following is a listing of the valid method indicators to show the method used by the reporting entity to determine the Rate Used to Obtain Fair Value.

"a" for securities where the rate is determined by a pricing service.

"b" for securities where the rate is determined by a stock exchange.

"c" for securities where the rate is determined by a broker or custodian. The reporting entity should obtain and maintain the pricing policy for any broker or custodian used as a pricing source. In addition, the broker must either be approved by the reporting entity as a counterparty for buying and selling securities or be an underwriter of the security being valued.

"d" for securities where the rate is determined by the reporting entity or a third party contracted by the reporting entity. The reporting entity is required to maintain a record of the pricing methodology used.

"e" for securities where the rate is determined by the unit price published in the NAIC *Valuation of Securities*.

Enter a combination of hierarchy and method indicator. The fair value hierarchy level indicator would be listed first and the method used to determine fair value indicator would be listed next. For example, use "1b" to report Level 1 for the fair value hierarchy level and stock exchange for the method used to determine fair value.

The guidance in *SSAP No. 100R—Fair Value* allows the use of net asset value per share (NAV) instead of fair value for certain investments. If NAV is used instead of fair value leave blank.

Column 13 – Source Used to Obtain Fair Value

For Method Code "a," identify the specific pricing service used.

For Method Code "b," identify the specific stock exchange used.

The listing of most **stock exchange codes can be found in the Investment Schedules General Instructions.**

For Method Code "c," identify the specific broker or custodian used.

For Method Code "d," leave blank.

For Method Code "e," leave blank.

If net asset value (NAV) is used instead of fair value, the reporting entity should use "NAV" to indicate net asset value used instead of fair value.

Column 14 – ISIN Identification

The International Securities Identification Numbering (ISIN) system is an international standard set up by the International Organization for Standardization (ISO). It is used for numbering specific securities, such as stocks, bonds, options and futures. ISIN numbers are administered by a National Numbering Agency (NNA) in each of their respective countries, and they work just like serial numbers for those securities. Record the ISIN number only if no valid CUSIP, CINS or PPN exists to report in Column 1.

The ISIN reported for this column should be determined in a manner consistent with the instructions of other schedules for the lines shown below:

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Lines 0019999999 through 0509999999 .... Schedule D, Part 1, Section 1, Column 35
Lines 1019999999 through 1909999999 .... Schedule D, Part 1, Section 2, Column 37
Lines 4019999999 through 4509999999 .... Schedule D, Part 2, Section 1, Column 27
Lines 5019999999 through 5989999999 .... Schedule D, Part 2, Section 2, Column 25

The ISIN number should be zero-filled for the following lines:

Real Estate (Schedule A type) 9209999999
Mortgage Loans on Real Estate (Schedule B type).. 9309999999
Other Invested Assets (Schedule BA type) 9409999999
Short-Term Invested Assets (Schedule DA, Part 1 type) 9509999999
Cash (Schedule E, Part 1 type)... 9609999999
Cash Equivalents (Schedule E, Part 2 type) 9709999999
Other Assets 9809999999

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LIFE/FRATERNAL & HEALTH BLANKS

SCHEDULE S – PART 8

Funds Withheld as of December 31 Current Year

1 CUSIP Identification	2 Description	3 MODCO (Yes/No)	4 Restricted Asset Code	5 NAIC Designation, NAIC Designation Modifier and SVO Administrative Symbol	6 Fair Value	7 Book/Adjusted Carrying Value	8 Modified Coinsurance (MODCO)
9999999999 Totals							XXX

1. 2. 3. 4. 5. 6. 7. 8.

PROPERTY/CASUALTY BLANK

SCHEDULE F – PART 7

Funds Withheld as of December 31 Current Year

1 CUSIP Identification	2 Description	3 MODCO (Yes/No)	4 Restricted Asset Code	5 NAIC Designation, NAIC Designation Modifier and SVO Administrative Symbol	6 Fair Value	7 Book/Adjusted Carrying Value	8 Modified Coinsurance (MODCO)
9999999999 Totals							XXX

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

Issue: SSAP No. 56 – Book Value Separate Accounts

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 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, paragraph 17 provides limited guidance for assets supporting fund accumulation contracts (GICs), and this measurement method is generally referred to as "book value":

> Assets supporting fund accumulation 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, will be recorded as if the assets were held in the general account. Assets supporting all other contractual benefits shall be recorded at fair value on the date of valuation, or if there is no readily available market, then in accordance with the valuation procedures in the applicable contract.

NAIC staff are aware that there has been an increase in assets reported at "book value" within the separate account. 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 have been approved by the state of domicile for reporting in the separate account.

The guidance in *SSAP No. 56—Separate Accounts* focuses on the accounting and reporting for both the separate account and general account, with specific focus on what is captured within each account as well as transfers between the two accounts. As the focus is on fair value separate account assets, there is not guidance that details how transfers should occur between the separate and general accounts when the assets will be retained and reported at "book value." Particularly, the guidance does not address whether assets should be disposed / recognized at fair value when transferring between accounts, with subsequent reporting at the general account measurement guidance or whether the assets should be transferred at the "book value" that is reported in the existing account. The process has the potential to impact recognition of gains / losses and IMR, so it should be clearly detailed to ensure consistent reporting.

Existing Authoritative Literature:

- ***SSAP No. 56—Separate Accounts***

Although the entirety of SSAP No. 56 may be relevant, key paragraphs have been identified.

General Account Reporting

> 5. For those separate account contracts classified as life contracts under *SSAP No. 50—Classification of Insurance or Managed Care Contracts,* premiums and annuity considerations shall be recorded as income in the Summary of Operations of the general account, and as transfers to premiums and considerations in the

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separate account statement. Deposit-type contracts shall be recorded in the general account in accordance with *SSAP No. 52—Deposit-Type Contracts*.(INT 00-03) Charges (e.g., fees associated with investment management, administration, and contract guarantees) assessed on the separate accounts, as well as the net gain from operations of the separate account, shall be recorded as income in the Summary of Operations of the general account. Expenses relating to investment management, administration, and contract guarantees pertaining to separate account operations, as well as benefits and surrenders incurred on behalf of separate account contracts classified as life contracts, net transfers between separate accounts, commissions, and premium taxes (if any) shall be recorded as expenses in the Summary of Operations of the general account.

6. The general account shall include the total assets and liabilities, including transfers due or accrued, of any separate accounts business which it maintains and, therefore, the surplus, if any, of its separate accounts business. Transfers to the general account due or accrued shall be reported on a net basis so that the asset and the liability totals of the general account are not overstated. Changes in the surplus of the separate accounts business of an insurer, except for changes resulting from the net gain from operations of the separate account, shall be charged or credited directly to the unassigned funds (surplus) of the general account.

Separate Account Reporting

15. The separate accounts annual statement is concerned with the flow of funds related to investment activities and obligations of the separate accounts and with the transfer of funds between the separate account and the general account. As a result, the separate account statement shall report only the assets, liabilities, and operations of the separate account and shall not include general account expenses related to investment management, administration, or contract guarantees pertaining to separate account operations which are recorded in the general account.

16. The separate account records premiums, considerations (net of loading for sales charges such as commissions and premium taxes) and receipts (other than for net investment income and realized capital gains and losses) as income transfers from the general account. Net investment income and realized and unrealized capital gains and losses relating to the investment operations of the separate account are recorded as income in the Summary of Operations. When the contract provides for such, expenses and taxes associated with the separate account investment operations shall be deducted in the determination of net investment income. Deposits and withdrawals on deposit-type contracts shall be recorded in the Summary of Operations. Benefits and surrenders, reserve transfers, policy loans1, policyholder charges (e.g., fees associated with investment management, administration, and contract guarantees), and federal income taxes relating to the separate account are recorded as expense transfers to the general account in the Summary of Operations. The net change in aggregate reserves relating to separate account contracts is reported as an expense in the Summary of Operations.

17. Assets supporting fund accumulation 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, will be recorded as if the assets were held in the general account. Assets supporting all other contractual benefits shall be recorded at fair value on the date of valuation, or if there is no readily available market, then in accordance with the valuation procedures in the applicable contract.

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):

1. Agenda Item 2022-19: Negative IMR introduced the discussion of interest maintenance reserve (IMR) within statutory accounting, specifically the guidance for nonadmittance of disallowed negative IMR. This agenda item resulted with *INT 23-01: Net Negative (Disallowed) Interest Maintenance Reserve*. This INT

[1] Policy loans related to separate account products shall follow the guidance in *SSAP No. 49—Policy Loans*. As detailed within SSAP No. 49, as part of the expense transfer, policy loans related to separate account products require a liquidation of the separate account assets to fund the loan issued by the general account. A transfer of assets from the separate account to the general account must have occurred to fund the policy loan issuance; otherwise the policy loan is nonadmitted in the general account.

permits admittance of disallowed negative IMR up to 10% of adjusted capital and surplus. The guidance permits admittance of the separate account negative IMR once the general account negative IMR has been admitted if the 10% limit has not been reached. The INT identifies that the concept of nonadmitted assets does not exist in the separate account, therefore the guidance includes application guidance for reversing prior actions that charged negative IMR to surplus before permitting the negative IMR to be recognized as an asset.

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 recommend that the Working Group move this item to the active listing of the maintenance agenda categorized as a SAP clarification with direction to work with industry in determining current application / differences in interpretations to present to the Working Group along with suggested revisions to codify the approach within SSAP No. 56.

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

Status:
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed this agenda item and directed NAIC staff to work with industry in determining current application and differences in the treatment of book value assets within the separate account and to prepare suggested revisions to codify an approach within *SSAP No. 56—Separate Accounts*.

Updated Recommendation – 2024 Summer National Meeting:

The IMR Ad Hoc Subgroup has discussed a number of elements generating IMR, including the transfer of assets for cash between the general account (GA) and book value separate accounts (BVSA). This discussion is about transfers of assets where one account is purchasing existing assets held by the other account. This discussion received information from the ACLI noting that reporting entities have taken different approaches in the recording of these transfers, with three broad methods. All methods have a net zero surplus impact.

1. Market Value Offsetting Method:
   - Selling Account transfers the asset at fair value, with a realized gain or loss and allocation to IMR.
   - Purchasing Account records the asset at book value, with an adjustment to IMR for the difference between the fair value and book value.
   - This method has offsetting IMR impacts between the GA and BVSA, with a zero net impact to surplus.

2. Market Value SSAP No. 25 Method:
   - Selling Account transfers the asset at fair value. If resulting in a gain, the gain is offset by a *SSAP No. 25—Affiliates and Other Related Parties* adjustment (deferral until gain is permanent). Losses are recognized and allocated to IMR.
   - Purchasing Account records the asset at market value and records applicable amortized cost valuation adjustments over the term to maturity.
   - This method results in different IMR treatment between the GA and BVSA based on whether the transaction resulted in a gain or loss. This method requires the reporting entity to track the asset and recognize the deferred gain once the asset is subsequently sold or matured in the BVSA.
   - The reporting results in a net zero impact to surplus.

3. Book Value Method:
   - Both accounts (selling / purchasing) record the asset at book value.
   - There is no IMR impact and no surplus impact.
   - This method has raised concerns on whether a transfer from the GA at book value to an insulated BVSA, provides appropriate treatment to the GA policyholders.

The ACLI noted that although the above different approaches have been used, if the NAIC decides a standard accounting practice should be applied for transfers for cash between the GA and BVSA (and vice versa), the ACLI would support the market value offsetting IMR method. The rationale for supporting this method is as follows:

1. Market value transactions ensure the insurer is transacting to meet the fiduciary obligations of all policyholders (both GA and BVSA).
2. The method results in a net zero impact to surplus.
3. The method ensures a net zero impact to the combined GA and BVSA IMR in both gain and loss scenarios. (Although IMR is recognized in both accounts, the amounts recognized are offsetting.)
4. The method is more favorable operationally than the SSAP No. 25 method in which gains from the transfer must be deferred until a subsequent act that makes the transaction permanent (subsequent selling or maturity of asset).
5. The transfer at fair value combined with the offsetting IMR ensure that both the GA and BVSA retain the economic impact of the transaction without mingling the economics between the books.

The ACLI noted that this recommendation was only for transfers for cash between the GA and BVSA accounts and recommend additional research and discussion before creating a standard practice for less common transactions between the GA and BVSA, such as asset for asset swaps, contributions of assets to support deficiency in the SA and dividends of assets from the BVSA.

For the 2024 Summer National Meeting, NAIC staff recommend that the Working Group expose proposed revisions to SSAP No. 56 to clarify and expand guidance for book value separate accounts, and to incorporate accounting guidance for transfers of assets in exchange for cash between the general account and book value separate accounts. (Due to the design / order of SSAP No. 56, the entire SSAP has been reflected with the proposed edits shown as tracked changes.)

Proposed Revisions to SSAP No. 56:
(Paragraph references have been shaded for subsequent confirmation.)

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for accounting and reporting for separate accounts in both the general account and separate account statements.

SUMMARY CONCLUSION

Introduction

2. Separate accounts are used to fund variable life insurance, variable annuities, modified guaranteed annuities and modified guaranteed life insurance, or various group contracts under pension or other employee benefit plans where funds are held in a separate account to support a liability. When separate accounts are established and filed accordingly, they may be used to fund guaranteed benefits. Separate account contracts may also be used to accumulate funds which are intended to be applied at some later time to provide life insurance or to accumulate proceeds applied under settlement or dividend options.

3. Assets held in separate accounts are owned by the insurer. All investment income and realized and unrealized capital gains and losses from assets allocated to a separate account, net of related investment expenses, are generally reflected in the separate account and, except for modified guaranteed annuities, modified guaranteed life insurance, and separate accounts established and filed to provide guaranteed benefits, investment performance is generally not guaranteed by the insurer. Charges relating to contract guarantees, administration, and investment management are deducted from separate accounts.

General Account Reporting

4. Insurance activities such as sales, underwriting and contract administration, premium collection and payment of premium taxes, claims, and benefits are functions of the insurance company distinct from the separate account and shall be accounted for as transactions of the general account.

5. For those separate account contracts classified as life contracts under *SSAP No. 50—Classification of Insurance or Managed Care Contracts*, premiums and annuity considerations shall be recorded as income in the Summary of Operations of the general account, and as transfers to premiums and considerations in the separate account statement. Deposit-type contracts shall be recorded in the general account in accordance with *SSAP No. 52—Deposit-Type Contracts*.[INT 00-03] Charges (e.g., fees associated with investment management, administration, and contract guarantees) assessed on the separate accounts, as well as the net gain from operations of the separate account, shall be recorded as income in the Summary of Operations of the general account. Expenses relating to investment management, administration, and contract guarantees pertaining to separate account operations, as well as benefits and surrenders incurred on behalf of separate account contracts classified as life contracts, net transfers between separate accounts, commissions, and premium taxes (if any) shall be recorded as expenses in the Summary of Operations of the general account.

6. The general account shall include the total assets and liabilities, including transfers due or accrued, of any separate accounts business which it maintains and, therefore, the surplus, if any, of its separate accounts business. Transfers to the general account due or accrued shall be reported on a net basis so that the asset and the liability totals of the general account are not overstated. Changes in the surplus of the separate accounts business of an insurer, except for changes resulting from the net gain from operations of the separate account, shall be charged or credited directly to the unassigned funds (surplus) of the general account.

7. Where a variable annuity contract or variable life insurance contract contains a guaranteed minimum death benefit, any reserve liability for such death benefit provision shall be recorded and held in the general account based on the reserving guidance in paragraphs 25 and 26. Any differences between the benefit paid and the separate

account asset value of the contract shall be charged against or credited to the general account in its net gain from operations.

8. Separate account surplus may not become negative. For example, for separate account contracts which have annuitized (i.e., contracts in the payout stage), lower than expected mortality on variable annuity contracts containing mortality guarantees may cause a deficiency in the investment funds underlying the contract reserves. Thus the general account incurs an expense and the separate account realizes revenue to cover the deficiency, if necessary. Conversely, excess funds from higher than expected mortality will result in mortality gains, which are included in the Summary of Operations of the separate account and are ultimately recorded as equity in net income from separate account operations as discussed in paragraph 5.

9. Separate account surplus created through the use of the commissioners' reserve valuation method (CRVM), commissioners' annuity reserve valuation method (CARVM), or other reserving methods, shall be reported by the general account as an unsettled transfer from the separate account. The net change on such transfers shall be included as a part of the net gain from operations in the general account.

10. Surplus funds transferred from the general account to the separate account, commonly referred to as seed money, and earnings accumulated thereon shall be reported as surplus in the separate accounts until transferred or repatriated to the general account. The transfer of such funds between the separate account and the general account shall be reported as surplus contributed or withdrawn during the year.

11. If an Asset Valuation Reserve (AVR) is required for investments held by separate accounts, it is combined with the general account AVR and accounted for in the general account financial statements (see *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*). The criteria for determining when an AVR is required for separate accounts are described in paragraph 18 of this statement.

12. Reporting entities collect fees for managing Separate Account Guaranteed Investment Contracts (GICs), Synthetic GICs, as well as participating separate account group annuities. These are in the form of administrative fees, risk fees and some investment management fees. For defined contribution business, these are in the form of fees related to mutual fund management. These fees are meant to offset expenses and generate some profit.

13. Amounts receivable from contractholders for separate account management fees meet the definition of assets as set forth in *SSAP No. 4—Assets and Nonadmitted Assets.*

14. An evaluation shall be made of the amounts receivable to determine any nonadmitted amounts. Next, an evaluation shall be made in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets,* to determine whether there is an impairment. This two-step process is set forth below:

a. Uncollected separate account management fees receivable over ninety days due shall be accounted for as a nonadmitted asset. Reporting entities shall begin aging the receivable when it is contractually required to be billed, or in the absence of contract specifications, when the reporting entity actually sends the bill to the contractholder;

b. Remaining amounts determined to be uncollectible shall be written off. If in accordance with SSAP No. 5R, it is "probable" the amount receivable is uncollectible, any uncollectible amount receivable shall be written off against operations in the period such determination is made. If it is "reasonably possible" the amount receivable is uncollectible, the disclosure requirements outlined in SSAP No. 5R, paragraph 32, shall be made.

Separate Account Reporting

15. The separate accounts annual statement is concerned with the flow of funds related to investment activities and obligations of the separate accounts and with the transfer of funds between the separate account and the general account. As a result, the separate account statement shall report only the assets, liabilities, and operations of the

separate account and shall not include general account expenses related to investment management, administration, or contract guarantees pertaining to separate account operations which are recorded in the general account.

16. The separate account records premiums, considerations (net of loading for sales charges such as commissions and premium taxes) and receipts (other than for net investment income and realized capital gains and losses) as income transfers from the general account. Net investment income and realized and unrealized capital gains and losses relating to the investment operations of the separate account are recorded as income in the Summary of Operations. When the contract provides for such, expenses and taxes associated with the separate account investment operations shall be deducted in the determination of net investment income. Deposits and withdrawals on deposit-type contracts shall be recorded in the Summary of Operations. Benefits and surrenders, reserve transfers, policy loans[2], policyholder charges (e.g., fees associated with investment management, administration, and contract guarantees), and federal income taxes relating to the separate account are recorded as expense transfers to the general account in the Summary of Operations. The net change in aggregate reserves relating to separate account contracts is reported as an expense in the Summary of Operations.

Measurement of Separate Account Assets

17. Assets supporting separate account contracts, except for contracts captured in paragraph 18, shall be reported at fair value, as determined under *SSAP No. 100—Fair Value*. Assets held in the separate account that reflect seed money from the general account shall follow all provisions of the SSAP to which the asset would be applicable if held in the general account. Assets that would not qualify for admittance in the general account are not permitted to be used as seed money in the separate account.

NAIC Staff Question: Information on the current measurement method for seed money is requested from industry. Although the guidance implies that seed money should be at book value, there is an assumption that companies may utilize fair value when included in a fair value separate account.

18. Assets supporting the following separate account contracts are permitted to be reported as if the assets were held in the general account. This measurement method is referred to as "book value." For these assets, measurement shall follow all provisions of the SSAP to which the asset would be applicable if held in the general account. Assets that would not qualify for admittance in the general account are not permitted in a book-value separate account. Separate account contracts that do not qualify in the following categories are not permitted at book value without a permitted or prescribed practice from the state of domicile.

a. Assets supporting fund accumulation 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, or established or maintained by an employer, will be recorded as if the assets were held in the general account.

b. With approval of the state insurance regulator, assets supporting insulated or non-insulated separate account contracts that are similar to contracts generally found in the general account[3]. Unlike traditional separate account contracts, these contracts do not have investment directives determined by the contract holder and investment performance results are not attributed to a specific contract holder. Furthermore, unlike traditional separate account contracts, the insurance reporting entity

[2] Policy loans related to separate account products shall follow the guidance in *SSAP No. 49—Policy Loans*. As detailed within SSAP No. 49, as part of the expense transfer, policy loans related to separate account products require a liquidation of the separate account assets to fund the loan issued by the general account. A transfer of assets from the separate account to the general account must have occurred to fund the policy loan issuance; otherwise the policy loan is nonadmitted in the general account.

[3] The inclusion of this guidance does not imply support for these contracts within the separate account instead of the general account. The domiciliary state insurance regulator is responsible for assessing and approving separate account contract classification in accordance with state statutes.

(general account) is often ultimately obligated to provide contract benefits that are not directly tied to the performance of the underlying assets, resulting with the general account serving as ann overall backstop or providing an implied guarantee, although a distinct performance guarantee is not specified (such as a minimum crediting rate, death benefit, etc.). Examples of contracts expected to be captured within this provision include pension risk transfer (PRT) contracts and registered index-linked annuity (RILA) contracts.

NAIC Staff Question: Feedback is requested on the named contracts (PRT and RILA) and whether other example contracts should be named.

~~18. Assets supporting fund accumulation 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, will be recorded as if the assets were held in the general account. Assets supporting all other contractual benefits shall be recorded at fair value on the date of valuation, or if there is no readily available market, then in accordance with the valuation procedures in the applicable contract.~~

Assets Transfers Between the General Account and Separate Account

19. Asset transfers that reflect sales for cash between the general account and separate account shall occur at fair value[4]. Specified guidance based on the measurement method of the assets in the separate account are detailed in paragraphs 20-21.

20. Asset sales for cash between the general account and "fair value" separate accounts:

a. The account (either general or separate account) selling the asset shall receive cash equal to fair value and dispose of the asset from the investment schedules at fair value.

i. Assets sold from the general account shall result in a realized gain or loss based on the difference between fair value and book adjusted carrying value (BACV). The realized gain or loss, if resulting from interest rate changes, shall be allocated to the general account IMR and amortized as if the asset had been sold to an unrelated third-party. Realized gains from these transactions shall not be deferred pursuant to *SSAP No. 25—Affiliates and Other Related Parties*, paragraph 17. Realized losses from credit-related factors shall be allocated to the AVR.

ii. Assets sold from a "fair value" separate account shall not result in a realized gain or loss.

b. The account (either general or separate account) purchasing the asset shall initially recognize the acquired asset at fair value. Subsequent measurements of the acquired asset should reflect the measurement method of the general or separate account.

21. Asset sales for cash between the general account and "book value" separate accounts:

a. Seller - The account (either general or separate account) selling the asset shall receive cash equal to fair value and dispose of the asset from the investment schedules at fair value with recognition of a realized gain or loss. The realized gain or loss, if resulting from interest rate changes, shall be allocated to IMR and amortized in the selling account as if the asset had been sold to an unrelated third-party. The transfer of an asset under this guidance that results in a gain shall not be deferred by the selling account pursuant to SSAP No. 25, paragraph 17, as such a deferral would create a

[4] This guidance is specific to asset sales for cash and is not intended to reflect administration functions for the payment of amounts owed to separate account policyholders/contractholders that may occur from the general account with reimbursement from the separate account.

mismatch in the IMR recognition between the general/separate accounts. Realized losses from credit-related factors shall be allocated to the AVR.

b. Purchaser - The account (either general or separate account) purchasing the asset shall recognize the acquired asset at the BACV from the selling account. The difference between the asset's fair value and the BACV shall be reported to IMR in the purchasing account.

c. The IMR activity between the selling account and the purchasing account shall be equal and offsetting resulting in a net zero impact in the IMR between the two accounts. IMR is tracked and reported separately in the general account and the separate account, but the net impact of the two accounts shall equal zero for each transfer transaction.

d. Subsequent to initial acquisition, the purchasing account shall account for the acquired asset pursuant to the measurement method of the applicable SSAP.

22. Asset transfers that do not reflect sales for cash between the general account and separate account are subject to domiciliary state approval. Any transfer that does not represent an asset sale for cash shall be specifically disclosed in both the general account and separate account as detailed in paragraph 34e. This shall include, but not be limited to, the following transfers:

a. Asset to asset swaps

b. Contributions of general account assets to support separate account deficiencies

c. Dividends of assets from the separate account to the general account.

NAIC Staff Question: Additional information is requested from industry on these transfers. NAIC staff recommend that these areas be expanded with consistent guidance for the treatment of transfers.

Separate Account AVR and IMR Reporting

19.23. An AVR is generally required for separate accounts when the insurerreporting entity, rather than the policyholder/contractholder, suffers the loss in the event of asset default or fair value loss. An AVR is required unless:

a. The asset default or fair value risk is borne directly by the policyholders; or

b. The regulatory authority for such separate accounts already explicitly provides for a reserve for asset default risk, where such reserves are essentially equivalent to the AVR.

20.24. Assets supporting traditional variable annuities and variable life insuranceseparate accounts that would qualify for separate account classification under U.S. GAAP generally do not require an AVR because the policyholders/contractholders bear the risk of change in the value of the assets. However, for those contracts an AVR is required for that portion of the assets representing seed money (including accumulated earnings on seed money) from the general account. the insurer's equity interest in the investments of the separate account (e.g., seed money).

21.25. Assets supporting separate account contracts where the insurer bears the risk of investment performance, which shall include all book value separate accounts, typical modified guaranteed contracts, market value adjusted contracts, and contracts with book value guarantees similar to contracts generally found in the general account do require an AVR because the insurer is responsible for credit related asset or fair value loss.

22.26. "Book Value" separate accounts, pursuant to paragraph 18, Certain separate accounts are alsoare required to maintain an Interest Maintenance Reserve (IMR). Separate accounts with assets reported at fair value are not required to maintain an IMR. The IMR requirements for investments held in separate accounts are applied on an

account by account basis. OnceIf an IMR is required for a separate account, all of the investments in that separate account are subject to the requirement. If an IMR is not required for a separate account, none of the investments in that separate account are subject to the requirement.

NAIC Staff Question: Clarification is requested to this guidance for seed money similar to the prior question.

23. As detailed in the Annual Statement Instructions, An IMR is required for separate accounts with assets recorded at book value, but is not required for separate accounts with assets recorded at fair value. For example, separate accounts for traditional variable annuities or variable life insurance do not require an IMR because assets and liabilities are valued at fair value.

24.27. If an Separate account IMR is required for investments held by separate accounts, it is kept separate from the general account IMR and accounted for in the separate accounts statement.

25.28. The AVR and IMR shall be calculated and reported in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve* and the NAIC Annual Statement Instructions for Life, Accident and Health Insurance Companies.

Policy Reserves

26.29. Statutory policy reserves shall be established for all contractual obligations of the insurer arising out of the provisions of the insurance contract. Where separate benefits are included in a contract, a reserve for each benefit shall be established as required in Appendix A-820. These statutory policy reserves are generally calculated as the excess of the present value of future benefits to be paid to or on behalf of policyholders less the present value of future net premiums. Statutory policy reserves meet the definition of liabilities as defined in SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets. The actuarial methodologies referred to in the following paragraph meet the criteria required for reasonable estimates in SSAP No. 5R.

27.30. The reserving methodologies and assumptions used in computation of policy reserves shall also meet the provisions of Appendices A-200, A-250, A-255, A-270; A-585, A-588, A-620, A-695, A-820, A-822 and the actuarial guidelines found in Appendix C of this Manual. Where separate account contracts have guaranteed elements, the basis for determining the value of the liability shall be consistent with the basis used for asset values (i.e., valuation interest rates as defined in Appendix A-820 shall be used when assets are recorded as if held in the general account and current interest rates based on market rates shall be used when assets are recorded at fair value). Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.

28.31. Statutory policy reserves for those group annuity contracts or other contracts that, in whole or in part, establish the insurer's obligations by reference to a segregated portfolio of assets not owned by the insurer shall be established in accordance with the guidance in Appendix A-695. Statutory policy reserves for those contracts with nonlevel premiums or benefits, or contracts with secondary guarantees shall be established in accordance with the guidance in Appendix A-830. Statutory policy reserves for those group life contracts utilizing a separate account that meet the requirements outlined in paragraph 1 of Appendix A-200 shall be computed in accordance with the guidance in that appendix.

Other Liabilities

29.32. The separate account shall accrue as a liability, subject to contractual provisions, amounts payable, including, but not limited to:

a. Fees associated with investment management, administration, and contract guarantees;

b. Investment expenses;

c. Investment taxes, licenses, and fees (Investment taxes such as real estate taxes, licenses and fees (excluding federal income taxes) are usually paid directly by the separate account but may be transferred to the general account for payment);

d. Federal income taxes;

e. Unearned investment income;

f. Net transfer due to (from) the general account;

g. Remittances and items not allocated;

h. Payable for investments purchased;

i. Net adjustments in assets and liabilities due to foreign exchange rates.

~~**Seed Money**~~

~~30. When a new separate account is initiated, the insurer may make a temporary transfer of surplus funds commonly referred to as seed money to the separate account. Such funds and earnings accumulated thereon shall be reported as surplus in the separate accounts statement until transferred or repatriated to the general account. The transfer of such funds to and from the separate account shall be reported as surplus contributed or withdrawn during the year.~~

Disclosures

~~31.~~33. Paragraphs 31-35 detail the separate account disclosure requirements that shall be included within the Life, Accident and Health Annual Statement Blank. Paragraphs 36-38 detail the separate account disclosure requirements that shall be included within the Separate Account Annual Statement Blank.

~~32.~~34. The general account financial statement shall include detailed information on the reporting entity's separate account activity. These disclosures shall include:

a. A narrative of the general nature of the reporting entity's separate account business.

b. Identification of the separate account assets that are legally insulated from the general account claims.

c. Identification of the separate account products that have guarantees backed by the general account. This shall include:

i. Amount of risk charges paid by the separate account to the general account for the past five (5) years[5] as compensation for the risk taken by the general account; and

ii. Amount paid by the general account due to separate account guarantees during the past five (5) years.

iii. Separate account contracts where the general account provides an inherent or ultimate guarantee, such as with pension risk transfer (PRT) or registered index-linked annuity (RILA) products. These products often do not have stated yield or death benefit guarantees, but rather the general account serves as a final backstop if the separate account assets are

[5] Reporting entities are permitted to prospectively 'build' the five-year disclosure. Thus, upon the first year of application of the disclosure requirements, reporting entities should illustrate one year of the disclosure requirement. In the second year, the reporting entity would disclose two years, and so forth until the disclosure includes five years of disclosures.

insufficient to support the product obligations. This disclosure shall identify whether risk charges have been provided to the general account and affirm the inclusion of these separate account products within asset-liability testing.

d. Discussion of securities lending transactions and repurchase/reverse repurchase agreements within the separate account. , This shall include separately including the amount of any loaned securities within the separate account and the amount of any sold / acquired securities under repurchase agreements, and if policy and procedures for the separate account differ from the general account.

e. Discussion of asset transfers that did not reflect sales in exchange for cash between the general account and the separate account. This shall include, but not be limited to, asset-for-asset swaps, contributions of general account assets to support separate account deficiencies, and dividends of assets from the separate account to the general account.

33.35. For each grouping (as detailed in paragraph 33), the following shall be disclosed:

a. Premiums, considerations or deposits received during the year;

b. Reserves by the valuation basis of the investments supporting the reserves at the financial statement date. List reserves for separate accounts whose assets are carried at fair value separately from those whose assets are carried at amortized cost/book value;

c. Reserves by withdrawal characteristics, including whether or not the separate account is subject to discretionary withdrawal. For reserves subject to discretionary withdrawal, the below categories are included if applicable:

i. With market value adjustment;

ii. at book value without market value adjustment and with surrender charge of 5% or more;

iii. at fair value;

iv. at book value without market value adjustment and with surrender charge of less than 5%;

d. Reserves for asset default risk, as described in paragraph 18.b., that are recorded in lieu of AVR.

34.36. For the disclosures required in paragraph 32, separate accounts shall be addressed in the following groupings (which are the same as those used for risk-based capital):

a. Separate Accounts with Guarantees:

1. Indexed separate accounts, which are invested to mirror an established index which is the basis of the guarantee;

2. Nonindexed separate accounts, with reserve interest rate at no greater than 4% and/or fund long-term interest guarantee in excess of a year that does not exceed 4%;

3. Nonindexed separate accounts, with reserve interest rate at greater than 4% and/or fund long-term interest guarantee in excess of a year that exceeds 4%.

b. Nonguaranteed Separate Accounts—Variable separate accounts, where the benefit is determined by the performance and/or fair value of the investments held in the separate account. Include variable accounts with incidental risks, nominal expense, and minimum death benefit guarantees.

~~35.~~37. Provide a reconciliation of the amount reported as transfers to and from separate accounts in the Summary of Operations of the separate accounts statement and the amount reported as net transfers to or from separate accounts in the Summary of Operations of the general accounts statement.

~~36.~~38. The disclosures in *SSAP No. 51R—Life Contracts*, and *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* related to the withdrawal characteristics of products include separate account products and shall be completed in the general account disclosures.

~~37.~~39. The Separate Account Annual Statement Blank shall include detailed information on the characteristics of the separate account assets, specifically categorizing separate account assets in accordance with the following characteristics:

a. Identification of separate account assets that are legally insulated from the general account and those which are not legally insulated.

b. Aggregation of separate account assets from products registered with the SEC and separate account assets from products excluded from registration. In addition to the overall aggregation, this disclosure shall specifically identify separate account assets from private placement variable annuities (PPVA) and private placement life insurance (PPLI). The disclosures in this paragraph (36.b.) ~~are~~ were effective December 31, 2018.

c. Amount of separate account assets that represent seed money, other fees and expenses due to the general account, and additional required surplus amounts.[6] This disclosure shall include the amount of seed money and other fees and expenses currently included in the separate account, as well as the amount of seed money received and repaid to the general account during the current year. This disclosure shall also include information on insulation (if applicable)[7], the time duration for which seed money and other fees and expenses due the general account are retained in the separate account, and information on how whether seed money is invested pursuant to general account directives or in accordance with stated policies and procedures.

d. Identification of the separate account assets in which the investment directive is not determined by a contractholder. (In most instances, having multiple investment choices at the option of a contractholder would be considered a situation in which the investment directive is determined by a contractholder. This is not true for situations in which the asset is invested in a manner that mirrors the investment directives of the general account.) Situations in which the investment directive is not determined by the contractholder (and situations in which the reporting entity is the contractholder) shall include disclosure regarding whether the investments of the respective separate account assets, if included within the general account investments, would have resulted with the reporting entity exceeding any investment limitations imposed on the general account.

e. Identification of the separate account assets in which less than 100% of investment proceeds are attributed to a contractholder. This shall include identification of the separate account investment income attributed to the reporting entity during the reporting period and whether such income was transferred to the general account or reinvested within the separate account. Instances in which such income is reinvested within the separate account shall include disclosure on whether the

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[6] Additional Required Surplus Amounts is defined as additional or permanent surplus that is required to be retained in the separate account in accordance with state law or regulations. These amounts should not include reinvested separate account investment proceeds that have not been allocated to separate account contract holders.

[7] As seed money is considered a temporary transfer of funds, it is generally not considered insulated.

subsequent investments, if categorized with investments in the general account, would have exceeded investment limitations imposed on the general account.

f. Identification of the assets supporting separate account contracts where the general account provides an inherent or ultimate guarantee, such as with pension risk transfer (PRT) or registered index-linked annuity (RILA) products. These products often do not have stated yield or death benefit guarantees, but the general account serves as a final backstop if the separate account assets are insufficient to support the product obligations or by the general account providing an inherent guarantee, although a distinct performance guarantee is not specified (such as a minimum crediting rate, death benefit, etc.).

~~38.~~40. For all separate account assets not reported at fair value, indicate the measurement basis (amortized cost or other method) for each asset (or asset class) and whether the measurement method ~~was grandfathered in under the transition~~is pursuant to the guidance in this SSAP, or whether the measurement method is allowed under a prescribed or permitted practice. This disclosure shall include a comparison of the assets' reported value to fair value with identification of the resulting unrealized gain/loss that would have been recorded if the assets had been reported at fair value.

41. For all separate accounts that include securities lending transactions, disclose the reporting entity's use and policy of securities lending within the separate account, including the amount of loaned securities from the separate account at the reporting date, the percentage of separate account assets lent as of that date, a description for which type of accounts (e.g., book value accounts, market value account accounts) are lent, if the separate account policyholder is notified or approves of such practices, the policy for requiring collateral, whether the collateral is restricted and the amount of collateral for transactions that extend beyond one year from the reporting date. This disclosure requires the entity to provide the following information as of the date of the statement of financial position: (1) the aggregate amount of contractually obligated open collateral positions (aggregate amount of securities at current fair value or cash received for which the borrower may request the return of on demand) and the aggregate amount of contractually obligated collateral positions under 30-day, 60-day, 90-day, and greater than 90-day terms, (2) the aggregate fair value of all securities acquired from the sale, trade and use of the accepted collateral (reinvested collateral), and (3) information about the sources and uses of that collateral.

42. For all separate accounts that include repurchase/reverse repurchase (repo) agreements, disclose the reporting entity's use and policies of repo agreements within the separate account, including the following: (1) fair value of securities sold or acquired, (2) cash collateral and the fair value of security collateral received or provided, (3) recognized liability or receivable for the return of collateral.

~~39.~~43. Identify all products reported as a separate account product under statutory accounting principles and identify whether each product was classified differently under GAAP. For products that resulted with different classifications between GAAP and SAP, identify the characteristic(s) of the product that prevented it from receiving a separate account classification under GAAP. This disclosure is applicable for all reporting entities. Thus, if GAAP financial statements were not filed, the reporting entity should complete this disclosure as if GAAP financials had been completed.

~~40.~~44. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

~~41.~~45. This statement rejects ASU 2022-05, Transition for Sold Contracts, ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts, and AICPA Statement of Position 03-1, Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts (SOP 03-1). The disclosure elements included within this SSAP are derived from the criteria for separate account reporting under SOP 03-1; however, this SSAP does not restrict separate account reporting pursuant to the criteria established in SOP 03-1.

~~42.~~46. This statement incorporates the requirements of Appendices A-200, A-250, A-255, A-270, A-585, A-588, A-620, A-695, A-812, A-820, A-821, A-822 the Actuarial Standards Board Actuarial Standards of Practice, and the actuarial guidelines found in Appendix C of this Manual.

Effective Date and Transition

~~43.~~47. This statement is effective for years beginning January 1, 2001. Contracts with assets held in a Separate Account that were issued in accordance with applicable state laws and regulations and issued prior to that effective date, for which assets and liabilities have been recorded using a consistent basis since issue, i.e., both assets and liabilities are recorded either as if in the general account ("book value") or as at fair value (current interest rates based on market rates shall be used for liabilities when assets are recorded at fair value), shall continue to be recorded using such basis until such time as the applicable contract terms or provisions are substantially changed, such as by a contract amendment modifying interest rate or withdrawal provisions. State laws and regulations shall be understood to include anything considered authoritative by the domiciliary state under the individual state's statutory authority and due process procedures. Changes that do not require change in the basis of recording would include: address changes, continued deposits, and other non-substantive changes such as these. For example, additional funds received after January 1, 2001 under contracts issued prior to January 1, 2001 may continue to be recorded using the basis in effect prior to January 1, 2001 until such time as a triggering change is made. 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*.

~~44.~~48. Disclosure revisions adopted in September 2009 to paragraphs 30-39 shall initially be reported within the 2010 annual financial statements, with annual reporting thereafter.

REFERENCES

Other

- *NAIC Financial Condition Examiners Handbook*
- *Actuarial Standards Board Actuarial Standards of Practice*

Relevant Issue Papers

- *Issue Paper No. 89—Separate Accounts*
- *Issue Paper No. 110—Life Contracts, Deposit-Type Contracts and Separate Accounts, Amendments to SSAP No. 51—Life Contracts, SSAP No. 52—Deposit-Type Contracts,* and *SSAP No. 56—Separate Accounts*

GLOSSARY

Guarantee represents an insurance company's general account contractual obligation to reimburse life insurance and annuity policyholders for their separate account investment losses including the return of principal, minimum crediting rates, minimum death, withdrawal, accumulation of income benefits and no-lapse guarantees, and for separate account mortality losses.

NAIC Staff Question: From informal discussions with industry reps, NAIC staff do not have the impression that the above definition of a guarantee captures the inherent guarantee when the general account is a backstop to the separate account. Rather, the above definition only captures explicit guarantees, such as a guaranteed yield, death benefit, etc. NAIC staff requests feedback on this interpretation and comments on whether revisions are necessary to ensure consistent interpretation with regulators and reporting entities.

Insulation is the legal protection of separate account assets equal to the reserves and supporting contract liabilities from the general account liabilities of the insurance enterprise ensuring that the separate account contract holder is not subjected to insurer default risk to the extent of their assets held in the separate account.

Risk Charge is the contractual amount the general account charges the separate account policyholders' account for compensation relating to the general account's guarantee on separate account assets or contract performance.

Total Maximum Guarantee is the difference between the total amount of liability the general account is subject to reimbursing as at the balance sheet date and the policyholder's contract value referenced by the guarantee (e.g., account value). For guarantees in the event of death, it is the minimum guaranteed amount available to the contractholder upon death in excess of the contractholder's contract value referenced by the guarantee (e.g., account balance) at the balance sheet date. For guarantees of amounts at annuitization, it is the present value of the minimum guaranteed annuity payments available to the contractholder determined in accordance with the terms of the contract in excess of the contract value referenced by the guarantee (e.g., account balance).

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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.

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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.

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/2024/08-13-24 Summer National Meeting/Hearing/18 - 24-11 - ASU 2023-09 Improvements to Income Tax Disclosures.docx

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Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
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Issue: Updates to SSAP No. 27

Check (applicable entity):

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

Description of Issue: During February 2024, it came to NAIC staffs' attention that *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures* references *Risk and Financial Instruments with Concentrations of Credit Risk* references *FASB Statement No. 105, Disclosure of Information about Financial Instruments with Off-Balance-Sheet* (FAS 105) which was superseded by *FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities* (FAS 133). By accident, FAS 133 did not include any guidance on non-derivative financial instruments with off-balance sheet risk and guidance on this issue had to be re-drafted and added back in during 2001 with *Statement of Position 01-6 Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others* (SOP 01-6) which was then incorporated into FASB codification Topic 825-10 in 2009. 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 in FAS 105 paragraphs 14 and 15.

NAIC staff suggest amending SSAP No. 27 to specifically list financial instruments excluded from the SSAP rather than referencing FAS 105, which is significantly out of date as it was superseded by FAS 133 prior to the creation of the Accounting Standards Codification which in turn superseded FAS 133. The only change made to these exclusions from FAS 105 was that financial instruments denominated in foreign currency would now be within scope of SSAP No. 27 as there did not appear to be a compelling reason for this exclusion from off-balance sheet risk reporting as financial instruments in foreign currency were not excluded from the scope of SOP 01-6. Staff also suggests updating the annual statement instructions to add an "Other" derivatives category and disclosure examples and instructions for non-derivative financial instruments with off-balance sheet credit risks.

Existing Authoritative Literature:
SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments, paragraph 18b, requires concentration risk disclosures in accordance with SSAP No. 27.

SSAP No. 26R—Bonds, paragraph 30b, requires concentration risk disclosures in accordance with SSAP No. 27.

SSAP No. 86R—Derivatives, paragraph 30b, note that derivatives meet the definition of financial instrument under SSAP No. 27, meaning that disclosures for off-balance sheet and concentration of credit risk are required for all derivatives.

SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, glossary, defines a Derivative Financial Instruments as "A derivative instrument (as defined in SSAP No. 86—Derivatives) that is a financial instrument (refer to SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures, paragraph 2)."

SSAP No. 105R—Working Capital Finance Investments, paragraph 30b, requires concentration risk disclosures in accordance with SSAP No. 27.

SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures Risk and Financial Instruments with Concentrations of Credit Risk:

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for disclosure of information about financial instruments with off-balance-sheet risk and financial instruments with concentration of credit risk.

SUMMARY CONCLUSION

2. A financial instrument shall be defined as cash, evidence of an ownership interest in an entity, or a contract that both:

   a. Imposes on one entity a contractual obligation (i) to deliver cash or another financial instrument to a second entity or (ii) to exchange other financial instruments on potentially unfavorable terms with the second entity; and

   b. Conveys to that second entity a contractual right (i) to receive cash or another financial instrument from the first entity or (ii) to exchange other financial instruments on potentially favorable terms with the first entity.

3. Examples of the financial instruments, which encompass both assets and liabilities recognized and not recognized in the financial statement, to which this statement applies include, but are not limited to, short-term investments, bonds, common stocks, preferred stocks, mortgage loans, derivatives[1], financial guarantees written, standby letters of credit, notes payable and deposit-type contracts.

Disclosure of Extent, Nature, and Terms of Financial Instruments with Off-Balance-Sheet Risk

4. For financial instruments[1] with off-balance-sheet risk, except as noted in paragraphs 14 and 15 of *FASB Statement No. 105, Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk* (FAS 105), a reporting entity shall disclose in the financial statements the following information by class of financial instrument:

   a. The face or contract amount (or notional principal amount if there is no face or contract amount); and

   b. The nature and terms including, at a minimum, a discussion of (i) the credit and market risk of those instruments, (ii) the cash requirements of those instruments, and (iii) the related accounting policy pursuant to the requirements of *APB Opinion No. 22, Disclosure of Accounting Policies*.

5. Additional disclosures related to derivatives and embedded credit derivatives are addressed in *SSAP No. 86—Derivatives*.

Disclosure of Credit Risk of Financial Instruments with Off-Balance-Sheet Credit Risk

6. For financial instruments[1] with off-balance-sheet credit risk, except as noted in paragraphs 14 and 15 of FAS 105, an entity shall disclose in the financial statements the following information by class of financial instrument:

   a. The amount of accounting loss the entity would incur if any party to the financial instrument failed completely to perform according to the terms of the contract and the collateral or other security, if any, for the amount due proved to be of no value to the entity; and

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[1] The financial instruments captured within this statement shall include financial instruments that contain embedded derivatives that are not separately recognized as financial instruments with derivatives under SSAP No. 86, and that expose the holder to the possibility (however remote) of making future payments.

b. The entity's policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the entity's access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments.

Disclosure of Concentrations of Credit Risk of All Financial Instruments

7. Except as noted in paragraph 14 of FAS 105, a reporting entity shall disclose all significant concentrations of credit risk arising from all financial instruments[1] whether from an individual or group. Group concentrations of credit risk exist if a number of individuals or groups are engaged in similar activities and have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. The following shall be disclosed in the financial statements about each significant concentration:

a. Information about the (shared) activity, region, or economic characteristic that identifies the concentration;

b. The amount of the accounting loss due to credit risk the entity would incur if parties to the financial instruments that make up the concentration failed completely to perform according to the terms of the contracts and the collateral or other security, if any, for the amount due proved to be of no value to the entity; and

c. The entity's policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the entity's access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments.

Annual and Quarterly Disclosure Requirements

8. Refer to the Preamble for further information regarding disclosure requirements. The disclosures in paragraph 7 shall be included in the annual audited statutory financial reports only.

Relevant Literature

9. This statement adopts the provisions of FAS 105 with the following modifications:

a. The disclosures required in paragraph 17 of FAS 105 shall distinguish between derivatives entered into for hedging purposes and for other-than-hedging purposes.

b. Paragraph 19 of FAS 105 is rejected. It addresses voluntary disclosures not required by this statement.

Effective Date and Transition

10. This statement is effective for years beginning January 1, 2001.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 27—Disclosure of Information about Financial Instruments with Concentration of Credit Risk*
- *Issue Paper No. 33—Disclosures about Fair Value of Financial Instruments*
- *Issue Paper No. 85—Derivative Instruments (as it relates to disclosure about financial instruments with off-balance-sheet risk)*

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 SSAP No. 27 and the Annual Statement Instructions.

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 *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures Risk and Financial Instruments with Concentrations of Credit Risk* which would remove references to FAS 105 and instead specify the assets excluded from SSAP No. 27. Additionally, revisions were exposed to the Annual Statement Instructions for Note 16 to add an "other" category to the derivatives tabular disclosure, add a non-derivative financial instrument disclosure and additional narrative disclosure examples for non-derivative financial instruments.

Proposed Revisions to SSAP No. 27:

SCOPE OF STATEMENT
1. This statement establishes statutory accounting principles for disclosure of information about financial instruments with off-balance-sheet risk and financial instruments with concentration of credit risk.

SUMMARY CONCLUSION
2. A financial instrument shall be defined as cash, evidence of an ownership interest in an entity, or a contract that both:

a. Imposes on one entity a contractual obligation (i) to deliver cash or another financial instrument to a second entity or (ii) to exchange other financial instruments on potentially unfavorable terms with the second entity; and

b. Conveys to that second entity a contractual right (i) to receive cash or another financial instrument from the first entity or (ii) to exchange other financial instruments on potentially favorable terms with the first entity.

3. Examples of the financial instruments, which encompass both assets and liabilities recognized and not recognized in the financial statement, to which this statement applies include, but are not limited to, short-term investments, bonds, common stocks, preferred stocks, mortgage loans, derivatives[fn], financial guarantees written, standby letters of credit, notes payable and deposit-type contracts.

4. The following types of financial instruments are not within the scope of this statement:

a. Insurance contracts, not held as an investment.

b. Unconditional purchase obligations.

c. Obligations and financial instruments within the scope of *SSAP No. 92—Postretirement Benefits Other Than Pensions* and *SSAP No. 102—Pensions*.

d. Substantively extinguished liabilities as defined within *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

e. Leases as defined within *SSAP No. 22R—Leases.*

Disclosure of Extent, Nature, and Terms of Financial Instruments with Off-Balance-Sheet Risk

4.5. For financial instruments with off-balance-sheet risk, except as noted in paragraphs 14 and 15 of *FASB Statement No. 105, Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk* (FAS 105), a the reporting entity shall disclose in the financial statements the following information by class of financial instrument:

a. The face or contract amount (or notional principal amount if there is no face or contract amount); and

b. The nature and terms including, at a minimum, a discussion of (i) the credit and market risk of those instruments, (ii) the cash requirements of those instruments, and (iii) the related accounting policy pursuant to the requirements of *APB Opinion No. 22, Disclosure of Accounting Policies**SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures*.

5.6. Additional disclosures related to derivatives and embedded credit derivatives are addressed in *SSAP No. 86—Derivatives*.

Disclosure of Credit Risk of Financial Instruments with Off-Balance-Sheet Credit Risk

6.7. For financial instruments[fn] with off-balance-sheet credit risk, the, except as noted in paragraphs 14 and 15 of FAS 105, an reporting entity shall disclose in the financial statements the following information by class of financial instrument:

a. The amount of accounting loss the entity would incur if any party to the financial instrument failed completely to perform according to the terms of the contract and the collateral or other security, if any, for the amount due proved to be of no value to the entity; and

b. The entity's policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the entity's access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments.

Disclosure of Concentrations of Credit Risk of All Financial Instruments

7.8. TheExcept as noted in paragraph 14 of FAS 105, a reporting entity shall disclose all significant concentrations of credit risk arising from all financial instruments whether from an individual or group. Group concentrations of credit risk exist if a number of individuals or groups are engaged in similar activities and have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. The following shall be disclosed in the financial statements about each significant concentration:

a. Information about the (shared) activity, region, or economic characteristic that identifies the concentration;

b. The amount of the accounting loss due to credit risk the entity would incur if parties to the financial instruments that make up the concentration failed completely to perform according to the terms of the contracts and the collateral or other security, if any, for the amount due proved to be of no value to the entity; and

c. The entity's policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the entity's access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments.

Annual and Quarterly Disclosure Requirements

~~8.~~9. Refer to the Preamble for further information regarding disclosure requirements. The disclosures in paragraph ~~7~~ 8 shall be included in the annual audited statutory financial reports only.

Relevant Literature

~~9.~~10. This statement adopts the provisions of FAS 105 with the following modifications:

a. The disclosures required in paragraph 17 of FAS 105 shall distinguish between derivatives entered into for hedging purposes and for other-than-hedging purposes.

b. Paragraph 19 of FAS 105 is rejected. It addresses voluntary disclosures not required by this statement.

Effective Date and Transition

~~10.~~11. This statement is effective for years beginning January 1, 2001.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 27—Disclosure of Information about Financial Instruments with Concentration of Credit Risk*
- *Issue Paper No. 33—Disclosures about Fair Value of Financial Instruments*
- *Issue Paper No. 85—Derivative Instruments (as it relates to disclosure about financial instruments with off-balance-sheet risk)*

Proposed Revisions to Annual Statement Instructions:

16. Information About Financial Instruments With Off-Balance-Sheet Risk And Financial Instruments With Concentrations of Credit Risk

Refer to *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures* for accounting guidance.

Instruction:

For financial instruments with off-balance-sheet risk, a reporting entity shall disclose in the financial statements the following information by class of financial instrument:

(1) The face or contract amount (or notional principal amount if there is no face or contract amount).

(2) The nature and terms, including, at a minimum, a discussion of (i) the credit and market risk of those instruments, (ii) the cash requirements of those instruments, and (iii) the related accounting policy pursuant to the requirements of *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures*~~APB Opinion No. 22, Disclosure of Accounting Policies~~.

(3) The amount of accounting loss the entity would incur if any party to the financial instrument failed completely to perform according to the terms of the contract and the collateral or other security, if any, for the amount due proved to be of no value to the entity.

(4) The entity's policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the entity's access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments.

Illustration:

THIS EXACT FORMAT MUST BE USED IN THE PREPARATION OF THIS NOTE FOR THE TABLE BELOW. REPORTING ENTITIES ARE NOT PRECLUDED FROM PROVIDING CLARIFYING DISCLOSURE BEFORE OR AFTER THIS ILLUSTRATION.

(NOTE: THIS DOES NOT INCLUDE THE ENDING NARRATIVE.)

(1) The table below summarizes the face amount of the Company's financial instruments with off-balance-sheet risk.

	Assets		Liabilities	
	20___	20___	20___	20___
Derivatives Contracts:				
a. Swaps	$ _______	$ _______	$ _______	$ _______
b. Futures	$ _______	$ _______	$ _______	$ _______
c. Options	$ _______	$ _______	$ _______	$ _______
d. Other	$ _______	$ _______	$ _______	$ _______
de. Total (a+b+c+d)	$ _______	$ _______	$ _______	$ _______
Other Financial Instruments:				
a. Loan Commitments	$ _______	$ _______	$ _______	$ _______
b. Standby Letters of Credit	$ _______	$ _______	$ _______	$ _______
c. Financial Guarantees	$ _______	$ _______	$ _______	$ _______
d. Other	$ _______	$ _______	$ _______	$ _______
e. Total (a+b+c+d)	$ _______	$ _______	$ _______	$ _______

See Schedule DB of the Company's annual statement for additional detail on derivative contracts.

(2) The Company uses interest rate swaps to reduce market risks from changes in interest rates and to alter interest rate exposures arising from mismatches between assets and liabilities. Under interest rate swaps, the Company agrees with other parties to exchange, at specified intervals, the difference between fixed-rate and floating-rate interest amounts calculated by reference to an agreed notional principal amount. Generally, no cash is exchanged at the outset of the contract and either party makes no principal payments. These transactions are entered into pursuant to master agreements that provide for a single net payment to be made by one counterparty at each due date.

Under exchange-traded currency futures and options, the Company agrees to purchase a specified number of contracts with other parties and to post variation margin on a daily basis in an amount equal to the difference in the daily fair values of those contracts. The parties with whom the Company enters into exchange-traded futures and options are regulated futures commissions merchants who are members of a trading exchange.

(3) The Company is exposed to credit-related losses in the event of nonperformance by counterparties to financial instruments, but it does not expect any counterparties to fail to meet their obligations given their high credit ratings. The credit exposure of interest rate swaps and currency swaps is represented by the fair value (market value) of contracts with a positive fair value (market value) at the reporting date. Because exchange-traded futures and options are affected through a regulated exchange and positions are marked to market on a daily basis, the Company has little exposure to credit-related losses in the event of nonperformance by counterparties to such financial instruments.

(4) The Company is required to put up collateral for any futures contracts that are entered. The amount of collateral that is required is determined by the exchange on which it is traded. The Company currently puts up cash and U.S. Treasury Bonds to satisfy this collateral requirement.

The current credit exposure of the Company's derivative contracts is limited to the fair value at the reporting date. Credit risk is managed by entering into transactions with creditworthy counterparties and obtaining collateral where appropriate and customary. The Company also attempts to minimize its exposure to credit risk through the use of various credit monitoring techniques. Approximately _____% of the net credit exposure for the Company from derivative contracts is with investment-grade counterparties.

(5) The Company's credit exposure related to outstanding derivatives contracts reported in "Other" consist of Treasury Lock and Forward contracts of $____ and $____, respectively.

(6) The Company's non-derivative off-balance sheet exposures consist of loan commitments, standby letters of credits, and financial guarantees and in accordance with Statutory Accounting Principles are not recorded on the Company's balance sheet. The amounts shown do not necessarily reflect actual future settlement value but rather the maximum liability the Company may incur from these contracts. The amounts shown for loan commitments and letters of credit represent the total credit available to be drawn upon with these instruments. The amounts shown for financial guarantees represent the Company's guarantee to pay the balance of the Affiliate's note payable due to an unrelated shareholder. The Company does not anticipate any material losses from its off-balance sheet arrangements.

(7) Approximately ____% of the Company's all premium receivables are due from policyholders which reside in the state of Missouri. The Company is in good standing with the Missouri Department of Insurance and is not aware of any circumstances which would impair its ability to continue operating within the state of Missouri. Approximately, ___% of mortgage loan assets, totaling $___, are due from a single borrower which operates in the biomedical industry within the state of Kansas. Were there to be a downturn within this economic space and the borrower becomes delinquent, the Company would have the ability to seize collateral of $___. The borrower is current on its mortgage payments and the Company is not aware of any circumstances which would indicate the borrower will be unable to meet its debt service obligations.

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Statutory Accounting Principles (E) Working Group
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Issue: Review of INT 03-02*: Modification to an Existing Intercompany Pooling Arrangement*

Check (applicable entity):

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

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

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

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

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

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

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

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

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

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

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

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

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

Existing Authoritative Literature:

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

> 8. Therefore, based on the foregoing guidance and background, the statutory accounting intent is to avoid surplus gains for the ceding entity as a result of implementing a modification to an intercompany pooling arrangement. On that basis, such a modification does not represent an economic transaction to the insurance group or to the impacted companies. As such, the transfer of both the assets and the liabilities valued at statutory book value ensures that there is no impact to surplus as a result of implementing a modification to an existing pooling arrangement.

11. The accounting issues are:

    a. What is the relevant guidance for modifications to intercompany pooling arrangements?

    b. What is the appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement?

The Working Group reached a consensus as follows:

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

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

SSAP No. 25—Affiliates and Other Related Parties

Transactions Involving the Exchange of Assets or Liabilities

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

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

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

a. Whether the seller has a continuing involvement in the transaction or in the financial interest transferred, such as through the exercise of managerial authority to a degree usually associated with ownership;

b. Whether there is an absence of significant financial investment by the buyer in the financial interest transferred, as evidenced, for example, by a token down payment or by a concurrent loan to the buyer;

c. Whether repayment of debt that constitutes the principal consideration in the transaction is dependent on the generation of sufficient funds from the asset transferred;

d. Whether limitations or restrictions exist on the buyer's use of the financial interest transferred or on the profits arising from it;

e. Whether there is retention of effective control of the financial interest by the seller.

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

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

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

a. Economic transactions between related parties shall be recorded at fair value at the date of the transaction. To the extent that the related parties are affiliates under common control, the controlling reporting entity shall defer the effects of such transactions that result in gains or increases in surplus (see paragraph 16);

b. Non-economic transactions between reporting entities, which meet the definition of related parties above, shall be recorded at the lower of existing book values or fair values at the date of the transaction;

c. Non-economic transactions between a reporting entity and an entity that has no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, shall be recorded at the fair value at

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

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

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

Transactions Involving Services

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

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

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

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

a. Structured settlement annuities for individual claims purchased to implement settlements of policy obligations;

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

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

c. The termination of, or reduction in participation in, reinsurance treaties entered into in the ordinary course of business;

d. Intercompany reinsurance agreements, and any amendments thereto, among companies 100% owned by a common parent or ultimate controlling person provided there is no gain in surplus as a result of the transaction; or

e. Reinsurance/retrocession agreements that meet the criteria of property/casualty run-off agreements described in paragraphs 102-105.

37. **Retroactive reinsurance agreements resulting in surplus gain to the ceding entity (with or without risk transfer)** entered into between affiliates or between insurers under common control (as those terms are defined in Appendix A-440) shall be reported as follows:

a. The consideration paid by the ceding entity shall be recorded as a deposit and reported as a nonadmitted asset; and

b. No deduction shall be made from loss and loss adjustment expense reserves on the ceding entity's balance sheet, schedules, and exhibits.

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

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

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

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

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

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

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

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

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

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

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

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

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

On December 13, 2022, the Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and re-exposed the intent to nullify INT 03-02. This re-exposure requested industry to provide comments on specific instances in which the interpretation was being applied. In addition, the following key points were noted for consideration during the exposure in response to some of the comments received.

1. In the current interest rate environment, the fair value of many bonds is below book value. For example, a bond with an amortized cost of 100 with a fair value of 85. The way INT 03-02 is written a bond with a fair value of 85 could be used to settle an intercompany reinsurance pooling obligation of 100. If the reporting entity paid with cash, they would be required to pay $100. The actual cash value of obligations when they are extinguished is a relevant measure of the transaction.

2. Using book value for measurement of payments between affiliates can result in either unrecognized or in effect dividend or losses. SSAP No. 25 requires such transfers of assets between affiliates to use fair value. If a subsidiary can pay the parent with assets that have a lower fair value than book value (ex, owes $100 but pays with a bond of 85), this has a similar effect as an unrecognized capital contribution to the subsidiary. SSAP No. 72 requires a capital contribution to be valued using fair value.

3. At the ultimate parent level such transfer of assets (in accordance with SSAP No. 25 guidance) may be noneconomic in that the parent continues to hold an interest in the same assets. Therefore, at the parent level, such transfers of assets may result in the deferral of gains. Staff believes that losses would not be deferred at the ultimate parent level.

4. While it may be more expedient to pay intercompany reinsurance pooling transactions with assets, the valuation used should be similar to if the obligation was extinguished with cash. Therefore, an entity can still choose to pay with assets, they just need to be valued consistently with SSAP No. 25 guidance.

5. SSAP No. 62R, paragraph 36d provides an exception to retroactive reinsurance accounting guidance which allows for prospective accounting treatment for intercompany reinsurance among 100% owned affiliated provided there is no gain to the ceding entity. If there is again to the ceding entity, there is guidance in SSAP No. 62R, paragraph 37 which requires a more punitive method of accounting than either prospective or retroactive reinsurance accounting. Therefore, NAIC staff comment is that the statutory accounting objective is to provide different treatment for retroactive reinsurance contracts if there is a gain to the ceding entity. This is another reason that the guidance in INT 03-02 is problematic. The object is to correctly measure the effects of the contract, which drives the accounting. The objective is not to obscure whether there is a gain to the ceding entity, which can happen in the event that the assets used in payment are not measured correctly.

6. Interested parties noted that modifications to intercompany pooling arrangements are typically effective retroactive to the beginning of the year. Staff notes that the payment value when the transaction is settled should be equivalent to the cash value of what is owed on the date of extinguishment of the liability.

7. Many of the interested parties' comments regarding GAAP use of book value are more relevant to consolidated basis accounting which is not consistent with the legal entity basis of statutory accounting.

8. Interested parties' comments noted that there is a difference in treatment for intercompany pooling participants who are not 100% owned by a common parent. NAIC staff notes that retroactive pooling agreement changes with participants that are not 100% under common control do not meet the exception to retroactive accounting provided in SSAP No. 62R, paragraph 36d. NAIC staff notes that SSAP No. 62R, paragraph 37 provides guidance for retroactive reinsurance agreements among affiliates where there is a gain to the ceding entity. Therefore, the regulatory objective is not to avoid gain but to properly account for intercompany retroactive contracts that include gains.

On March 22, 2023, the Working Group re-exposed the intent to nullify INT 03-02, effective December 31, 2023. The nullification is proposed as INT 03-02 is inconsistent with SSAP No. 25 guidance regarding economic and non-economic transactions between related parties. The guidance in INT 03-02 can result with, in essence, unrecognized gains (dividends) or losses through the using the statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements. Treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group re-exposed the intent to nullify INT 03-02 and directed NAIC staff to work with industry regarding some of their comments and examples to be submitted by industry.

On December 1, 2023, the Statutory Accounting Principles (E) Working Group deferred action on this agenda item and directed NAIC staff to continue working with interested parties on the proposal.

On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed its intent to nullify INT 03-02, and exposed revisions to *SSAP No. 25—Affiliates and Other Related Parties* and *SSAP No. 63—Underwriting Pools* to address transfers of assets when modifying intercompany pooling agreements. The exposed revisions were based on interested parties' comments with minor edits proposed by NAIC staff.

Exposed Revisions to SSAP No. 25 and SSAP No. 63 are illustrated below.

SSAP No. 25—Affiliates and Other Related Parties

4. If a company transfers assets or liabilities to effectuate a modification to an existing intercompany pooling arrangement, the transaction, including the transfer of assets, shall be accounted for and valued in accordance with the guidance in *SSAP No. 63—Underwriting Pools.* The guidance in SSAP No. 63 regarding the transfers of assets or liabilities to effectuate a modification of an intercompany pooling arrangements shall not be applied or analogized to other transactions involving transfers of assets and liabilities.

SSAP No. 63—Underwriting Pools *(only impacted paragraph are reflected.)*

1. This statement establishes statutory accounting principles for underwriting pools and associations, including intercompany pooling arrangements.

8. Insurance groups that utilize intercompany pooling arrangements often modify these arrangements from time to time for various business reasons. These business reasons commonly include mergers, acquisitions, dispositions, or a restructuring of the group's legal entity structure. In order to effectuate a relatively simple modification, such as changing pooling participation percentages without changing the pool participants, companies often simply amend the existing pooling agreement. Alternatively, in order to effectuate a more complex modification, such as changing (by adding or removing) the number of pool participants, a company may commute the existing pooling agreement and execute a new pooling agreement(s). In conjunction with executing the appropriate intercompany pooling agreements, a transfer of assets and liabilities amongst the impacted affiliates may also be required in order to implement the new pooling agreement(s). The following subparagraphs provide guidance specific to modifications of intercompany pooling arrangements and shall not be applied to an analogous transaction or event.

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

b. The net amount of the assets and liabilities being moved among entities as a result of a modification to an intercompany pooling shall be used to settle the intercompany payable/receivable (i.e., the assets that are transferred in conjunction with the modification) to minimize the amount of assets transferred in the modification.

12. Note that other applicable reinsurance guidance from *SSAP No. 61R—Life, Deposit Type and Accident and Health Reinsurance* or *SSAP No. 62R—Property and Casualty Reinsurance*, depending on the type of business, applies to intercompany pooling arrangements and voluntary and involuntary pools. This includes the SSAP No. 62R guidance in paragraphs 33 through 39 regarding retroactive reinsurance.

New disclosure in paragraph 13

13.i For modifications to an existing intercompany pooling arrangement that involve the transfer of assets with fair values that differ from cost or amortized cost, the statement value and fair value of assets received or transferred by the reporting entity.

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Interpretation of the Emerging Accounting Issues (E) Working Group

INT 03-02: Modification to an Existing Intercompany Pooling Arrangement

NOTE: The Statutory Accounting Principles (E) Working Group has exposed the intent to nullify this interpretation.

INT 03-02 Dates Discussed

March 9, 2003; June 22, 2003; August 10, 2022; December 13, 2022; March 22, 2023; August 13, 2023; December 1, 2023; March 16, 2024

INT 03-02 References

Current:
SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance
SSAP No. 62R—Property and Casualty Reinsurance
SSAP No. 63—Underwriting Pools

INT 03-02 Issue

1. Insurance groups that utilize intercompany pooling arrangements often modify these arrangements from time to time for various business reasons. These business reasons commonly include mergers, acquisitions, dispositions or a restructuring of the group's legal entity structure. As an insurance group's business objectives and strategies evolve, it may be necessary for the insurance group's legal entity structure to similarly evolve in order to address the insurance group's business needs.

2. SSAP No. 63, paragraphs 5 and 7, defines and describes intercompany pooling as an arrangement among affiliated entities whereby "all of the pooled business is ceded to the lead entity and then retroceded back to the pool participants in accordance with their stipulated shares." This arrangement is established through "a conventional quota share reinsurance agreement…" Arrangements whereby there is one lead company that retains 100% of the pooled business and all or some of the affiliated companies have a 0% net share of the pool may qualify as intercompany pooling."

3. Therefore, in order to effectuate a modification to the existing intercompany pooling arrangement, companies must either 1) amend the existing reinsurance agreement, or 2) execute new agreements. The latter scenario may entail executing at least two agreements: a commutation of the existing agreement, and a new quota share agreement(s) that covers both past and future periods.

4. To illustrate, in order to effectuate a relatively simple modification, such as changing pooling participation percentages without changing the pool participants, companies often simply amend the existing pooling agreement. Alternatively, in order to effectuate a more complex modification, such as changing (by adding or removing) the number of pool participants, a company must commute the existing pooling agreement and execute a new quota share agreement(s). In conjunction with executing the appropriate reinsurance agreements, a transfer of assets and liabilities amongst the impacted affiliates is also required in order to implement the new reinsurance agreement(s). At issue is the appropriate valuation basis to be used for assets and liabilities that are transferred pursuant to the new reinsurance agreement(s).

5. Since SSAP No. 63 does not specifically address modifications to intercompany pooling arrangements, insurance groups that modify their intercompany pooling arrangements must refer elsewhere in Statutory Accounting Principles (SAP) for relevant guidance. The obvious guidance for such transactions is SSAP No. 62R since an intercompany pooling arrangement is, by definition, affiliated

reinsurance. There is, however, a minority opinion that *SSAP No. 25—Affiliates and Other Related Parties* appears to apply due to the affiliated nature of these transactions. Since the guidance and intent of SSAP No. 62R and SSAP No. 25 provide for different valuation bases, this interpretation serves to provide definitive guidance as to which SSAP is relevant for these transactions and, therefore, clarify the appropriate valuation basis to be used for assets and liabilities transferred pursuant to a modification to an intercompany pooling arrangement.

SSAP No. 62R Approach:

6. This approach refers to the guidance and statutory accounting intent from SSAP No. 62R since intercompany pooling arrangements are defined and established through reinsurance. Further, since modifications to intercompany pooling agreements typically involve the transfer of net liabilities incurred since the inception of the existing pooling agreement (i.e., prior to the effective date of the new agreement), the retroactive reinsurance accounting guidance in paragraphs 33-39 of SSAP No. 62R is applicable. Paragraph 33 states that this special accounting treatment is warranted "due to the potential abuses involving the creation of surplus to policyholders and the distortion of underwriting results…" However, paragraph 36.d. specifically applies to intercompany reinsurance arrangements, and amendments to intercompany reinsurance agreements, since the reinsurance agreement is among companies 100% owned by a common parent. This paragraph allows prospective accounting treatment for intercompany reinsurance agreements that do not result in a gain in surplus as a result of the transaction.

7. To provide historical perspective, prior to the adoption (with modification) of FASB *Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* (FAS 113) as SAP, paragraph 36.d. was added as one of the SAP modifications. The intent of adding paragraph 36.d. was to specifically exclude intercompany reinsurance agreements among entities 100% owned by a common parent from retroactive reinsurance accounting requirements as a result of amending or modifying these agreements, provided there is no surplus gain. The presumption in this intent was that there would be no gains to the ceding entity resulting from implementing amendments or modifications to these types of reinsurance agreements.

8. Therefore, based on the foregoing guidance and background, the statutory accounting intent is to avoid surplus gains for the ceding entity as a result of implementing a modification to an intercompany pooling arrangement. On that basis, such a modification does not represent an economic transaction to the insurance group or to the impacted companies. As such, the transfer of both the assets and the liabilities valued at statutory book value ensures that there is no impact to surplus as a result of implementing a modification to an existing pooling arrangement.

SSAP No. 25 Approach:

9. An approach different from that which refers to reinsurance accounting guidance is to refer to the guidance in SSAP No. 25 since some may view a modification to an intercompany pooling agreement as a related party transaction involving the exchange of assets or liabilities. In this case, paragraphs 14-18 of SSAP No. 25 would appear applicable. This guidance specifies differing valuation bases, depending on whether the transaction is considered an economic or a non-economic transaction. SSAP No. 25, paragraph 14, states that "…The appearance of permanence is also an important criterion is assessing the economic substance of a transaction. In order for a transaction to have economic substance and thus warrant revenue (loss) recognition, it must appear unlikely to be reversed …" Since insurance groups often modify intercompany pooling arrangements, this type of transaction is not permanent, and may be construed as a non-economic transaction. SSAP No. 25, paragraph 18.b., states that "non-economic transactions … shall be recorded at the lower of existing book value or fair value at the date of the transaction."

10. It appears that this guidance is intended to address matters involving discrete or isolated transfers of assets and/or liabilities between affiliates rather than transfers of assets and liabilities effected in relation to executing reinsurance transactions (the guidance for which is SSAP No. 62R). Additionally, application of this guidance would result in a change to the surplus of the insurance group as a result of implementing a modification to an existing intercompany pooling arrangement. As previously stated, the statutory accounting intent is to avoid surplus gains for the insurance group as a result of implementing a modification to an intercompany pooling arrangement.

11. The accounting issues are:

a. What is the relevant guidance for modifications to intercompany pooling arrangements?

b. What is the appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement?

INT 03-02 Discussion

The Working Group reached a consensus as follows:

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

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

INT 03-02 Status

14. No further discussion is planned.

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

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April 17, 2024

Dale Bruggeman
Chair, NAIC Statutory Accounting Principles (E) Working Group (SAPWG)

Re: SAPWG 2024-04 (Conforming Repurchase Agreements)

Dear Chair Bruggeman:

The American Council of Life Insurers (ACLI) appreciates the opportunity to respond to SAPWG's March 16th exposure of its report on conforming repurchase agreements (repo). The exposure requests that industry address three issues:

1. Inconsistent reporting of reinvested asset detail between conforming securities lending and conforming repo

2. While the RBC Instructions provide guidance on the criteria to establish conforming securities lending and repo programs, similar guidance should be provided in the Annual Instructions

3. Regulators are unsure about whether the limitations on "acceptable collateral" apply to:
   a. Securities being lent by the insurer
   b. Cash or cash equivalents received by the insurer
   c. Assets within the reinvestment pool
   d. Some combination of the 3 categories above

Below are ACLI's responses to each of these three issues.

Reinvested Asset Detail

NAIC staff are correct in pointing out that, while reinvested assets for conforming securities lending programs are listed CUSIP-by-CUSIP in Schedule DL, ACLI is not proposing a similarly detailed

The American Council of Life Insurers is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI's member companies are dedicated to protecting consumers' financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI's 275 member companies represent 93 percent of industry assets in the United States.
acli.com

asset listing for conforming repo programs. Instead, ACLI believes that the following disclosures should provide regulators sufficient comfort in the integrity of the reinvested assets:

1. Reinvested assets must conform to the Investment Guidelines established within the conforming repo program

2. Reinvestment assets must be dedicated and sufficient to satisfy a potential run-off of the repo liability. As a demonstration, both the book value and fair (market) value of the reinvested assets for conforming repo programs are reported in Footnote 5F(10) of Quarterly/Annual Statements. A full listing of the nine Footnotes related to conforming repo programs is listed as Appendix 1.

ACLI believes that these disclosures provide regulators with a more fulsome overview of the integrity of reinvested assets than a simple CUSIP-by-CUSIP asset listing.

Annual Statement Instructions

In the 2024-04 exposure, NAIC staff proposes that guidelines for conforming securities lending and conforming repo programs should appear in the Annual Statement Instructions as well as the RBC Instructions. In Appendix 2, ACLI proposes expanded Annual Statement Instructions incorporating guidelines for conforming securities lending and conforming repurchase agreement programs.

Scope of "Acceptable Collateral"

It can often be difficult to define the scope of the word "collateral." ACLI would like to clarify that the restrictive limitations on "acceptable collateral" apply ***only*** to the collateral received by an insurer when the insurer posts securities to the counterparty. "Acceptable collateral" limitations should ***not*** be applied to either securities lent or to assets in the reinvestment pool:

1. Securities lent are subject to restrictions in the binding written legal agreement between borrower and insurer
2. Assets in the reinvestment pool or portfolio are subject to restrictions in the Investment Guidelines

Securities lent, as well as assets in the reinvest pool, typically have a broader range of asset types than cash within "acceptable collateral." It should not be surprising, therefore, that assets in conforming securities lending reinvestment portfolios can fall outside the restrictive asset classes within "acceptable collateral."

Thank you once again for the consideration of our comments and we look forward to further discussion on this topic at a future meeting of SAPWG.

Sincerely,

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

APPENDIX 1

5F(3) shows the bands of maturity for the repo liability itself – both maximums and "as of" for each quarter within each band
5F (4) discloses if any securities involved were in default
5F(5) shows the FV of the securities that are out on repo- both maximums and "as of" for each quarter. Only at YE do we need to disclose the book values (hence "XXX" in the quarters)
5F (6) shows FV and BV of securities out on repo by NAIC rating by asset class as of the current quarter end
5F (7) shows the value of the "collateral" received by type (cash vs securities) both "as of" and maximum for each quarter
5F (8) shows the bv/fv of the collateral received by type and NAIC rating as of the current quarter end
5F (9) shows the FV of the securities on loan +free collateral securities by remaining maturity.
5F (10) shows the BV (amortized cost) and FV of the Reinvested collateral by remaining contractual maturity as of the current quarter
5F (11) in aggregate displays the maximum liability and as of liability

APPENDIX 2

From the Official NAIC Annual Statement Instructions, insertion of conforming repurchase agreement program and subsequent reordering would be applied to the relevant portion of the General Interrogatories, Investment section, beginning on page 322.

25.04 *For the reporting entity's securities lending program*, report amount for collateral for confirming program as outlined in the Risk-Based Instructions.

25.05 *For the reporting entity's securities lending program*, report amount of collateral for other programs.

25.06 For the reporting entity's repurchase agreement program, report amount of collateral for conforming programs as outlined in the footnote 5 F (7). Repurchase Agreements Transactions Accounted for as Secured Borrowing.

25.07 For the reporting entity's repurchase agreement program, report amount of overcollateralization for conforming programs, as the difference between footnote 5 F (5) and 5 F (7), Repurchase Agreements Transactions Accounted for as Secured Borrowing.

25.08 For the reporting entity's repurchase agreement program, report amount of collateral for other programs.

May 30, 2024

Dale Bruggeman
Chair, Statutory Accounting Principles (E) Working Group
National Association of Insurance Commissioners

Re: Exposure 2024-06; Risk Transfer Analysis on Combination Reinsurance Contracts

Dear Mr. Bruggeman:

Thank you for the opportunity to provide comments to the NAIC's Statutory Accounting Practices Working Group regarding Exposure 2024-06. Please note that my comments only reflect my own opinion and not necessarily those of my past or present employer or of any professional organization.

Regarding Exposure 2024-06, I agree that a reinsurance agreement that is comprised of interdependent reinsurance arrangements (such as coinsurance and YRT) needs to be evaluated as a single agreement to determine risk transfer compliance. One of the primary intentions of Appendix A-791 of the Accounting Practices and Procedures Manual is to require, in order to qualify for reinsurance credit, that there generally not be a possibility that a ceding company's surplus could be adversely impacted by the performance of the ceded business. If a coinsurance agreement on its own would comply with Appendix A-791, but the reinsurance agreement it is part of **obligates** the ceding company to cede business under a YRT reinsurance arrangement, then that obligation needs to be considered in evaluating compliance with Appendix A-791.

In the drafting of the Life and Health Reinsurance Agreements Model Regulation and Appendix A-791, insurance regulators were primarily concerned about reinsurance agreements that provided surplus relief to the ceding company. These teams of insurance regulators believed that surplus relief should not be recognized if it was not permanent, thus the idea that the ceding company's surplus should not be adversely impacted at any future time by the ceded business. This includes the payment of any risk charge, which can only be paid from the income of the ceded policies and not from the surplus of the ceding company.

The Summary of Exposure 2024-06 frequently mentions experience refunds. The existence of an experience refund (which actually should benefit the ceding company) is generally not the concern. Rather, an experience refund may be typical of the types of reinsurance agreements that combine coinsurance with YRT reinsurance and charge YRT reinsurance premiums that are higher than what they would be otherwise, with the "excess" expected to be returned to the ceding company as part of an experience refund but which would provide a buffer to the reinsurer for at least some of the losses in the case that actual experience is sufficiently adverse. Such a reinsurance agreement should be evaluated in its entirety to determine if this buffer can result in a reduction of the ceding

company's surplus. It should not matter whether a potential reduction of the ceding company's surplus is due to the coinsurance premiums exceeding policy premiums or due to YRT reinsurance premiums exceeding policy charges for the mortality risk, since the two reinsurance arrangements are connected.

In summary, the determination of a reinsurance agreement's compliance with Appendix A-791 of the NAIC Accounting Practices and Procedures Manual should include consideration of all obligations of the ceding company under the reinsurance agreement.

Sincerely,

Sheldon Summers, FSA, MAAA
Claire Thinking, Inc.
Actuary

CC: Kevin Clark, Vice Chair; Julie Gann, NAIC; Robin Marcotte, NAIC

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May 31, 2024

Mr. Dale Bruggeman, Chairman
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RE: Interested Parties Comments on the Items Exposed for Comment by the Statutory Accounting Principles Working Group with Comments due May 31st

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 Phoenix with comments due May 31st.

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

The Working Group exposed its intent to nullify INT 03-02, and exposed revisions to *SSAP No. 25—Affiliates and Other Related Parties* and *SSAP No. 63—Underwriting Pools* to address transfers of assets when modifying intercompany pooling agreements. The exposed revisions were based on interested parties' comments with minor edits proposed by NAIC staff.

The exposed Revisions to SSAP No. 25 and SSAP No. 63 are illustrated below.

SSAP No. 25—Affiliates and Other Related Parties

4. If a company transfers assets or liabilities to effectuate a modification to an existing intercompany pooling arrangement, the transaction, including the transfer of assets, shall be accounted for and valued in accordance with the guidance in *SSAP No. 63—Underwriting Pools.* The guidance in SSAP No. 63 regarding the transfers of assets or liabilities to effectuate a modification of an intercompany pooling arrangements shall not be applied or analogized to other transactions involving transfers of assets and liabilities.

SSAP No. 63—Underwriting Pools (only impacted paragraph are reflected.)

1. This statement establishes statutory accounting principles for underwriting pools and associations, including intercompany pooling arrangements.

8. Insurance groups that utilize intercompany pooling arrangements often modify these arrangements from time to time for various business reasons. These business reasons commonly include mergers, acquisitions, dispositions, or a restructuring of the group's legal entity structure. In order to effectuate a relatively simple modification, such as changing pooling participation percentages without changing the pool participants, companies often simply amend the existing pooling agreement. Alternatively, in order to effectuate a more complex modification, such as changing (by adding or removing) the number of pool participants, a company may commute the existing pooling agreement and execute a new pooling agreement(s). In conjunction with executing the appropriate intercompany pooling agreements, a transfer of assets and liabilities amongst the impacted affiliates may also be required in order to implement the new pooling agreement(s). The following subparagraphs provide guidance specific to modifications of intercompany pooling arrangements and shall not be applied to an analogous transaction or event.

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

b. The net amount of the assets and liabilities being moved among entities as a result of a modification to an intercompany pooling shall be used to settle the intercompany payable/receivable (i.e., the assets that are transferred in conjunction with the modification) to minimize the amount of assets transferred in the modification.

12. Note that other applicable reinsurance guidance from *SSAP No. 61R—Life, Deposit Type and Accident and Health Reinsurance* or *SSAP No. 62R—Property and Casualty Reinsurance*, depending on the type of business, applies to intercompany pooling arrangements and voluntary and involuntary pools. This includes the SSAP No. 62R guidance in paragraphs 33 through 39 regarding retroactive reinsurance.

New disclosure in paragraph 13

13.i For modifications to an existing intercompany pooling arrangement that involve the transfer of assets with fair values that differ from cost or amortized cost, the statement value and fair value of assets received or transferred by the reporting entity.

Interested parties agree with and support adoption of the proposed changes. For purposes of clarity, we recommend that the wording following the comma in the new disclosure in paragraph 13 of SSAP No. 63 be moved to the beginning of the sentence to read as follows: The statement value and fair value of assets received or transferred by the reporting entity for modifications to an existing

intercompany pooling arrangement that involved the transfer of assets with fair value that differ from costs or amortized cost.

Ref #2023-26: ASU 2023-06, Disclosure Improvements

The Working Group exposed revisions to adopt, with modification, certain disclosures from *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative*, for statutory accounting within *SSAP No. 15—Debt and Holding Company Obligations* and *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The Working Group also requested input from regulators and interested parties on whether the derivative cash flow accounting policy disclosure, described in ASC 230-10-50-9, would provide useful information to regulators.

Interested parties have no comments on this item.

Ref #2024-01: Bond Definition – Debt Securities Issued by Funds

The Working Group re-exposed this item with a request for regulators and industry to provide comment on the proposed language that assists with clarifying the scope of guidance and to 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.

This agenda item was developed to clarify guidance in the principles-based bond definition on the treatment on debt securities issued by funds, particularly to eliminate inconsistent application between similar funds and to better align with the recently adopted definition of residual tranches. In the adopted bond definition, bonds issued by business development corporations (BDCs), closed-end funds (CEFs), or similar operating entities are provided as examples of issuer credit obligations (ICOs) when they are registered under the Investment Company Act of 1940 (1940 Act). It has been noted that this guidance is inconsistent with the stated intent of having the bond definition be principles-based as the registration of the fund appears to be the basis of classification as an ICO vs ABS, rather than based on principles. It has been noted that with the current guidance, two funds with issued debt that are virtually identical can have separate SSAP classification of the debt securities (resulting with different accounting/reporting) simply based on whether the fund is registered. Additionally, it would lead to debt securities being classified inconsistently with their equity counterparts. In concept, there should be consistency between the classification of a debt security as an asset-backed security, and the equity of that structure being classified as a residual interest. Using SEC-registration as currently adopted would result in misalignment of these concepts.

The changes captured within this agenda item propose to revise the principles-based bond definition guidance to clarify that debt securities issued by funds representing operating entities qualify as ICOs. This would allow consistent treatment of similar funds regardless of SEC registration status.

Guidance is also proposed to assist with distinguishing whether a fund represents an operating entity or a securitization vehicle.

The original guidance, and the reference to the SEC registration, was an easy approach to determine whether a debt security from a fund qualified as an ICO. This is because SEC registered funds have leverage limits on how much debt can be issued. Although debt securities issued from SEC registered CEFs and BDCs are still permitted as ICOs, the proposed edits permit debt securities from non-registered funds to qualify as ICO if the funds are functioning as operating entities and are not issuing securities for the primary purpose of raising debt capital.

Interested parties reviewed the NAIC Staff proposal and support with the revised language and believe it will achieve the stated objective of greater consistency for debt issued by like funds.

Ref #2024-02: ASU 2023-01, Leases (Topic 842), Common Control Arrangements

The Working Group exposed revisions to adopt, with modification, *ASU 2023-01, Leases (Topic 842), Common Control Arrangements* in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Heath Care Facilities*. The proposed revisions reject the practical expedient for private companies and not-for-profit entities but recommend adoption of the leasehold improvement guidance from the ASU, with modification to the language to align with existing guidance in SSAP No. 19 and SSAP No. 73.

Interested parties have no comments on this item.

Ref #2024-03: ASU 2023-08, Accounting for and Disclosure of Crypto Assets

The Working Group exposed revisions to adopt, with modification *ASU 2023-08, Accounting for and Disclosure of Crypto Assets* for statutory accounting. The revisions propose to adopt the definition of crypto assets from the ASU but establishes within *SSAP No. 20—Nonadmitted Assets* that directly held crypto assets are nonadmitted assets for statutory accounting. Additionally, the exposure includes the intent to nullify *INT 21-01, Accounting for Cryptocurrencies*. This agenda item does not intend to modify the general interrogatory disclosures that had previously been added to the Annual Statement blanks and instructions.

Interested parties have no comments on this item.

Ref #2024-04: Conforming Repurchase Agreements

The Working Group exposed this agenda item and directed NAIC staff to work with industry in determining current application/interpretation differences on the reporting of securities lending collateral and repurchase agreement collateral for possible consistency revisions.

Interested parties support the ACLI comment letter submitted on April 17, 2024. We look forward to continuing to work with the statutory accounting staff on this topic.

Ref #2024-05: A-791 Paragraph 2.c.

The Working Group exposed revisions to remove the first sentence of *Appendix A-791—Life and Health Reinsurance Agreements* (A-791), paragraph 2c's Question and Answer. In addition, the Working Group directed NAIC staff to notify the Valuation Analysis (E) Working Group, the Life Actuarial (A) Task Force and the Reinsurance (E) Task Force of the exposure.

Interested parties have no comments on this item.

Ref #2024-06: Risk Transfer Analysis on Combination Reinsurance Contracts

The Working Group exposed revisions to incorporate guidance to *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* that is consistent with the guidance currently in *SSAP No. 62R—Property and Casualty Reinsurance*, Exhibit A - Implementation Questions and Answers, question 10. This guidance requires risk transfer to be evaluated in aggregate for contracts with interrelated contract features such as experience rating refunds. The revisions also add a reference in *Appendix A-791 Life and Health Reinsurance Agreements* (A-791), paragraph 6 regarding the entirety of the contract. In addition, the Working Group directed NAIC staff to notify the Valuation Analysis (E) Working Group, the Life Actuarial (A) Task Force and the Reinsurance (E) Task Force of the exposure.

Overview

While the exposed language is characterized as a clarification, it is unclear that the proposed changes are strictly clarifications as there is confusion regarding the potential interpretation and resulting implications of these changes. Specifically, interested parties are concerned that the exposed language could lead to broader interpretive changes by regulators, auditors, and companies than is currently intended, which could cause confusion and inconsistency in approach across the industry. Interested parties suggest that further discussion between industry participants, the NAIC, and regulators on this important topic would ensure mutual understanding of intent.

Comments

Reinsurance agreements that combine coinsurance and yearly renewable term (YRT) coverage are not uncommon in the industry and have been historically interpreted (at least by some regulators and audit firms) as appropriately providing quota share credit on the coinsured policies and a YRT credit for the YRT component. We believe it would be in the interest of both regulators and the industry to fully understand the impact that the adoption of the exposed changes would have at the industry level before proceeding further with these changes.

The exposure states that "the substance of this interdependent agreement design is more akin to the risk transferred under a nonproportional reinsurance agreement. This is because in aggregate, proportionate amounts of the risk are not transferred." We believe that the determination of a contract being proportional or non-proportional should continue to be based on a careful consideration of the specific contractual terms of the reinsurance agreement(s) in question and the

resulting reinsurance coverage provided to the ceding entity rather than the adoption of any automatic and universal conclusion for all combination coinsurance / YRT arrangements. Such belief is supported by the currently codified statutory guidance. SSAP 61R separately defines coinsurance, modified coinsurance, YRT and non-proportional reinsurance arrangements and provides applicable risk transfer guidance for each. Specifically, a non-proportional reinsurance arrangement is defined as follows:

> These arrangements provide for financial protection to the ceding entity for aggregate losses rather than providing indemnification for an individual policy basis as described in the preceding three reinsurance arrangements [i.e., coinsurance, modified coinsurance and YRT]. Catastrophic and stop loss reinsurance are written on an annual basis to protect the ceding entity from excessive aggregate losses. Usually, the coverage does not extend over the life of the underlying policy nor is there any requirement on the ceding entity to renew the arrangement.

The combination of coinsurance and YRT arrangements should not be automatically deemed non-proportional as many of these arrangements provide indemnification for losses on an individual policy basis, consistent with the current definition of proportional reinsurance under SSAP 61R. For many such arrangements, each component individually and in combination provides coverage over the life of the underlying policies and offers indemnification on an individual policy basis; and neither the coinsurance nor the YRT component, whether considered independently or in combination, constitutes a non-proportional arrangement.

In addition, the exposure states that "taking a full proportional reserve credit on the coinsured component is not reflective of the actual risk being transferred." While interested parties agree that combination arrangements can be structured in ways that do not meet statutory risk transfer requirements, we believe that combination arrangements can also be structured to meet these requirements and taking a full proportional reserve credit on the coinsured component would be considered appropriate.

Any risk transfer assessment of combination coinsurance / YRT arrangements should be conducted in the context of applicable SAP guidance and based on the facts and circumstances of the relevant reinsurance agreement(s). SAP guidance should be applied both individually to each of the coinsurance and YRT components of the agreement(s) and, in addition, an overall assessment of the combined agreement should be performed consistent with the requirement that "the agreement shall constitute the entire agreement between the parties with respect to the business being reinsured thereunder[.]" Interested parties agree that if any individual component of a combination coinsurance / YRT arrangement does not pass statutory risk transfer, then the aggregate transaction would not pass statutory risk transfer regardless of how it is structured. This overall assessment should include, among other things, an evaluation of (i) the coinsured business to ensure that all significant risks inherent in the reinsured business are transferred, and (ii) the YRT arrangement to ensure that the agreement does not violate any of the conditions described in Appendix A-791, paragraphs 2.b., 2.c., 2.d., 2.h., 2.i., 2.j. or 2.k.

Interested parties agree that transactions that inappropriately preclude any possibility of reinsurance losses being incurred as a result of excessive YRT premiums would be of concern from a statutory risk transfer perspective. In evaluating whether this is the case, YRT premium levels should be assessed using statutory principles as any resulting reserve credit will also have been established using statutory principles. In applying statutory principles, statutory valuation assumptions can serve as an acceptable benchmark. More specifically:

- YRT reinsurance results in the assumption of mortality risk for the lifetime of the underlying business. In such a context, the statutory valuation framework already defines a reasonably prudent valuation mortality basis for direct writers when reserving for such risks. As such, this same valuation mortality basis should also serve as a reasonable and prudent benchmark for reinsurers to consider when committing to the assumption of mortality risk for the lifetime of the underlying business.

- The determination of reserve credit relates to the underlying statutory reserves that are held by the ceding entity and determined based on statutory principles and assumptions. It would be inconsistent to determine a reserve credit using GAAP principles and assumptions in relation to underlying reserves that are computed using statutory principles and assumptions.

The exposure also states that SSAP 61R, paragraph 36, notes that the reinsurance credit is only for the risk reinsured. The exposure references this as a reason that it is not appropriate for a ceding company to take a proportional reserve credit that reflects the transfer of all actuarial risks when not all actuarial risks are transferred. This is a misinterpretation of paragraph 36. That section of the paragraph refers to coinsurance and states "It [the credit] is, of course, only for the percentage of the risk that was reinsured." As such, paragraph 36 refers to the quota share of risk and does not imply that coinsurance agreements satisfying risk transfer requirements could be subject to "partial risk transfer". Historically, risk transfer testing for life insurance, accident and health insurance, and annuity contracts has been performed on a pass/fail basis where companies evaluate the contractual terms of their reinsurance agreements and assess the substance of the transaction based upon SAP risk transfer guidance. Once the risk transfer assessment has been completed, full reserve credit is established for contracts deemed to have successfully satisfied risk transfer. For agreements not successfully demonstrating risk transfer, deposit accounting is utilized. No framework currently exists for assessing an appropriate level of partial reserve credit.

Summary Conclusion

There are established differences in the approach to evaluating risk transfer under SAP and GAAP. It is recognized that there are life reinsurance contracts that satisfy SAP risk transfer rules for life reinsurance but are not considered to have transferred the reasonable possibility of a significant loss to the reinsurer, as required under GAAP. Different types of reinsurance (i.e., coinsurance, YRT, and non-proportional) follow different risk transfer rules under SAP. Applying GAAP standards when evaluating risk transfer / reserve credit for life reinsurance is not appropriate as statutory life reserves are based on prudent assumptions, correspondingly reserve credit should be established on a consistent basis.

A substantive change from pass/fail risk transfer assessment and full reserve credit recognition to a separate assessment of partial reserve credit requires significant changes to SAP, is inconsistent with the current risk transfer assessment framework and would need to be tested further to understand resulting consequences (i.e., intended and unintended).

Interested parties do not believe that the SAPWG exposure pertaining to risk transfer represents a clarification but instead is a significant departure from the currently accepted practices for evaluating risk transfer for life reinsurance contracts under SAP guidance. Therefore, if the exposure remains unchanged, the resulting consequences could be material, and insurers may not be able to unilaterally renegotiate existing agreements even if they desired to do so. Thus, in addition to the broader concerns with the proposal, retroactively changing the historical accounting treatment for existing reinsurance agreements would be inappropriate.

Additional discussion between interested parties, the NAIC, and regulators on this important topic would be greatly beneficial.

We note there are several concurrent efforts at the NAIC related to reinsurance. We suggest the NAIC take a broader view to address these concerns, and ensure coordination of the efforts at LATF, SAPWG, and other NAIC groups working on these issues. Such an approach avoids duplication of work, promotes consistency, and ensures concerns are addressed and understood broadly.

Ref #2024-07: Reporting of Funds Withheld and Modco Assets

The Working Group exposed a project which proposes 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, which is similar in structure to Schedule DL and would include all assets held under a funds withheld arrangement and would include a separate signifier for modified coinsurance assets.

Interested parties acknowledge the importance of transparency in financial reporting with respect to assets backing funds withheld and modco reinsurance transactions and regulators' preference to be able to understand the assets supporting these contracts. We look forward to working with the Working Group as it further refines its proposal.

Having reviewed the exposure, interested parties have several comments that relate to the effort. These include: a) sensitivities concerning the potential exposure of competitive information, b) the impracticability of providing such information in commonplace cases where specifically identifiable assets require are not ring-fenced as part of a funds held arrangement, and c) any new asset schedule would considerable resources, which are currently constrained by the bond definition project.

Granularity of reporting may expose proprietary competitive information
While we support giving regulators the information they need to regulate properly, there are issues of commercial sensitivity with having funds withheld and modco assets made public. Concerns

have been expressed about the level of granularity that will be required. Investment strategy is a critical component of reinsurance pricing, which is considered proprietary, and the level of reporting could force companies to share this information publicly. Requiring public disclosure of such proprietary information may reduce the availability of funds withheld collateralized deals in the marketplace. Interested parties urge the Working Group to consider other non-public alternatives which would provide regulators with the information they require while maintaining the confidentiality of proprietary competitive information.

Identifying specific assets under Funds Withheld arrangements without trust accounts is not truly possible

The proposal to report assets held under funds withheld arrangements is also problematic for funds that are not held in trust accounts. Interested parties note that for property casualty companies in particular, many funds withheld arrangements do not require funds to be held in trust accounts. Rather, the funds are maintained by the insurer in their own cash or short-term investment accounts and are allowed to be co-mingled with other cash or invested assets of the insurer. The agreements that govern such funds withheld may specify an interest rate that is applied to the funds withheld for purposes of crediting the funds with interest, but there is no specific invested asset associated with the funds held. Therefore, it would not be possible to identify and report specific assets deemed to be the "funds withheld" under these arrangements.

In addition, interested parties note that for property casualty insurers, the amounts of funds held under reinsurance treaties are already reported in Schedule F Part 3 Column 20 of the annual statement by individual reinsurance treaty. We believe the current reporting in Column 20 was designed to accommodate both funds held agreements with and without trust accounts. For those arrangement where a trust account is used, regulators can easily confirm the invested assets held in the trust accounting during a financial examination.

A new asset schedule will require significant time, effort, and cost to build

A new schedule will increase the complexity of asset reporting requirements. To facilitate the required reporting, commercial annual statement reporting vendors will need to build the new schedule into their software. Beyond that, many companies note additional work may be required to modify their investment and/or accounting systems to populate the proposed new schedules with the assets associated with funds withheld or modco agreements. Others may not have the ability to make changes to their investment and/or accounting systems and would need to create manual processes including appropriate controls to meet the reporting obligations. Allocation processes may need to be established for situations where an asset is backing more than one agreement. This will all require significant time, effort, and cost. Additionally, in a significant part of the industry, the staff and vendor resources that would be involved in implementing the necessary changes for the funds withheld and modco asset schedule are currently heavily involved in the new Bond Definition project that is set to be effective reporting year 2025. Having both issues active at the same time would cause significant resource strain across the industry.

Finally, we note there are several concurrent efforts at the NAIC related to reinsurance. We suggest the NAIC take a broader view to address these concerns and ensure coordination of the efforts at LATF, the Working Group, and other NAIC groups working on these issues. Such an approach

avoids duplication of work, promotes consistency, and ensures concerns are addressed and understood broadly.

We recognize the importance of this issue and want to be helpful and work collaboratively to address the Working Group's objectives of having full visibility of investments, specifically in funds withheld and modco agreements.

Ref #2024-08: SSAP No. 21R, 26R, 30R, 32R, 43R, & 48 – Consistency Revisions for Residuals

The Working Group exposed consistency revisions for residuals so that *SSAP No. 26R—Bonds* (Effective 2025), *SSAP No. 30R—Unaffiliated Common Stock*, *SSAP No. 32R—Preferred Stock*, *SSAP No. 43R—Asset-Backed Securities* (Effective January 1, 2025), and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* refer directly to *SSAP No. 21R—Other Admitted Assets* for the formal definition and accounting and reporting guidance.

This agenda item was developed to incorporate consistency revisions for residual tranches and residual security interests. Over the last couple of years, a variety of 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 discussion that accompanied these revisions have noted that conforming revisions would be needed coinciding with the effective date of the principles-based bond definition guidance to have consistency of guidance location, terminology and definitions.

With the revisions to *SSAP No. 21R—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. 21R and be reported on Schedule BA.

To ensure consistency in definitions and guidance, this agenda item proposes to centralize the guidance in SSAP No. 21R and use a consistent approach in the other investment SSAPs to exclude residuals from the scope of those investment SSAPs and refer directly to SSAP No. 21R.

Interested parties support the proposed changes.

Ref #2024-09: SSAP No. 2R – Clarification

The Working Group exposed revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to eliminate lingering references that imply that asset-backed securities, mortgage loans, or other Schedule BA items are permitted to be reported as cash equivalents or short-term investments.

Interested parties have no comments on this item.

Ref #2024-10: SSAP No. 56 – Book Value Separate Accounts

The Working Group exposed this agenda item and directed NAIC staff to work with industry in determining current application and differences in the treatment of book value assets within the separate account and to prepare suggested revisions to codify an approach within *SSAP No. 56—Separate Accounts*.

Interested parties is currently working with NAIC staff and the IMR Adhoc Working Group on this agenda item.

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

The Working Group is proposing expanded statutory income tax disclosures by adopting, with modification, *ASU 2023-09, Improvements to Income Tax Disclosures*. The additional disclosures primarily focus on tax jurisdictional information, impacting both taxes paid and the rate reconciliation. Interested Parties does not believe the additional disclosures as written provide useful or better information on a company's tax position in the context of statutory financial statements.

Interested parties appreciate the Working Group's partnership on the proposal, including various meetings to discuss potential changes to the proposed language. Through these meetings we have provided detailed responses so have only included here a summary of our concerns:

- One of the main changes in ASU 2023-09 is an expanded rate reconciliation, applicable to only public filers. Requiring expanded rate reconciliation disclosures to all insurance companies expands the scope of ASU 2023-09 and will create an additional burden for non-public insurance companies.

- Under paragraph 4 of SSAP No. 101, state income taxes are not accounted for under SSAP No. 101. They are instead accounted for under SSAP 5R and included in taxes, licenses, and fees above the line. During the drafting process of SSAP No. 101 state taxes were intentionally not recorded as part of income tax expense in the statutory financial statements because of the immateriality of this type of tax to insurance companies. Given that insurance companies primarily pay premium taxes in lieu of state income taxes (all but nine states have exempted insurance companies from state income tax), state tax income tax disclosures will have limited value from a statutory reporting perspective. Of the states that charge income tax, several have provisions that significantly reduce the net tax impact, including premium tax credits. State tax disclosures will therefore likely require additional guidance regarding what to report (e.g., before or after any credits for premium tax paid, consideration for mixed group and combined reporting).

- ASU 2023-09 was in part adopted to provide additional foreign tax information to investors to enable them to "understand an entity's exposure to potential changes in jurisdictional tax legislation" over worldwide income. These additional disclosures were also intended to help investors identify where companies operate in low-tax or no-tax jurisdictions. Foreign

subsidiaries and affiliates are not consolidated into statutory statements, so tax jurisdiction information would not be as applicable as it would in consolidated GAAP group reporting. Moreover, Schedule Y already provides regulators with subsidiary information, including the jurisdiction such subsidiaries operate. Material foreign tax amounts will be limited to few insurers who have branches, which are fully taxable in the jurisdictions where they operate as well as in the U.S., with foreign tax credits offsetting the U.S. tax due. This dual taxation results in branches generally having tax rates of at least 21% even if the branch operates in a low or no tax jurisdiction.

Overall, ASU 2023-09 was driven by the investor community, whose disclosure wants and needs are not the same as the regulator focusing on solvency. The current statutory tax footnote provides extensive disclosures, some redundant to those in ASU 2023-09, with a goal of enabling regulators to assess the financial stability of the entity (as it relates to tax). Interested parties thus believe the additional disclosures and requirements under the new ASU 2023-09 would provide limited benefits to the regulators.

Interested parties suggest rejecting adoption of the ASU 2023-09 and all modifications to SSAP No. 101, except for the deletion of SSAP No. 101, paragraph 23b. Interested parties agree the disclosure is no longer necessary given revisions to the Internal Revenue Code.

Ref #2024-12: Updates to SSAP No. 27

The Working Group exposed revisions to *SSAP No. 27— Off-Balance-Sheet and Credit Risk Disclosures Risk and Financial Instruments with Concentrations of Credit Risk* which would remove references to FAS 105 and instead specify the assets excluded from SSAP No. 27.

Additionally, revisions were exposed to the Annual Statement Instructions for Note 16 to add an "other" category to the derivatives tabular disclosure, add a non-derivative financial instrument disclosure and additional narrative disclosure examples for non-derivative financial instruments. The added disclosure would include disclosures regarding loan commitments, standby letters of credit, financial guarantees, and other related items.

Interested parties note that Note 14 of the annual statement already requires disclosures regarding an insurer's commitments to provide any type of future funding as well as an insurer's guarantees of the performance of other parties. These disclosures are already very lengthy and detailed. It would seem repetitive to have to include most of the information in Note 16 again.

We recommend that the Working Group evaluate the current disclosure requirements under Note 14 to determine if there is information that should be provided in addition to what is already disclosed instead of having insurers duplicate the information in two different notes.

Ref #2024-14EP: Accounting Practices and Procedures Manual Editorial

The Working Group exposed revisions to the "Revised" and "R" identifiers from SSAP titles and SSAP references throughout the Accounting Practices and Procedures Manual. NAIC staff consider the "Revised" and "R" identifier to no longer be useful.

Interested parties have no comment on this item.

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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
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June 21, 2024

Mr. Dale Bruggeman, Chairman
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RE: Interested Parties Comments on the Item Exposed for Comment by the Statutory Accounting Principles Working Group with Comments due June 21st

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) during the NAIC National Meeting with comments due June 21st.

Ref #2019-21: Issue Paper – Bond Project

The Working Group exposed revisions to the draft issue paper documenting the most recent historical discussions and decisions with the principles-based bond project to reflect the final actions and adoption. The issue paper documenting the discussions and decisions within the principles-based bond project has been updated to reflect the final actions. Additionally, consistency edits and reorganization has been reflected as the authoritative statutory accounting revisions have been adopted.

Interested parties have the following three comments:

- Paragraph 32c – Editorial edits are needed to remove the following language which is included twice, "In contrast, an ABS Issuer has a primary purpose of raising debt capital………..These features support the entity's primary purpose of raising debt capital."
- Paragraphs 107, 110, 111, 113, & 115 – The example number cadence is off such that each needs to be reduced by 1 (e.g., in paragraph 107, Example 5 Rationale needs to be shown as Example 4 Rationale, etc.

- Paragraph 59 – SSAP No. 26 discusses that the practical expedient could only be used if less than 50% of the principal relies on sale or refinancing. The Issue Paper (paragraph 59) discusses that the practical expedient could only be used if contractual cash flows at origination are sufficient to cover all interest and at least 50% of the original principal. To avoid confusion, we suggest the following sentence be added to the Issue Paper, paragraph 59 as a last sentence: "That means, as discussed in SSAP 26, paragraph 9b, that the practical expedient can only be used if less than 50% of the principal relies upon sale or refinancing."

* * *

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