A. Consideration of Maintenance Agenda – Pending List

1. Ref #2020-01: Update / Remove References to SVO Listings
2. Ref #2020-02: Accounting for Bond Tender Offers
3. Ref #2020-03: Enhanced Goodwill Disclosures
5. Ref #2020-05: Repeal of the Affordable Care Act Section 9010 Assessment
6. Ref #2020-06EP: Editorial and Maintenance Update
7. Ref #2020-07: Change to the Summary Investment Schedule
8. Ref #2020-08: ASU 2016-20, Technical Corrections & Improvements - Topic 606
11. Ref #2020-11: ASU 2020-02—Amendments to SEC Paragraphs in Credit Losses and Leases

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<td>2020-01</td>
<td>Update / Remove References to SVO Listings</td>
<td>A - Agenda Item</td>
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<td>SSAP No. 26R</td>
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<td>SSAP No. 30R</td>
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Summary:

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

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

Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to 1) SSAP No. 26R—Bonds and SSAP No. 30R—Unaffiliated Common Stock to eliminate references to the NAIC Bond Fund List (Bond List) and 2) add reference to the “NAIC Fixed Income-Like SEC Registered Funds List” in SSAP No. 30R. (This item will have shortened exposure period to allow for a timely response back to the Task Force.)

Although the Working Group is recommended to proceed with exposure on this agenda item and solicit comments for consideration, final action and determination of an effective date will not occur until revisions have first been adopted by the Valuation of Securities (E) Task Force. NAIC SAPWG staff will coordinate with the VOSTF staff to stay current on their discussion and action on this item. NAIC staff also notes that referrals to the Blanks (E) Working Group and the Capital Adequacy (E) Task Force will be needed to reflect the title change in Blanks and RBC. NAIC staff also highlights that the reference to the SVO “bond fund list” often causes confusion as this listing only includes funds with 100% of their investments in U.S. Government Securities. If the action to delete the listing does not occur at the Task Force, NAIC staff would recommend that the listing name be revised to reflect the “U.S. Government Fund” to eliminate confusion through reference as a “bond fund” listing.
Summary:
Questions have arisen regarding the accounting treatment for when a held bond is retired early through the acceptance of a “bond tender offer.” A bond tender offer occurs when the bond issuer repurchases some, or all, of a particular bond issuance prior to its scheduled maturity date. These offers are generally an attempt to retire a substantial amount of outstanding debt by making a one-time, special offer to bond holders. Generally, the purpose of a tender offer is to retire bonds that were originally issued at higher interest rates; however, some tender offers have occurred as a mechanism for capital restructuring. As expected, these activities are most common in a decreasing or depressed interest rate environment.

Tender offers typically share similar characteristics in that the offer is: 1) for a predetermined (finite) number of bonds, 2) a specified, nonnegotiable price, 3) available to the market as a whole – generally advertised through a press release, 4) only available for a limited period of time, and 5) contingent upon acceptance by a substantial percentage of debt holders – generally requiring accepted by at least 25% of those eligible for early buyout.

From a bond holder’s perspective, the only material difference between a called and tendered bond is that with the tender offer, the bond holder must elect to accept the repurchase offer. If the tender offer is not accepted, the bond’s terms (including scheduled maturity date) remain unchanged. Bond tender offers are generally offered at rates slightly above market value, as an economic enticement for the holder to “sell” the bond. This increased compensation is reflective of prepayment penalties and/or acceleration fees noted in called bonds. The reinvestment risk assumed by holding a bond with a call option is generally compensation through a higher yield or a known prepayment penalty. Similarly, through a bond tender offer, increased compensation comes in the form of additional termination payout as compared to current market value.

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

Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 26R—Bonds to clarify that the accounting and reporting of investment income and capital gain/loss, due to the early liquidation either through a call or a tender offer, shall be similarly applied. NAIC staff believes this is in line with original intent as the initial SSAP No. 26 codification guidance (still reflected in paragraph 16 of SSAP No. 26R) is not specific to called bonds. Rather, the guidance refers to “prepayment penalties or acceleration fees in the event the bond is liquidated prior to its scheduled termination date.” This guidance would seemingly include all dynamics in which an issuer provides a penalty / fee to the holder to terminate the bond.

A bond retired early through either a call or tender offer are functionally equivalent to a bond holder. The only potential additional consideration for the bond holder is that the yield-to-worst concept was likely not applied in relation to the bond tender offer (as the tender offer amount and date were not known/expected at the time of acquisition). However, this concern is negated as bond tender offers are generally at or above market value and the holder must elect to participate. If a bond tender offer is not economically beneficial to the holder, the holder would simply not participate.
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<td>2020-03 SSAP No. 68 (Jim)</td>
<td>Enhanced Goodwill Disclosures</td>
<td>C - Agenda Item</td>
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**Summary:**
This agenda item was drafted to request additional goodwill information and to clarify reporting on Schedule D, Part 6, Section 1 – Valuation of Shares of Subsidiary, Controlled and Affiliated Companies.

1. With the adoption of agenda item 2017-18: Goodwill Limitations in *SSAP No. 68—Business Combinations and Goodwill* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, the information reported regarding goodwill, as provided in annual statement footnote 3 – Business Combinations and Goodwill, has improved. This agenda item proposes additional disclosures to enhance the reporting of an SCA’s book adjusted carrying value (BACV). As goodwill is a significant component of many SCA’s BACV, this agenda item will assist in facilitating review and disclosure of each balance.

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

3. The goodwill limitation of 10% of the insurance reporting entity’s goodwill is a calculation that all reporting entities and companies must perform. While the admitted result is in the annual statement, the details of the calculation are not easily identifiable This agenda item proposes the addition of a disclosure to capture the admissibility information, to ensure transparency in the admission of goodwill.

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

**Recommendation:**
Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *SSAP No. 68—Business Combinations and Goodwill* to add additional goodwill disclosures. The proposed disclosures will improve the validity and accuracy of numbers currently being reported and will assist with the regulators’ review of reported assets not readily available for the payment of policyholder claims.

Additionally, changes are proposed to Schedule D-6-1 and D-6-2, primarily focusing on the current reference to intangible assets. This exposure requests feedback on this disclosure and proposes language to clarify only goodwill shall be disclosure.
Summary:
The Valuation Manual became operative on January 1, 2017 and is required to be used for all applicable products effective January 1, 2020. This agenda item has been drafted to maintain comparability by providing disclosures regarding the use of commissioner discretion pursuant to the Valuation Manual.

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

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

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

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

Summary:
SSAP No. 106—Affordable Care Act Section 9010 Assessment addresses the Affordable Care Act (ACA) Section 9010 assessment for entities that issue health insurance. This assessment was effective for calendar years beginning on January 1, 2014. This assessment is also known as the health insurer’s tax (HIT).

The ACA Section 9010 assessment has had more than one moratorium, as addressed in INT 16-01: ACA Section 9010 Assessment 2017 Moratorium. The assessment is required to be paid for calendar year 2020. In December 2019, the House of Representatives and Senate passed year-end spending bills which repealed the Section 9010 assessment for calendar years beginning January 1, 2021. This bill was subsequently signed into law. This agenda item addresses the impacts of the repeal for calendar years beginning on January 1, 2021, by recommending the following actions:
• Superseding SSAP No. 106—Affordable Care Act Section 9010 Assessment
• Nullifying INT 16-01: ACA Section 9010 Assessment 2017 Moratorium

Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as substantive and expose the intent to supersede SSAP No. 106—Affordable Care Act Section 9010 Assessment and nullify INT 16-01: ACA Section 9010 Assessment 2017 Moratorium. Both actions are proposed to be effective January 1, 2021. With these actions, both SSAP No. 106 and INT 16-01 would be moved to Appendix H - Superseded Statements of Statutory Accounting Principles and Nullified Interpretations for the 2021 publication of the NAIC Accounting Practices and Procedures Manual.

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

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


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<tr>
<td>2020-06EP SSAP No. 21R SSAP No. 51R (Robin)</td>
<td>Editorial and Maintenance Update</td>
<td>F - Agenda Item</td>
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Summary:
Maintenance updates provide revisions to the NAIC Accounting Practices and Procedures Manual, such as editorial corrections, reference changes and formatting as summarized below:

• SSAP No. 21R—Other Admitted Assets - In paragraph 2, remove the excerpts from SSAP No. 4—Assets and Nonadmitted Assets regarding the definition and accounting treatment for admitted assets.

• SSAP No. 51R—Life Contracts - Update paragraph references in paragraph 36 related to change in valuation basis to be consistent with the originally adopted language in Issue Paper No. 154—Implementation of Principle Based Reserving, Exhibit A.

Recommendation:
NAIC staff recommends that the Working Group move this agenda item to the active listing, categorized as nonsubstantive, and expose the editorial revisions to SSAP No. 21R and SSAP No. 51R. (This item is proposed to have a shortened exposure period.)
Summary:
SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures requires disclosures as detailed in Appendix A-001: Investments of Reporting Entities (A-001). Section 3 of A-001 requires the Summary Investment Schedule in the statutory annual statements and in the notes to the annual audited financial statements.

NAIC staff support for the Blanks (E) Working Group were notified of a crosscheck error within the Annual Reporting Blanks where total mortgage loans reported on the Summary Investment Schedule do not tie to the amounts reported in Schedule B, Part 1. After research, it was found that this is due to the Total Valuation Allowance not being included on the Summary Investment Schedule. This agenda item will add in Valuation Allowance to ensure that these schedules will tie together.

The purpose of the referral was to allow coordination to update the Appendix A-001 requirements for the Summary Investment Schedule and the related financial statement notes. This agenda item is intended to be exposed concurrently with a Blanks (E) Working Group proposal.

Recommendation:
NAIC staff recommends that the Working Group move this agenda item to the active listing, categorized as nonsubstantive, and expose revisions to Appendix A-001, Section 3, Summary Investment Schedule to add a line for Total Valuation Allowance. The updates proposed match those that are expected to be concurrently exposed by the Blanks (E) Working Group at the Spring National Meeting. (This item will have a shortened comment period to allow for adoption of the blanks proposal for year-end 2020.)

Summary:
ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers, was issued to clarify narrow aspects of the guidance issued in ASU 2014-09, Revenue from Contracts with Customers. In 2018, the Working Group rejected the guidance in ASU 2014-09 and several other ASUs related to Revenue Recognition in SSAP No. 47—Uninsured Plans. The guidance in ASU 2016-20 provides updates and clarifications based on issues that were found during the initial U.S. GAAP implementation of ASU 2014-09 and ASC Topic 606.

Recommendation:
NAIC Staff recommends the Working Group move this agenda item to the active listing, categorized as nonsubstantive and expose revisions to reject ASU 2016-20 in SSAP No. 47—Uninsured Plans. This recommendation is consistent with how the prior ASUs related to Topic 606 have been treated. (This item is proposed to have a shortened exposure period.)
Summary:
ASU 2018-18, Collaborative Arrangements (Topic 808), Clarifying the Interaction between Topic 808 and Topic 606, clarifies and aligns revenue recognition under the new Topic 606 for collaborative arrangements. A collaborative arrangement is defined as a contractual arrangement that involves a joint operating activity, involving two (or more) parties that are both: 1) active participants in the activity and 2) are exposed to significant risks and rewards dependent on the commercial success of the activity. The intent of this guidance is to ensure that revenue recognized within a collaborative arrangement is consistent with revenue recognition in Topic 606.

Recommendation:
NAIC Staff recommends the Working Group move this agenda item to the active listing, categorized as nonsubstantive and expose revisions to reject ASU 2018-18 in SSAP No. 47—Uninsured Plans. This recommendation is consistent with the treatment of prior ASUs related to Topic 606. (This item is proposed to have a shortened exposure period.)

Summary:

The revisions to Topic 220 update references from “income statement” to “statement of comprehensive income” and add a reference to revenue recognition in Topic 606. The revisions to Topic 605 remove guidance from and references to SEC Staff Accounting Bulletin 13, Revenue Recognition. The updates to Topic 606 add in guidance from SEC Release No. 33-10403, which is guidance for revenue recognition for sales of vaccines and bioterror countermeasures to the federal government for strategic national stockpiles, specifically for SEC registrants.

Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2017-14, Income Statement—Reporting Comprehensive Income (Topic 220), Revenue Recognition (Topic 605), and Revenue from Contracts with Customers (Topic 606), Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 116 and SEC Release No. 33-10403 as not applicable to statutory accounting. This item is proposed to be rejected as not applicable as ASU 2017-14 is specific to deletion and modification of SEC paragraphs, which are not applicable for statutory accounting purposes. (This item is proposed to have a shortened exposure period.)
Summary:
ASU 2020-02, Financial Instruments—Credit Losses (Topic 326) and Leases (Topic 842), Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 119 and Update to SEC Section on Effective Date Related to Accounting Standards Update No. 2016-02, Leases (Topic 842), which effects the codification in Credit Losses (Topic 326) and Leases (Topic 842).

The update provides a new SEC section in Topic 326 that clarifies reporting for SEC registrants and updates the effective date for these provisions. The updates to Topic 842 update the effective dates for the new lease guidance for SEC reporting companies.

Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2020-02, Financial Instruments—Credit Losses (Topic 326) and Leases (Topic 842), Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 119 and Update to SEC Section on Effective Date Related to Accounting Standards Update No. 2016-02, Leases (Topic 842) as not applicable to statutory accounting. This item is proposed to be rejected as not applicable as ASU 2020-02 is specific to deletion of SEC paragraphs, which are not applicable for statutory accounting purposes. (This item is proposed to have a shortened exposure period.)

B. Consideration of Maintenance Agenda – Active Listing

Summary:
This agenda item was originally presented during the 2019 Summer National Meeting to clarify the scope of SSAP No. 43R—Loan-backed and Structured Securities, particularly with regards to collateralized fund obligations (CFOs) and similar structures that reflect underlying equity interests but are issued in the form of bonds / debt instruments. In response to initial comments received, the Working Group conducted a conference call on January 8, 2020 and directed an issue paper to review and revise and SSAP No. 43R. In accordance with the direction from the Working Group on January 8, 2020:

1. This issue paper will consider dividing the SSAP No. 43R guidance between items considered “asset backed securities” under the Code of Federal Regulations (CFR) and items that do not meet this definition.

2. The issue paper will review differing investments that do not fit the ABS CFR definition and consider the appropriate accounting and reporting guidance.

3. This issue paper will propose to remove from the scope of SSAP No. 43R investments in the form of a debt instrument where the investment provides that the amount of principal or interest to be returned to the holder is calculated solely with reference of the S&P 500 Index (or other market indicator, whether public or proprietary).
4. This issue paper will consider the inclusion of guidance, investment reporting provisions, and disclosures to clearly identify and assess “insurer sponsored securitizations.” These disclosures will require disclosure of the conditions in SSAP No. 103R, paragraph 8 and how an insurer sponsor concluded that the conditions were met to attain “sale” accounting treatment upon securitization.

5. This issue paper will review and consider revisions to explicitly reference equipment trust certificates, credit tenant loans and lease-backed securities. This review will coordinate work with the SVO staff on the *Purpose and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) provisions and discussions the SVO is having with industry representatives.

In addition to the direction for the issue paper, the Working Group directed NAIC staff to work with industry in discussing concepts and items for discussion during the interim and in developing the issue paper.

*Recommendation:*
NAIC staff has been working on an issue paper to review and substantively revise SSAP No. 43R. Since the January 2020 conference call, NAIC staff has had many conversations with industry representatives as well as investment providers to discuss differing structures that may have been captured in scope of SSAP No. 43R. For this National Meeting, NAIC staff has provided a preliminary issue paper (discussion document) for initial assessment. As detailed within the document, the topics are not complete, but the draft intends to provide initial information, key concepts that are being considered and a request for information on issues and questions presented within the document.

Although NAIC staff plans to continue working / expanding the current document, *it is recommended that the preliminary draft be exposed to solicit information and comments on the items detailed. (A comment deadline of June 26, 2020, has been proposed for this item.)*

**ANY OTHER MATTERS**

a. **Reference Rate Reform - LIBOR – (Jim)**
NAIC staff is actively monitoring the FASB discussion on “reference rate reform” (e.g., references to LIBOR in hedging instruments and other financial instruments). The issuance of the ASU is anticipated in early March of 2020. Once issued, NAIC staff plan to promptly review and will likely request an interim exposure of the agenda item.

b. **Ref #2016-20: Credit Losses – (Jim)**
The Working Group has had several discussions / exposures regarding *ASU 2016-13: Credit Losses*. As discussed during the 2019 Fall National Meeting, discussion on this ASU is deferred. No significant consideration has occurred since deferral.

NAIC staff continues to monitor the Financial Accounting Standards Board (FASB) discussions involving this topic. On October 18, 2019, the FASB board voted unanimously to delay implementation of the Credit Loss accounting standard until 2023. While large SEC filers are required to follow CECL in 2020, small SEC reporting companies, financial institutions and other public business entities are granted a reprieve until 2023.

c. **Risk Corridors - Supreme Court – (Robin)**
On December 10, 2019, the Supreme Court of the United States heard oral argument over whether insurers are entitled to more than $12 billion in unpaid Affordable Care Act (ACA) risk corridor payments from 2014 to 2016. The lawsuit, *Maine Community Health Options v. United States*, stems from three consolidated cases, brought by four insurers: Maine Community Health Options, Moda Health Plan, Blue Cross and Blue Shield of North Carolina, and Land of Lincoln Mutual Health Insurance Company. A decision, which will have implications beyond the risk corridors program, is expected by summer 2020. NAIC staff is monitoring this topic and will prepare agenda items if needed based on the Supreme court outcome.
NAIC Staff has held preliminary discussions with the federal counterparts at Department of Health and Human Services (HHS) and indicated the willingness to coordinate on any subsequent accounting and other issues that may arise.

**Background:** The program is addressed in SSAP No. 107—Risk-Sharing Provisions of the Affordable Care Act. When the government portion of the risk corridors premium was not funded by Congress, for 2014 payment, the Working Group issued INT 15-01: ACA Risk Corridors Collectability to address impairment and other questions. This interpretation addresses the unpaid 2014 program amounts and non-admits 2014 amounts in excess of proration. For the 2015 and 2016 benefit years estimated in accordance with SSAP No. 107, paragraphs 59.b. and 59.e. are nonadmitted 1) until such time that the prior benefit year is paid in full and 2) until additional proration amounts are confirmed by HHS or other information of a sufficient nature supports that collectability is probable and reasonable.

d. **Referrals – (Jim) – Attachment M**
The Working Group received four referrals from the Valuation of Securities (E) Task Force. While each referral is in the attachment, below is a list of the titles of each referral and any associated SAPWG action.

1. **Referral - Retitling of the NAIC Money Market Mutual Fund List/ Discontinuance of the NAIC Bond Fund List.**
   SAPWG Response – New agenda item (Ref. 2020-01)

2. **Referral – Including Ground Lease Financing Transactions in scope of SSAP No. 43R—Loan-Backed and Structured.**
   SAPWG Response – No actions were deemed necessary.

3. **Referral – Removal of the multi-step financial modeling instructions for RMBS/CMBS securities.**
   SAPWG Response – Related agenda item was previously exposed for comment. (Ref. 2019-41)

4. **Referral – Updated to interim instructions for Mortgage Reference Securities.**
   SAPWG Response – No actions were deemed necessary.

e. **Process Update for SCA Filing Reviews – (Fatima)**
NAIC staff have proposed a process update to the SCA review process, thereby eliminating manual portions of the process, which will save NAIC staff a substantial amount of time. With this proposal, NAIC staff will still provide regulators SCA filing information on a monthly basis, but insurance company filers will be able to gather this information from the SCA filing screen themselves.

f. **Review of GAAP Exposures – Attachment N - (Jim)**
The attachment details the items currently exposed by FASB. NAIC staff recommends reviewing the issued ASUs under the standard SAP Maintenance process.

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

g. **Health Test Update Notice – (Julie)**
The Health RBC Working Group is considering a new health test for determining whether an entity would be more appropriately represented on the Health or Life, Accident and Health blank. Regulators and industry are encouraged to monitor that exposure and discussion at that Working Group.
Comment Deadlines:
The following agenda items have a **May 1, 2020 comment deadline**. (This listing includes items with blanks proposals, the editorial revisions and items that are proposed to be rejected for statutory accounting.)

Items with Corresponding Blanks Revisions:
- 2019-20: Rolling Short-Term Investments
- 2019-36: Expand TPA and MGA disclosures (if exposed)
- 2019-47: VM-21 Grading (if exposed)
- 2020-01: Update / Remove References to SVO Listings
- 2020-07: Changes to the Summary Investment Schedule

Editorial / Proposed to be Rejected
- 2020-06EP: Editorial Update
- 2020-08: ASU 2016-20, Technical Corrections & Improvements - Topic 606
- 2020-09: ASU 2018-18, Collaborative Arrangements
- 2020-10: ASU 2017-14, Amendments to SEC Paragraphs in Topic 220, 605 and 606
- 2020-11: ASU 2020-02, Amendments to SEC Paragraphs in Credit Losses and Leases

All remaining agenda items have a **May 29, 2020 comment deadline** except for the SSAP No. 43R Issue Paper (Ref #2019-21). Although feedback on the SSAP No. 43R is welcome throughout the exposure process, all comments on the issue paper are requested by June 26, 2020.
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Statutory Accounting Principles (E) Working Group  
Maintenance Agenda Submission Form  
Form A

Issue: Update / Remove References to SVO Listings

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

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

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

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

SSAP No. 26R—Bonds

3. Bonds shall be defined as any securities representing a creditor relationship, whereby there is a fixed schedule for one or more future payments. This definition includes:

a. U.S. Treasury securities;
b. U.S. government agency securities;
c. Municipal securities;
d. Corporate bonds, including Yankee bonds and zero-coupon bonds;
e. Convertible bonds, including mandatory convertible bonds as defined in paragraph 11.b;

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

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

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

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

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

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

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

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

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

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

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

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

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

Staff Recommendation:

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

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

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

Proposed Revisions to SSAP No. 26R—Bonds

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

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

b. Bond mutual funds which qualify for the Bond List, as identified in Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office and published.
4. In addition, the following equity investments are captured within scope of this statement:

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

   b. Publicly traded common stock warrants;

   c. Shares of SEC registered Investment Companies captured under the Investment Company Act of 1940 (open-end investment companies (mutual funds), closed-end funds and unit investment trusts), regardless of the types or mix of securities owned by the fund (e.g., bonds or stocks), including shares of funds referenced in the “NAIC Fixed Income-Like SEC Registered Funds List” as identified in Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office.

   d. except for Bond Mutual Funds which qualify for bond treatment, as identified in Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office and published on the SVO’s web page of www.NAIC.org;

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

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

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

Staff Review Completed by: Jim Pinegar, NAIC Staff – January 2020
**Issue:** Accounting for Bond Tender Offers

**Check (applicable entity):**

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<thead>
<tr>
<th>Modification of Existing SSAP</th>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
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</thead>
<tbody>
<tr>
<td>New Issue or SSAP</td>
<td></td>
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<tr>
<td>Interpretation</td>
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**Description of Issue:** Questions have arisen regarding the accounting treatment for when a held bond is retired early through the acceptance of a “bond tender offer.” A bond tender offer occurs when the bond issuer repurchases some, or all, of a particular bond issuance prior to its scheduled maturity date. These offers are generally an attempt to retire a substantial amount of outstanding debt by making a one-time, special offer to bond holders. Generally, the purpose of a tender offer is to retire bonds that were originally issued at higher interest rates; however, some tender offers have occurred as a mechanism for capital restructuring. As expected, these activities are most common in a decreasing or depressed interest rate environment.

Tender offers typically share similar characteristics in that the offer is: 1) for a predetermined (finite) number of bonds, 2) a specified, nonnegotiable price, 3) available to the market as a whole – generally advertised through a press release, 4) only available for a limited period of time, and 5) contingent upon acceptance by a substantial percentage of debt holders – generally accepted by at least 25% of those eligible for early buyout.

From a bond holder’s perspective, the only material difference between a called and tendered bond is that with the tender offer, the bond holder must elect to accept the repurchase offer. If the tender offer is not accepted, the bond’s terms (including scheduled maturity date) remain unchanged. Bond tender offers are generally offered at rates slightly above market value, as an economic enticement for the holder to “sell” the bond. This increased compensation is reflective of prepayment penalties and/or acceleration fees noted in called bonds. The reinvestment risk assumed by holding a bond with a call option is generally compensation through a higher yield or a known prepayment penalty. Similarly, through a bond tender offer, increased compensation comes in the form of additional termination payout as compared to current market value.

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

**Existing Authoritative Literature:**

The reporting of prepayment penalties or acceleration fees in the event a bond is liquidated prior to its scheduled termination date are detailed in SSAP No. 26R—Bonds.

**Income**

15. Interest income for any period consists of interest collected during the period, the change in the due and accrued interest between the beginning and end of the period as well as reductions for premium amortization and interest paid on acquisition of bonds, and the addition of discount accrual. In accordance with SSAP No. 34—Investment Income Due and Accrued, investment income shall be reduced for amounts...
which have been determined to be uncollectible. Contingent interest may be accrued if the applicable provisions of the underlying contract and the prerequisite conditions have been met.

16. A bond may provide for a **prepayment penalty or acceleration fee in the event the bond is liquidated prior to its scheduled termination date. Such fees shall be reported as investment income when received.**

17. The amount of prepayment penalty and/or acceleration fees to be reported as investment income or loss shall be calculated as follows:

- For called bonds in which the total proceeds (consideration) received exceeds par:
  - **i.** The amount of investment income reported is equal to the consideration received less the par value of the investment; and
  - **ii.** Any difference between the book adjusted carrying value (BACV) and the par value at the time of disposal shall be reported as realized capital gains and losses, subject to the authoritative literature in SSAP No. 7.

- For called bonds in which the consideration received is less than par:
  - **i.** To the extent an entity has in place a process to identify explicit prepayment penalty or acceleration fees, these should be reported as investment income. (An entity shall consistently apply their process. Once a process is in place, an entity is required to maintain a process to identify prepayment penalties for called bonds in which consideration received is less than par.)
  - **ii.** After determining any explicit prepayment penalty or acceleration fees, the reporting entity shall calculate the resulting realized gain as the difference between the remaining consideration and the BACV, which shall be reported as realized capital gain, subject to the authoritative literature in SSAP No. 7.

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

**Information or issues (included in Description of Issue) not previously contemplated by the Working Group:**
While bond tenders were not specifically discussed, the accounting and reporting of revenues as a result of early termination, was addressed in agenda item 2018-32: SSAP No. 26R—Prepayment Penalties. In this agenda item, authoritative guidance was adopted detailing the breakout of revenues between investment income and capital gains when the called bond consideration was less than par.

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

**Staff Recommendation:** NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 26R—**Bonds** to clarify that the accounting and reporting of investment income and capital gain/loss, due to the early liquidation either through a call or a tender offer, shall be similarly applied. NAIC staff believes this is in line with original intent as the initial SSAP No. 26 codification guidance (still reflected in paragraph 16 of SSAP No. 26R) is not specific to called bonds. Rather, the guidance refers to “prepayment penalties or acceleration fees in the event the bond is

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1 This guidance applies to situations in which consideration received is less than par but greater than the book adjusted carrying value (BACV). Pursuant to the yield-to-worst concept, bonds shall be amortized to the call or maturity date that produces the lowest asset value. In the event a bond has not been amortized to the lowest value prior to the call (BACV is greater than the consideration received), the entire difference between consideration received and the BACV shall be reported to investment income.
liquidated prior to its scheduled termination date.” This guidance would seemingly include all dynamics in which an issuer provides a penalty / fee to the holder to terminate the bond.

A bond retired early through either a call or tender offer are functionally equivalent to a bond holder. The only potential additional consideration for the bond holder is that the yield-to-worst concept was likely not applied in relation to the bond tender offer (as the tender offer amount and date were not known/expected at the time of acquisition). However, this concern is negated as bond tender offers are generally at or above market value and the holder must elect to participate. If a bond tender offer is not economically beneficial to the holder, the holder would simply not participate.

SSAP No. 26R – Proposed Updates

16. A bond may provide for a prepayment penalty or acceleration fee in the event the bond is liquidated prior to its scheduled termination date. Such fees shall be reported as investment income when received.

17. The amount of prepayment penalty and/or acceleration fees to be reported as investment income or loss shall be calculated as follows:

a. For called or tendered bonds in which the total proceeds (consideration) received exceeds par:
   i. The amount of investment income reported is equal to the consideration received less the par value of the investment; and
   ii. Any difference between the book adjusted carrying value (BACV) and the par value at the time of disposal shall be reported as realized capital gains and losses, subject to the authoritative literature in SSAP No. 7.

b. For called or tendered bonds in which the consideration received is less than par:
   iii. To the extent an entity has in place a process to identify explicit prepayment penalty or acceleration fees, these should be reported as investment income. (An entity shall consistently apply their process. Once a process is in place, an entity is required to maintain a process to identify prepayment penalties for called bonds in which consideration received is less than par.)
   iv. After determining any explicit prepayment penalty or acceleration fees, the reporting entity shall calculate the resulting realized gain as the difference between the remaining consideration and the BACV, which shall be reported as realized capital gain, subject to the authoritative literature in SSAP No. 7.

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

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2 This guidance applies to situations in which consideration received is less than par but greater than the book adjusted carrying value (BACV). Pursuant to the yield-to-worst concept, bonds shall be amortized to the call or maturity date that produces the lowest asset value. In the event a bond has not been amortized to the lowest value prior to the call, or in cases of an accepted tender bond offer (BACV is greater than the consideration received), the entire difference between consideration received and the BACV shall be reported to investment income.
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**Statutory Accounting Principles (E) Working Group**

**Maintenance Agenda Submission Form**

**Form A**

**Issue:** Enhanced Goodwill Disclosures

**Check (applicable entity):**

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**Description of Issue:** This agenda item was drafted to request additional goodwill information and to clarify reporting on Schedule D, Part 6, Section 1 – Valuation of Shares of Subsidiary, Controlled and Affiliated Companies.

1) With the adoption of agenda item 2017-18: Goodwill Limitations in SSAP No. 68—Business Combinations and Goodwill and SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, the information reported regarding goodwill, as provided in Annual Statement Footnote 3 – Business Combinations and Goodwill, has improved. This agenda item proposes additional disclosures to enhance the reporting of an SCA’s book adjusted carrying value (BACV). As goodwill is a significant component of many SCAs’ BACV, this agenda item will assist in facilitating review and disclosure of each balance.

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

3) The goodwill limitation of 10% of the insurance reporting entity’s goodwill is a calculation that all reporting entities who have goodwill must perform. While the admitted result is in the Annual Statement, the details of the calculation are not easily identifiable. This agenda item proposes the addition of a disclosure to capture the admissibility information, to ensure transparency in the admission of goodwill.

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

**Existing Authoritative Literature:**

Goodwill calculation and admittance limitations are detailed in SSAP No. 68—Business Combinations and Goodwill. Relevant areas in relation to this agenda item have been bolded for emphasis.

**Statutory Purchases of SCA Investments**

3. The statutory purchase method of accounting is defined as accounting for a business combination as the acquisition of one entity by another. It shall be used for all purchases of SCA entities including partnerships, joint ventures, and limited liability companies. The acquiring reporting entity shall record its investment at cost. Cost is
defined as the sum of: (a) any cash payment, (b) the fair value of other assets distributed, (c) the fair value of any liabilities assumed, and (d) any direct costs of the acquisition. Contingent consideration issued in a purchase business combination that is embedded in a security or that is in the form of a separate financial instrument shall be recorded by the issuer at fair value at the acquisition date.

4. For those acquired SCA entities accounted for in accordance with paragraphs 8.b.i., 8.b.ii., 8.b.iii. or 8.b.iv. of SSAP No. 97, and joint venture, partnership or limited liability company entities accounted for in accordance with paragraph 8 of SSAP No. 48, goodwill is defined as the difference between the cost of acquiring the entity and the reporting entity’s share of the book value of the acquired entity. **When the cost of the acquired entity is greater than the reporting entity’s share of the book value, positive goodwill exists.** When the cost of the acquired entity is less than the reporting entity’s share of the book value, negative goodwill exists. **Goodwill resulting from assumption reinsurance shall be recorded as a separate write-in for other-than-invested assets. All other goodwill shall be reported in the carrying value of the investment.**

5. A business combination accounted for under the statutory purchase method and in which the acquired entity is valued in accordance with paragraphs 8.b.ii., 8.b.iii. or 8.b.iv. of SSAP No. 97 shall determine the amount of positive goodwill or negative goodwill created by the combination using the reporting entity’s share of the GAAP net book value of the acquired entity, adjusted to a statutory basis of accounting in accordance with paragraph 9 of SSAP No. 97 in the case of acquired entities valued in accordance paragraphs 8.b.ii. or 8.b.iv. of SSAP No. 97. Business combinations accounted for under the statutory purchase method and in which the acquired entity is valued in accordance with, paragraph 8.b.i. of SSAP No. 97 shall determine the amount of positive or negative goodwill created by the business combination using the insurer’s share of the statutory book value of the acquired entity.

6. For those acquired SCA entities accounted for in accordance with paragraph 8.b.i. of SSAP No. 97 under the statutory purchase method, the historical bases of the acquired entity shall continue to be used in preparing its statutory financial statements. Therefore, pushdown accounting is not permitted.

7. Positive goodwill recorded under the statutory purchase method of accounting shall be admitted subject to the following limitation: **Positive goodwill from all sources, including life, accident and health, and deposit-type assumption reinsurance and goodwill resulting from the acquisition of an SCA by the insurance reporting entity that is reported on the SCA's financial statements (resulting from the application of pushdown accounting), is limited in the aggregate to 10% of the acquiring entity’s capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for its most recently filed statement with the domiciliary state commissioner adjusted to exclude any net positive goodwill, EDP equipment and operating system software, and net deferred tax assets.** Additionally, all positive goodwill shall be nonadmitted when the underlying investment in the SCA or partnership, joint venture and limited liability company is nonadmitted. When negative goodwill exists, it shall be recorded as a contra-asset.

8. **Positive or negative goodwill resulting from the purchase of an SCA, joint venture, partnership or limited liability company shall be amortized to unrealized capital gains and losses on investments over the period in which the acquiring entity benefits economically, not to exceed 10 years. Positive or negative goodwill resulting from life, accident and health, and deposit-type assumption reinsurance shall be amortized to operations as a component of general insurance expenses over the period in which the assuming entity benefits economically, not to exceed 10 years. Goodwill shall be evaluated separately for each transaction.**

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1 The “acquiring” entity is intended to reflect the insurance reporting entity that reports the investment resulting in goodwill. The goodwill limitation test shall be completed at the individual reporting company level.

2 This includes, but is not limited to, situations in which the investment is nonadmitted as the audited financial statements for the SCA, joint venture, partnership or limited liability company includes substantial doubt on the entity’s ability to continue as a going concern, or on the basis/contents of the audit opinion pursuant to paragraph 21 of SSAP No. 97.

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Disclosures:

15. For business combinations accounted for under the statutory purchase method, the financial statements shall disclose the following for as long as unamortized goodwill is reported as a component of the investment:
   a. The name and brief description of the acquired entity;
   b. Method of accounting, that is the statutory purchase method;
   c. Acquisition date, cost of the acquired entity and the original amount of admitted goodwill; and
   d. The amount of amortization of goodwill recorded for the period; the admitted goodwill as of the reporting date, and admitted goodwill as a percentage of the SCA’s book adjusted carrying value (gross of admitted goodwill).

16. For business combinations taking the form of a statutory merger, the financial statements shall disclose:
   a. The names and brief description of the combined entities;
   b. Method of accounting, that is the statutory merger method;
   c. Description of the shares of stock issued or cancelled in the transaction;
   d. Details of the results of operations of the previously separate entities for the period before the combination is consummated that are included in the current combined net income, including revenue, net income, and other changes in surplus; and
   e. A description of any adjustments recorded directly to surplus for any entity that previously did not prepare statutory statements.

17. The financial statements shall disclose the following information regarding goodwill resulting from assumption reinsurance:
   a. The name of the ceding entity;
   b. The type of business assumed;
   c. The cost of the acquired business and the amount of goodwill; and
   d. The amount of amortization of goodwill recorded for the period.

18. A reporting entity that recognizes an impairment loss shall disclose the following in the financial statements that include the period of the impairment write-down:
   a. A description of the impaired assets and the facts and circumstances leading to the impairment; and
   b. The amount of the impairment charged to realized capital gains and losses and how fair value was determined.

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

In March 2018, the Working Group adopted agenda item 2017-18: Goodwill Limitations in SSAP Nos. 68 and 97, requiring additional goodwill disclosures in Footnote 3 – Business Combinations and Goodwill (shown below).
Additional goodwill items under consideration by the Working Group relate to the currently exposed, agenda items:

1) Agenda item 2019-14: Attribution of Goodwill. This agenda item proposes the expansion of statutory guidance regarding the attribution of purchase price and goodwill from an acquisition and to add explicit language regarding the accounting treatment for situations in which an insurance company acquires a holding company that owns multiple companies.

2) Agenda item 2019-17: Pushdown Accounting. This agenda item reviewed the guidance in ASU 2014-17, Business Combinations – Pushdown Accounting and its applicability for statutory accounting. Three options were suggested for consideration which included complete rejection, allowance of pushdown for non-insurance entities, or allowance of pushdown only if previously elected (for SEC Registrants).

Also, in December 2019, the Working Group adopted an edit to SSAP No. 68—Business Combinations and Goodwill to clarify that all goodwill from an insurance entity’s acquisition of SCAs, regardless of whether pushdown accounting is applied, is subject to the existing 10% admittance limitation.

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

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

Staff Recommendation:
Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose this agenda item with nonsubstantive revisions to SSAP No. 68—Business Combinations and Goodwill, as detailed below, to add additional goodwill disclosures. The proposed disclosures will improve the validity and accuracy of numbers currently being reported and will assist with the regulators’ review of reported assets not readily available for the payment of policyholder claims.

Proposed additional disclosures in SSAP No. 68—Business Combinations and Goodwill:

Disclosures
19. For business combinations accounted for under the statutory purchase method, the financial statements shall disclose the following for as long as unamortized goodwill is reported as a component of the investment:

   a. The name and brief description of the acquired entity;
   b. Method of accounting, that is the statutory purchase method;
   c. Acquisition date, cost of the acquired entity, the original amount of goodwill and the original amount of admitted goodwill; and
   d. Each SCA’s book value, the amount of amortization of goodwill recorded for the period; the SCA’s admitted goodwill as of the reporting date;
   e. Total admitted goodwill as of the reporting date; and
   f. Admitted goodwill as a percentage of the SCA’s book adjusted carrying value (gross of admitted goodwill).

20. For business combinations taking the form of a statutory merger, the financial statements shall disclose:

   a. The names and brief description of the combined entities;
   b. Method of accounting, that is the statutory merger method;
c. Description of the shares of stock issued or cancelled in the transaction;

d. Details of the results of operations of the previously separate entities for the period before the combination is consummated that are included in the current combined net income, including revenue, net income, and other changes in surplus; and

e. A description of any adjustments recorded directly to surplus for any entity that previously did not prepare statutory statements.

21. The financial statements shall disclose the following information regarding goodwill resulting from assumption reinsurance:

a. The name of the ceding entity;

b. The type of business assumed;

c. The cost of the acquired business and the amount of goodwill; and

d. The amount of amortization of goodwill recorded for the period.

22. A reporting entity that recognizes an impairment loss shall disclose the following in the financial statements that include the period of the impairment write-down:

a. A description of the impaired assets and the facts and circumstances leading to the impairment; and

b. The amount of the impairment charged to realized capital gains and losses and how fair value was determined.

23. A reporting shall disclose the subcomponents and calculation of adjusted surplus and total admitted goodwill as a percentage of adjusted surplus:

**Proposed Blank updates related to SSAP No. 68 include the following:**

**Footnote 3 (A) Illustration:**

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<th>Purchased Entity</th>
<th>Acquisition Date</th>
<th>Cost of Acquired Entity</th>
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<th>Original Amount of Admitted Goodwill</th>
<th>Admitted Goodwill as of the Reporting Date</th>
<th>Amount of Goodwill Amortized During the Reporting Period</th>
<th>Book Value of SCA</th>
<th>Admitted Goodwill as a % of SCA BACV, Gross of Admitted Goodwill</th>
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New Footnote, proposed to be numbered 3(E):

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Limitation on amount of goodwill (adjusted capital and surplus times 10%)

Current period reported Admitted Goodwill | XXX. |

Current Period Admitted Goodwill as a % of prior period Adjusted Capital and Surplus | % |

In addition to the above, changes are proposed for the following schedules which detail the Valuation of Shares of Subsidiary, Controlled of Affiliated Companies. As previously addressed, column clarifications regarding the reporting of Goodwill as opposed to Intangible Assets (as currently indicated).

**Schedule D – Part 6 – Section 1 (Original) – Valuation of Shares of Subsidiary, Controlled or Affiliated Companies**

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<td>NAIC Valuation Method</td>
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</table>

<table>
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<td>Do Insurer's Assets Include Intangible Assets Connected with Holding of Such Company's Stock?</td>
<td>Total Amount of Such Intangible Assets</td>
<td>Book / Adjusted Carrying Value</td>
<td>Nonadmitted Amount</td>
<td>Stock of Such Company Owned by Insurer on Statement Date</td>
<td>Number of Shares</td>
</tr>
</tbody>
</table>
### Schedule D – Part 6 – Section 1 (Proposed Tracked Changes) – Valuation of Shares of Subsidiary, Controlled or Affiliated Companies

<table>
<thead>
<tr>
<th>CUSIP Identification</th>
<th>Description Name Of Subsidiary, Controlled or Affiliated Company</th>
<th>Foreign</th>
<th>NAIC Company Code</th>
<th>ID Number</th>
<th>NAIC Valuation Method</th>
<th>7 Book / Adjusted Carrying Value</th>
<th>8 Total Amount of Goodwill included in Book / Adjusted Carrying Value Such Intangible Assets</th>
<th>9 Book / Adjusted Carrying Value Nonadmitted Amount</th>
<th>Stock of Such Company Owned by Insurer on Statement Date</th>
</tr>
</thead>
<tbody>
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</tbody>
</table>

**Note 1** in Schedule D-Part 6-Section 1 (below), is proposed for removal due to the addition of footnote 3 (D). It is anticipated that if adopted as exposed, both changed would occur simultaneously.

1. Amount of insurer’s capital and surplus from the prior period’s statutory statement reduced by any admitted EDP, goodwill and net deferred tax assets included therein: $.................................

12. Total amount of intangible assets—goodwill nonadmitted $ ..............................................................

For brevity, only instructions for affected columns have been included. Remaining paragraph numbers will be renumbered accordingly.

**Column 7** — Do Insurer’s Assets Include Intangible Assets Connected with Holding of Such Company’s Stock?

State whether the assets shown by the reporting entity in this statement include, through the carrying value of stock of the SCA company valued under the SSAP No. 97—Subsidiary, Controlled and Affiliated Entities, intangible assets arising out of the purchase of such stock by the reporting entity or the purchase by the SCA Company of the stock of a lower-tier company controlled by the SCA Company. For purposes of this question, intangible assets at purchase shall be defined as the excess of the purchase price over the tangible net worth (total assets less intangible assets and total liabilities) represented by such shares as recorded, immediately prior to the date of purchase, on the books of the company whose stock was purchased.

**Column 8** — Total Amount of Such Intangible Assets—Goodwill

If the answer in Column 7 is “Yes,” give Report the total amount of intangible—goodwill assets involved whether admitted or nonadmitted. The intangible assets shown for the SCA Company should include any intangible assets that are included in the SCA Company’s carrying value of the stock of one or more lower-tier companies controlled by the SCA Company. In all cases, the goodwill—current intangible assets equals the goodwill calculated intangible assets at purchase, as defined above in SSAP No. 68—Business Combinations and Goodwill, minus any impairments/write-off thereof between the date of purchase and the statement date. If any portion of the total amount of intangible assets—goodwill is required to be nonadmitted for all SCA companies combined in accordance with SSAP No. 97—
**Investments in Subsidiary, Controlled and Affiliated Entities** and **SSAP No. 68—Business Combinations and Goodwill** state the total amount nonadmitted in the footnote at the bottom of the this section of the schedule.

### Schedule D – Part 6 – Section 2 – Valuation of Shares of Subsidiary, Controlled or Affiliated Companies

<table>
<thead>
<tr>
<th>1</th>
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<tbody>
<tr>
<td>CUSIP Identification</td>
<td>Name of Lower-Tier Company</td>
<td>Name of Company Listed in Section 1 Which Controls Lower-Tier Company</td>
<td>Total Amount of Intangible Assets Goodwill Included in Amounts Shown in Column 8, Section 1</td>
<td>Stock in Lower-Tier Company Owned Indirectly by Insurer on Statement Date</td>
<td>Number of Shares</td>
</tr>
</tbody>
</table>

For brevity, only instructions for affected columns have been included.

**Column 4**  – Total Amount of **Intangible Assets Goodwill** Included in Amount Shown in Column 8, Section 1

As explained in the instructions for Section 1, this amount is based on the intangible assets at **goodwill** purchase of the stock of the lower-tier company, reduced by any subsequent impairment/write-off. The reporting entity also bases the amount shown on the proportionate ownership of the lower-tier company.

**Staff Review Completed by:** Jim Pinegar & Fatima Sediqzad, NAIC Staff – January 2020

G:\FRS\DATA\Stat Acctg\3. National Meetings\A. National Meeting Materials\2020\Spring\Meeting\C - 20-03 Enhanced Goodwill Disclosures.docx
Issue: Commissioner Discretion in the *Valuation Manual*

Check (applicable entity):

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

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

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

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

Existing Authoritative Literature:

**SSAP No. 3—Accounting Changes and Corrections of Errors**

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

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

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

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

SSAP No. 51R—Life Contracts

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

Change In Valuation Basis

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

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

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

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

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

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

SSAP No. 52—Deposit-Type Contracts
Change In Valuation Basis

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

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

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

Change In Valuation Basis

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

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

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

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

**VM-20**

Section 9C3d(iii)

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

Section 9C5a

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

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

Section 2B

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

Section 2C - The Additional Standard Projection Amount

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

Section 3E - Alternative Methodology

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

Section 4A4a(ii)b - Modeling of Hedges

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

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

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

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

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

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

Section 6B2

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

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Several updates to the Accounting Practices and Procedures Manual were adopted to address the operative date of the Valuation Manual.

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

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

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

Proposed revisions for Spring 2020 Discussion:

SSAP No. 51R—Life Contracts:

Change In Valuation Basis

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

37. Changes in reserves developed under paragraph 22 or AG 43 shall be reviewed to determine whether the change represents a change in valuation basis and if it meets the definition of a change in accounting as defined in SSAP No. 3.
   a. Changes in principle-based reserving assumptions are often the result of updating assumptions and other factors required by the existing reserving methodology. Reserve changes resulting from the application of principle-based reserving methodology including, but not limited to, updating assumptions based on reporting entity, industry or other experience, and having the reported reserve transition between net premium reserve, deterministic reserve or stochastic reserve, as required under existing guidance, shall not be considered a change in valuation basis. These types of changes also include, but are not limited to, periodic updates in Valuation Manual tables, such as industry valuation basic tables, asset spread tables and default cost tables.
   b. A change in valuation basis for principle-based reserves shall include cases where the required reserve methodology has changed or the insurer makes a voluntary decision to choose one allowable reserving method over another. These types of changes include, but are not limited to, new standardized mortality tables such as Commissioners Standard Ordinary tables and regulatory changes in methodology. Voluntary decisions to choose one allowable reserving methodology over another, which require commissioner approval under the Valuation Manual shall be reported as a change in valuation basis.

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

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

SSAP No. 52—Deposit-Type Contracts:

Change In Valuation Basis

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

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

Change In Valuation Basis

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

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

Issue: Repeal of Affordable Care Act Section 9010 Assessment

Check (applicable entity):

<table>
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<tr>
<th>Modification of Existing SSAP</th>
<th>P/C</th>
<th>Life</th>
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<tr>
<td>Interpretation</td>
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Description of Issue:

SSAP No. 106—Affordable Care Act Section 9010 Assessment addresses the Affordable Care Act (ACA) Section 9010 assessment for entities that issue health insurance. This assessment was effective for calendar years beginning on January 1, 2014. This assessment is also known as the health insurer’s tax (HIT).

The Section 9010 assessment has had more than one moratorium, as addressed in INT 16-01: ACA Section 9010 Assessment 2017 Moratorium. The following is a history of years in which the assessment was in effect and payable.

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

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

- Superseding SSAP No. 106—Affordable Care Act Section 9010 Assessment
- Nullifying INT 16-01: ACA Section 9010 Assessment 2017 Moratorium

Existing Authoritative Literature:

- SSAP No. 106—Affordable Care Act Section 9010 Assessment
- INT 16-01: ACA Section 9010 Assessment 2017 Moratorium

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Although prior one-year moratoriums have been discussed by the Working Group, this is the first discussion of a repeal.

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

Staff Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as substantive and expose the intent to supersede SSAP No. 106—Affordable Care Act Section 9010 Assessment and nullify INT 16-01: ACA Section 9010 Assessment 2017 Moratorium. Both actions are proposed to be effective January 1, 2021. With these actions, both SSAP No. 106 and INT 16-01 would be moved to Appendix H - Superseded Statements of Statutory Accounting Principles and Nullified Interpretations for the 2021 publication of the NAIC Accounting Practices and Procedures Manual.

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

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


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

<table>
<thead>
<tr>
<th>SSAP/Appendix</th>
<th>Description/Revision</th>
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<tr>
<td>SSAP No. 21R</td>
<td>In paragraph 2, remove the excerpts from <em>SSAP No. 4—Assets and Nonadmitted Assets</em> regarding the definition and accounting treatment for admitted assets.</td>
</tr>
<tr>
<td>SSAP No. 51R</td>
<td>Update paragraph references in paragraph 36 related to change in valuation basis to be consistent with the originally adopted language in the related issue paper.</td>
</tr>
</tbody>
</table>

**Recommendation:**
NAIC staff recommends that the Statutory Accounting Principles (E) Working Group move this agenda item to the active listing, categorized as nonsubstantive, and expose editorial revisions, as illustrated below.

**SSAP No. 21R**

1. *SSAP No. 21R—Other Admitted Assets* in paragraph 2, remove the excerpts from SSAP No. 4 regarding the definition and accounting treatment for admitted assets.

**SUMMARY CONCLUSION**

2. The definition and accounting treatment for admitted assets is outlined in paragraphs 2 and 3 of *SSAP No. 4—Assets and Nonadmitted Assets* as follows:

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

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

      a. Specifically identified within the Accounting Practices and Procedures Manual as a nonadmitted asset; or

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

3. Consistent with paragraph 2, the following assets shall be considered admitted and shall be reported in accordance with SSAP No. 4. These admitted assets are not addressed in other statements.

**SSAP No. 51R**

**SSAP No. 51R—Life Contracts** - Update paragraph references in SSAP No. 51R, paragraph 36.

Update paragraph references in paragraph 36 related to changes in valuation basis to be consistent with the originally adopted language in the related issue paper. Paragraph 36 refers to “a change in valuation basis for reserves determined under paragraphs 18-21 and the reference should be updated to be paragraphs 17-21. This edit is consistent with Issue Paper No. 154—Implementation of Principle Based Reserving, Exhibit A, which documents changes to SSAP No. 51, paragraph 36 and includes a reference to paragraphs 17-21.

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

Issue: Change to the Summary Investment Schedule

Check (applicable entity):

<table>
<thead>
<tr>
<th>Modification of Existing SSAP</th>
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<tr>
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<tr>
<td>Interpretation</td>
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Description of Issue:

SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures requires disclosures as detailed in Appendix A-001: Investments of Reporting Entities (A-001). Section 3 of A-001 requires the Summary Investment Schedule in the statutory annual statements and in the notes to the annual audited financial statements.

NAIC staff support for the Blanks (E) Working Group were notified of a crosscheck error within the Annual Reporting Blanks where total mortgage loans reported on the Summary Investment Schedule do not tie to the amounts reported in Schedule B, Part 1. After research, it was found that this is due to Valuation Allowance not being included on the Summary Investment Schedule. This agenda item will add in Valuation Allowance to ensure that these schedules will tie together.

The purpose of the referral was to allow coordination to update the Appendix A-001 requirements for the Summary Investment Schedule and the related financial statement notes. This agenda item is intended to be exposed concurrently with a Blanks (E) Working Group proposal.

Existing Authoritative Literature:

SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures

Supplemental Investment Disclosure

26. For the current year, reporting entities shall disclose the information required by Appendix A-001, Investments of Reporting Entities. A Summary Investment Schedule and Investment Risk Interrogatories shall be filed with the audited statutory financial statements. The Summary Investment Schedule shall be filed with the Annual Statement whereas the interrogatories shall be filed as a supplement to the Annual Statement by April 1 for the applicable reporting period.

Appendix A-001

The annual statement must include:
- Supplement to Annual Statement filed by April 1 Investment Risk Interrogatories (as specified in A-001, Section 2) and
- Summary Investment Schedule (as specified in A-001, Section 3)

The audited statutory financial statements must include:
- Investment Risk Interrogatories (as specified in A-001, Section 2) and
- Summary Investment Schedule (as specified in A-001, Section 3)

SSAP No. 83—Mezzanine Real Estate Loans

Disclosures
6. The financial statements shall disclose, as applicable, the requirements of SSAP No. 37, paragraphs 25-27. The MREL lender shall report in Appendix A-001 to its annual statement the amount and percentages of its total admitted assets held in MREL and the largest three investments held in MREL except that such detail shall not be required for assets held in MREL totaling less than 2.5% of its total admitted assets.

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

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

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

Staff Recommendation:
NAIC staff recommends that the Working Group move this agenda item to the active listing, categorized as nonsubstantive, and expose revisions to Appendix A-001, Section 3, Summary Investment Schedule to add a line for Total Valuation Allowance as illustrated below. The updates below match those that will be concurrently exposed by the Blanks (E) Working Group at the Spring National Meeting.

Section 3. Summary Investment Schedule (Revised for reporting periods effective January 1, 2019)

<table>
<thead>
<tr>
<th>Investment Categories</th>
<th>Gross Investment Holdings</th>
<th>Admitted Assets as Reported in the Annual Statement</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>Percentage</td>
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<tr>
<td>4. Mortgage Loans (Schedule B)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.1 Farm Mortgages</td>
<td></td>
<td></td>
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<tr>
<td>4.2 Residential Mortgages</td>
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<td></td>
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<tr>
<td>4.3 Commercial Loans</td>
<td></td>
<td></td>
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<tr>
<td>4.4 Mezzanine Real Estate Loans</td>
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<td></td>
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<tr>
<td><strong>4.5 Total Valuation Allowance</strong></td>
<td></td>
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<tr>
<td>4.56 Total Mortgages</td>
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</table>

Staff Review Completed by: Jake Stultz, February 2020

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attachment H
Ref #2020-08

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

Issue: ASU 2016-20, Technical Corrections and Improvements to Topic 606

Check (applicable entity):

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<td>Interpretation</td>
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Description of Issue:
In December 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers, to clarify narrow aspects of the guidance issued in ASU 2014-09, Revenue from Contracts with Customers, which was the result of a joint project between FASB and the International Accounting Standards Board (IASB). This project clarified the principles for recognizing revenue and develop a common revenue standard for U.S. GAAP and IFRS (the IASB issued IFRS 15 – Revenue from Contracts with Customers) and created ASC Topic 606 – Revenue from Contracts with Customers.

In 2018, the Working Group rejected the guidance in ASU 2014-09 and several other ASUs related to Revenue Recognition in SSAP No. 47—Uninsured Plans. The guidance in ASU 2016-20 provides updates and clarifications based on issues that were found during the initial implementation of ASU 2014-09 and ASC Topic 606.

Existing Authoritative Literature:
Premium revenue recognition is detailed throughout the SSAPs, including the following: SSAP No. 51—Life Contracts; SSAP No. 53—Property Casualty Contracts – Premiums; SSAP No. 54—Individual and Group Accident and Health Contracts and SSAP No. 57—Title Insurance. The ASUs related to ASC Topic 606 have been rejected in SSAP No. 47.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Agenda item 2016-19 and 2017-37 address the previous ASUs related to ASC Topic 606.

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

Convergence with International Financial Reporting Standards (IFRS): ASC Topic 606 and IFRS 15 are the result of the joint project between the FASB and IASB to improve financial reporting by creating common revenue recognition guidance.

Staff Recommendation:
NAIC Staff recommends the Working Group move this agenda item to the active listing, categorized as nonsubstantive and expose revisions to reject ASU 2016-20 in SSAP No. 47—Uninsured Plans. This recommendation is consistent with how the prior ASUs related to Topic 606 have been treated.

Staff Review Completed by: Jake Stultz, February 2020

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

**Issue: ASU 2018-18, Collaborative Arrangements (Topic 808)**

**Check (applicable entity):**

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**Description of Issue:**  
FASB issued ASU 2018-18, Collaborative Arrangements (Topic 808), Clarifying the Interaction between Topic 808 and Topic 606, which clarifies and aligns revenue recognition under the new Topic 606 for collaborative arrangements. A collaborative arrangement is defined as a contractual arrangement that involves a joint operating activity, involving two (or more) parties that are both: 1) active participants in the activity and 2) are exposed to significant risks and rewards dependent on the commercial success of the activity. The intent of this guidance is to ensure that revenue recognized within a collaborative arrangement is consistent with revenue recognition in Topic 606.

**Existing Authoritative Literature:**  
Collaborative arrangements in Topic 808 are similar in nature to voluntary pooling arrangements that are discussed in SSAP No. 63—Underwriting Pools. ASU 2014-09, Revenue from Contracts with Customers established ASC Topic 606 with the new revenue recognition guidance and was rejected for statutory accounting in SSAP No. 47—Uninsured Plans.

**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):** ASU 2014-09, which created ASC Topic 606, and IFRS 15 are the result of the joint project between the FASB and IASB to improve financial reporting by creating common revenue recognition guidance.

**Staff Recommendation:**  
Staff recommends the Working Group move this agenda item to the active listing, categorized as nonsubstantive and expose revisions to reject ASU 2018-18 in SSAP No. 47—Uninsured Plans. This recommendation is consistent with the treatment of prior ASUs related to Topic 606.

**Staff Review Completed by:** Jake Stultz, February 2020
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Issue: ASU 2017-14—Amendments to SEC Paragraphs in Topic 220, Topic 605 and Topic 606

Check (applicable entity):

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Description of Issue:
FASB issued ASU 2017-14, Income Statement—Reporting Comprehensive Income (Topic 220), Revenue Recognition (Topic 605), and Revenue from Contracts with Customers (Topic 606), Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 116 and SEC Release No. 33-10403, which effects only SEC paragraphs in Topic 220, Topic 605 and Topic 606.

The revisions to Topic 220 update references from “income statement” to “statement of comprehensive income” and add a reference to revenue recognition in Topic 606. The revisions to Topic 605 remove guidance from and references to SEC Staff Accounting Bulletin 13, Revenue Recognition. The updates to Topic 606 add in guidance from SEC Release No. 33-10403, which is guidance for revenue recognition for sales of vaccines and bioterror countermeasures to the federal government for strategic national stockpiles, specifically for SEC registrants.

Existing Authoritative Literature:
Generally, all SEC guidance from ASUs is rejected as not applicable for statutory accounting in Appendix D. The ASUs related to ASC Topic 606 have been rejected in SSAP No. 47—Uninsured Plans.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Agenda item 2016-19 and 2017-37 address the previous ASUs related to ASC Topic 606.

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

Convergence with International Financial Reporting Standards (IFRS): ASC Topic 606 and IFRS 15 are the result of the joint project between the FASB and IASB to improve financial reporting by creating common revenue recognition guidance.

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2017-14, Income Statement—Reporting Comprehensive Income (Topic 220), Revenue Recognition (Topic 605), and Revenue from Contracts with Customers (Topic 606), Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 116 and SEC Release No. 33-10403 as not applicable to statutory accounting.

This item is proposed to be rejected as not applicable as ASU 2017-14 is specific to deletion and modification of SEC paragraphs, which are not applicable for statutory accounting purposes.

Staff Review Completed by: Jake Stultz, February 2020
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: ASU 2020-02—Amendments to SEC Paragraphs in Credit Losses (Topic 326) and Leases (Topic 842)

Check (applicable entity):

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<tr>
<td>Interpretation</td>
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Description of Issue:
FASB issued ASU 2020-02, Financial Instruments—Credit Losses (Topic 326) and Leases (Topic 842), Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 119 and Update to SEC Section on Effective Date Related to Accounting Standards Update No. 2016-02, Leases (Topic 842), which effects the codification in Credit Losses (Topic 326) and Leases (Topic 842). The update provides a new SEC section in Topic 326 that clarifies reporting for SEC registrants and updates the effective date for these provisions, and the updates to Topic 842 update the effective dates for the new lease guidance for SEC reporting companies.

Existing Authoritative Literature:
Credit Losses (Topic 326) while not yet addressed, is being actively monitored by the Working Group.

Leases are covered in SSAP No. 22R—Leases. Basic discussion of the nature of assets, and specifically admitted assets, is covered in SSAP No. 4—Assets and Nonadmitted Assets.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): The Working Group adopted substantive revisions to create SSAP No. 22R, which brings in language from Topic 842 but retains the operating lease treatment for statutory accounting.

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

Convergence with International Financial Reporting Standards (IFRS):
The leases project began as a joint project with the IASB and many of the requirements in Topic 842 are the same as the requirements in IFRS 16.

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2020-02, Financial Instruments—Credit Losses (Topic 326) and Leases (Topic 842), Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 119 and Update to SEC Section on Effective Date Related to Accounting Standards Update No. 2016-02, Leases (Topic 842) as not applicable to statutory accounting.

This item is proposed to be rejected as not applicable as ASU 2020-02 is specific to deletion of SEC paragraphs, which are not applicable for statutory accounting purposes.

Staff Review Completed by: Jake Stultz – February 2020

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Statutory Issue Paper No. 1XX

Loan-Backed and Structured Securities

STATUS
Discussion Document

Original SSAP: SSAP No. 43; Current Authoritative Guidance: SSAP No. 43R

Type of Issue:
Common Area

Staff Note – This Issue Paper has been divided into key sections to allow for focused discussion. This issue paper being completed in phases and further development is required. Comments are welcome on all aspects, but are specifically requested on the discussion elements captured at each section.

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<td>2) Defining Asset Backed Security</td>
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<td>3) Accounting and Reporting for Asset Backed Securities</td>
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<td>4) Accounting and Reporting for Non-CFR ABS (Traditional Securitizations)</td>
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<tr>
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<td>a. One Underlying Obligor</td>
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<td>b. Collateral Not Owed by Many Payers</td>
<td>20-21</td>
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<td>c. Security Partially Impacted by Equity Collateral</td>
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<td>d. Security is Solely Impacted by Equity Collateral / Equity Index</td>
<td>25-26</td>
</tr>
<tr>
<td>e. Principal Protected Notes</td>
<td>27-29</td>
</tr>
<tr>
<td>f. Collateral is Not Cash Generating and Not Equity (e.g., artwork held in trust)</td>
<td>30</td>
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</tbody>
</table>

The issue paper does not currently address the following topics. These items are currently in development and will be the focus of subsequent exposures.

a. Equipment Trust Certificates / Non-CFR Leased Back Securities (and other VOSTF-related items)
b. Self-Securitizations / Retained Beneficial Interests
SECTION 1: SUMMARY OF ISSUE

1. The guidance within this issue paper introduces substantive revisions to SSAP No. 43R—Loan-backed and Structured Securities (SSAP No. 43R) 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 captured and reported in scope of the current SSAP No. 43R that were not contemplated at issuance. The Investment Classification Project is a comprehensive review to address a variety of issues pertaining to definitions, measurement and overall scope of the investment SSAPs.

2. The concepts discussed in this issue paper reflect the following:
   
   a. Overall Scope of SSAP No. 43R: Current application of SSAP No. 43R by some reporting entities has extended beyond SEC and Federal Code “asset-backed securities,” with investments captured in scope designed to meet explicit structural scope requirements of the SSAP. This expansion has resulted in various securities, including securities with investment returns coupled with equity/asset performance, and the issuance of principal-protected notes, where the issued security does not fully reflect the resulting investments held in SPV/trust.

   b. Use of NAIC Designations in Determining Measurement: Current application of SSAP No. 43R uses an NAIC designation in determining measurement method. With the expansion of investments reported in scope of this standard, for certain securities, alternative measurement approaches not driven by NAIC designation may be more appropriate.

   c. Insurer Sponsored Securitizations: The ability to remove previously-owned assets through a “sale” with reacquisition as a securitization in scope of SSAP No. 43R (and reported on Schedule D-1) is not clear. Furthermore, with the exception of the “sale” guidance in SSAP No. 103—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, there are no safeguards or disclosures surrounding these transactions.

   d. SVO Assessment of Securities: The current SSAP No. 43R intends to include certain items in scope that have passed a structural assessment by the NAIC SVO. However, the inclusion of these items is not currently detailed in the scope section and the generic references to these types of securities (in current paragraph 26.c) does not include any indication of compliance with the provisions in the Purposes and Procedures Manual of the Investment Analysis Office (P&P Manual). This has resulted in confusion, and likely inconsistent application, of the guidance.

DISCUSSION

3. This issue paper intends to provide information on discussions that occurred when considering substantive revisions to SSAP No. 43R.

History of the Definition / Scope Development of SSAP No. 43R

4. SSAP No. 43—Loan-backed and Structured Securities was originally effective with the codification of statutory accounting principles (SAP) and resulted with separate guidance for “bonds” (in SSAP No. 26—Bonds, excluding loan-backed and Structured Securities) 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.) 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 prepayment assumptions and resulting cash flows of the underlying loans, as changes in assumptions would necessitate a recalculation of the effective yield.

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5. 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.

6. Original definition / scope guidance in 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 trusted 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.

7. 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.

8. In 2009, the Working Group adopted a substantively-revised SSAP No. 43R (effective September 30, 2009). The focus of the substantive revisions were 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. 43R, 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.”

9. 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 Jan. 1, 2011.

a. Although the agenda item 2010-12 identifies that this item was exposed in August 2010, and 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 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. 43R 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. 43R. 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.

Staff Note; With the revisions adopted in 2010, NAIC staff is under the impression that all securities issued from an SPV/trust structure were intended to be in scope of SSAP No. 43R. This provision is expected to be discussed and clarified in accordance with this issue paper.

10. 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. 43R (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. 43R, 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.

11. Between the adoption of agenda item 2010-12 and the items adopted in 2019, there were several revisions to SSAP No. 43R, 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 RMBS/CMBS, clarification of disclosures, updating Q/A guidance, and guidance for prepayment fees.

12. 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
Loan-Backed and Structured Securities

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 reflect assets issued by affiliates of the insurance reporting entity, the insurance reporting entity only has direct recourse to the assets held in trust, the transaction shall be considered an affiliated investment, and the transaction shall also subject to the accounting and reporting provisions in SSAP No. 25—Affiliates and Other Related Parties.

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

6. Investments within the scope of this statement are also subject to the provisions and disclosure requirements of SSAP No. 25 if the SSAP No. 43R transaction is a related party arrangement. 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,

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

2 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.

3 As discussed in paragraph 4.a. of this statement, a SSAP No. 43R security may still be considered a related party transaction even if the asset trustee or security issuer is a non-related party.
c. Loan-backed and structured securities for which it is probable, either known at acquisition or identified during the holding period\(^4\), 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\(^5\).

**Benefits of Reporting in Scope of SSAP No. 43R**

13. There are a variety of benefits for reporting investments in scope of SSAP No. 43R. Depending on the investment, reporting in scope of SSAP No. 43R may be more advantageous than reporting in scope of SSAP No. 26R—Bonds. These benefits include:

a. Capturing an investment in scope of SSAP No. 43R 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 (if designated as high quality), the asset is admitted and 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. 43R SPV/trust has been particularly noted as providing “regulatory capital relief.”)

b. Capturing an investment in scope of SSAP No. 43R 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 SPV/trust were reported separately on the statutory financial statements.

i. Under the SSAP No. 43R bifurcated impairment model, an entity is not required to recognize an other-than-temporary impairment (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 43R security to recover the amortized cost basis and there is no credit-related decline. (*This has been a key factor in the PPN design, as a high-quality bond is placed in SPV/trust (along with other assets), and the bond – over several years – will single-handedly satisfy the contractual requirements of the SSAP No. 43R issued security, preventing any recognition of OTTI or a reduction of NAIC designation even when the other securities held in SPV/trust could completely default to zero.*)

ii. The SSAP No. 43R bifurcated impairment can be considered an advantage over SSAP No. 26R as under SSAP No. 43R, 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 credit-related loss. Under SSAP No. 26R, if there is any assessed OTTI (regardless if interest or credit related), a reporting entity must recognize an OTTI down to the then-current fair value for the security.

iii. Guidance in SSAP No. 43R does not currently differentiate between different types of tranches or payment streams for SSAP No. 43R issued securities. This is easiest to illustrate through the “equity” tranche of a SSAP No. 43R 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

\(^4\) 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.

\(^5\) The accounting requirements related to these types of securities included in paragraphs 22-25 shall be determined at acquisition or initial transfer.
junior notes.) For the “equity” tranche, which is a term that refers to the junior-most layer of issued 43R securities, this tranche is the first-loss position and only receives payment after all other layers have been satisfied. Without specific guidance in SSAP No. 43R for this layer, if they are included in scope, with the same guidance as other non-equity tranche SSAP No. 43R investments. This process raises questions on the use of amortized cost for these tranches (if they have qualifying designations), as well as situations where these tranches are unrated. The guidance in SSAP No. 43R does not provide provisions for unrated securities and a designation is required for reporting on Schedule D-1. (Without guidance, if reported in scope of SSAP No. 43R, these would presumably default to insurer-assigned designations of 5GI or 6.)

c. SSAP No. 43R permits admittance of a SSAP No. 43R security without any verification to the assets held in SPV/trust. As an example, if a reporting entity was to derecognize a joint venture or LLC from Schedule BA, and reacquire through the ownership of a 43R security, the reporting entity would be permitted to admit the security without any verification of the joint venture or LLC held in SPV/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 the Current Scope / Definition Application of SSAP No. 43R

14. With the existing guidance in SSAP No. 43R, there are no restrictions to the assets that can be placed in SPV/trust used to collateralize securities issued from the SPV/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.

15. As an additional issue of the existing guidance, questions have been raised on whether securities captured in scope of SSAP No. 43R 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. 43R, a rating from an NRSRO that is not approved by the SEC for “asset-backed securities” could provide a valid rating for a SSAP No. 43R instrument permitted as “filing exempt” if that asset was not an “asset-backed security” in accordance with the CFR definition. This has caused questions as regulators have identified designations from NRSROs not SEC approved to provide “ABS” designations and have questioned the use of these ratings in determining the NAIC designation.

Concepts Considered to Revise SSAP No. 43R

16. The approach in drafting this issue paper is to principally discuss different types of investments based on their characteristics to determine appropriate investment classification and overall accounting and reporting. This approach will begin with an initial assessment of “asset backed securities” under the Code of Federal Regulations (CFR) and instruments that do not meet this definition. The issue paper intends to document discussions on differing investments and proposals considered to ensure documentation for future reference. Regardless of final revisions, this issue paper will document the proposals considered, and the resulting conclusions to provide historical reference.

References in the issue paper to “trust” are intended to reflect either an SPV or trust structure. Generally, these structures hold the underlying assets used to satisfy the interest or principal repayment of an investment issued from the SPV/trust structure.
17. In accordance with direction from the Working Group conference call on January 8, 2020:

a. This issue paper will consider dividing the SSAP No. 43R guidance between items considered “asset backed securities” under the Code of Federal Regulations (CFR) and items that do not meet this definition. It is anticipated that investments, with potential exceptions, that meet the ABS CFR definition will primarily continue the historical accounting and reporting guidance contained in SSAP No. 43R.

b. The issue paper will review differing investments that do not fit the ABS CFR definition and consider the appropriate accounting and reporting guidance. For these discussions, the issue paper may consider whether the investment shall be retained in SSAP No. 43R with accounting and reporting treatment consistent to ABS CFR securities, whether the investment shall be reported at the lower of amortized cost or fair value regardless of NAIC designation, whether the investment shall be permitted to be “filing exempt,” whether the investment shall be captured on a different reporting schedule, whether the investment shall be nonadmitted and/or whether any other differing accounting and reporting guidance should apply.

c. This issue paper will remove from the SSAP No. 43R scope investments in the form of a debt instrument where the investment provides that the amount of principal/interest to be returned to the holder is calculated solely with reference of the S&P 500 Index (or other market indicator, whether public or proprietary). (Presumably, such investments will be captured under the scope of SSAP No. 48 and reported on Schedule BA or be considered derivative instruments and captured in scope of SSAP No. 86—Derivatives.) (Staff Note: This is not intended to capture normal creditor relationships with a borrowing rate that may be variable based on the change of LIBOR or other reference rate.)

d. This issue paper will consider the inclusion of guidance, investment reporting provisions, and disclosures to clearly identify and assess “insurer sponsored securitizations.” These disclosures will require disclosure of the conditions in SSAP No. 103R, paragraph 8 and how an insurer sponsor concluded that the conditions were met to attain “sale” accounting treatment upon securitization. (Staff Note: NAIC staff proposes to capture the various examples provided by interested parties into an exhibit or application guidance to assist in determining whether the insurer-sponsored securitization qualifies for sale treatment and resulting securitization. Only investments that qualified for sale treatment under SSAP No. 103R could be removed from their prior reporting classified and considered for SSAP No. 43R eligibility. If sale accounting treatment was met, the actual resulting security will need to be assessed to determine if it qualifies as a SSAP No. 43R security and in determining the appropriate accounting and reporting treatment. Additionally, discussion will occur on the interaction between SSAP No. 25 and SSAP No. 103)

e. This issue paper will review and consider revisions to explicitly reference equipment trust certificates, credit tenant loans and lease-backed securities. This review will coordinate work with the SVO staff on the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) provisions and discussions the SVO is having with industry representatives. Consideration is expected to subsequently occur on the accounting and reporting for these investments as well as identification on the investment schedules and whether additional disclosures are necessary. (Note: The reference to lease-backed securities pertains to those that do not qualify as CFR ABS or traditional securitizations that are addressed in the structural assessments reflected in the P&P Manual assessment.)
Overview of Key Concepts:

- This section details the overall issue, history of development and key concepts and issues that provide the background for the overall discussion / project.

Questions / Comments:

- Is there additional information that should be captured to provide more information on the overall issue or discussion?
Section 2: Defining Asset-Backed Security

18. Pursuant to the initial Jan. 8, 2020 direction, this issue paper proposes that the term “asset-backed security” be clearly defined to be consistent with the definition pursuant to the Code of Federal Regulations as detailed in 17 CFR 229.1101(c). Securities referenced in this issue paper as “asset-backed securities” are specifically those that comply with the CFR definition.

NAIC Staff Note: By using the CFR definition, only NRSROs that are registered with the SEC to provide designations for ABS could be used if the security was permitted as filing exempt (FE) under the Purposes and Procedures Manual of the NAIC Investment Analysis Office. As of December 2018, of the 10 NRSROs, three were not registered for asset-backed securities. These three included Egan-Jones Rating Company, HR Ratings de Mexico, and the Japan Credit Rating Agency.

19. The definition of an “asset-backed security” pursuant to the Securities Exchange Act of 1934:

(79) ASSET-BACKED SECURITY.—The term “asset-backed security”—(A) means a fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset, including—(i) a collateralized mortgage obligation; (ii) a collateralized debt obligation; (iii) a collateralized bond obligation; (iv) a collateralized debt obligation of asset-backed securities; (v) a collateralized debt obligation of collateralized debt obligations; and (vi) a security that the Commission, by rule, determines to be an asset-backed security for purposes of this section; and (B) does not include a security issued by a finance subsidiary held by the parent company or a company controlled by the parent company, if none of the securities issued by the finance subsidiary are held by an entity that is not controlled by the parent company.

20. The definition of an “asset-backed security” and an “asset-backed issuer” pursuant to the CFR:

17 CFR 229.1101 (b)
 Asset-backed issuer means an issuer whose reporting obligation results from either the registration of an offering of asset-backed securities under the Securities Act, or the registration of a class of asset-backed securities under section 12 of the Exchange Act (15 U.S.C. 78l).

17 CFR 229.1101(c)
(1) Asset-backed security means a security that is primarily serviced by the cash flows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period, plus any rights or other assets designed to assure the servicing or timely distributions of proceeds to the security holders; provided that in the case of financial assets that are leases, those assets may convert to cash partially by the cash proceeds from the disposition of the physical property underlying such leases.

(i) The following additional conditions apply in order to be considered an asset-backed security:

(ii) Neither the deposit or the issuing entity is an investment company under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.) nor will become an investment company as a result of the asset-backed securities transaction.

(ii) The activities of the issuing entity for the asset-backed securities are limited to passively owning or holding the pool of assets, issuing the asset-backed securities supported or serviced by those assets, and other activities reasonably incidental thereto.

(iii) No non-performing assets are part of the asset pool as of the measurement date.

(iv) Delinquent assets do not constitute 50% or more, as measured by dollar volume, of the asset pool as of the measurement date.
With respect to securities that are backed by leases, the portion of the securitized pool balance attributable to the residual value of the physical property underlying the leases, as determined in accordance with the transaction agreements for the securities, does not constitute:

A. For motor vehicle leases, 65% or more, as measured by dollar volume, of the securitized pool balance as of the measurement date.

B. For all other leases, 50% or more, as measured by dollar volume, of the securitized pool balance as of the measurement date.

(3) Notwithstanding the requirement in paragraph (c)(1) of this section that the asset pool be a discrete pool of assets, the following are considered to be a discrete pool of assets for purposes of being considered an asset-backed security:

i. Master trusts. The offering related to the securities contemplates adding additional assets to the pool that backs such securities in connection with future issuances of asset-backed securities backed by such pool. The offering related to the securities also may contemplate additions to the asset pool, to the extent consistent with paragraphs (c)(3)(ii) and (c)(3)(iii) of this section, in connection with maintaining minimum pool balances in accordance with the transaction agreements for master trusts with revolving periods or receivables or other financial assets that arise under revolving accounts.

ii. Prefunding periods. The offering related to the securities contemplates a prefunding account where a portion of the proceeds of that offering is to be used for the future acquisition of additional pool assets, if the duration of the prefunding period does not extend for more than one year from the date of issuance of the securities and the portion of the proceeds for such prefunding account does not involve in excess of:

A. For master trusts, 25% of the aggregate principal balance of the total asset pool whose cash flows support the securities; and

B. For other offerings, 25% of the proceeds of the offering.

iii. Revolving periods. The offering related to the securities contemplates a revolving period where cash flows from the pool assets may be used to acquire additional pool assets, provided, that, for securities backed by receivables or other financial assets that do not arise under revolving accounts, the revolving period does not extend for more than three years from the date of issuance of the securities and the additional pool assets are of the same general character as the original pool assets.

Instructions to Item 1101(c).

1. For purposes of determining non-performing, delinquency and residual value thresholds, the “measurement date” means either:

   a. The designated cut-off date for the transaction (i.e., the date on and after which collections on the pool assets accrue for the benefit of asset-backed security holders), if applicable; or

   b. In the case of master trusts, the date as of which delinquency and loss information or securitized pool balance information, as applicable, is presented in the prospectus for the asset-backed securities to be filed pursuant to §230.424(b) of this chapter.

2. Non-performing and delinquent assets that are not funded or purchased by proceeds from the securities and that are not considered in cash flow calculations for the securities need not be considered as part of the asset pool for purposes of determining non-performing and delinquency thresholds.
3. For purposes of determining non-performing, delinquency and residual value thresholds for master trusts, calculations are to be measured against the total asset pool whose cash flows support the securities.

21. The definition of an “asset-backed security” from Model 280:

"Asset-backed security" means a security or other instrument, excluding a mutual fund, evidencing an interest in, or the right to receive payments from, or payable from distributions on, an asset, a pool of assets or specifically divisible cash flows which are legally transferred to a trust or another special purpose bankruptcy-remote business entity, on the following conditions:

1. The trust or other business entity is established solely for the purpose of acquiring specific types of assets or rights to cash flows, issuing securities and other instruments representing an interest in or right to receive cash flows from those assets or rights, and engaging in activities required to service the assets or rights and any credit enhancement or support features held by the trust or other business entity; and

2. The assets of the trust or other business entity consist solely of interest bearing obligations or other contractual obligations representing the right to receive payment from the cash flows from the assets or rights. However, the existence of credit enhancements, such as letters of credit or guarantees, or support features such as swap agreements, shall not cause a security or other instrument to be ineligible as an asset-backed security.

22. In reviewing the definitions for ABS from the SEC, CFR and Model 280, all of the definitions are consistent in that the assets held in trust must have contractual components that generate cash flow as the primary source to satisfy the issued ABS security. This is explicit in the CFR definition:

Asset-backed security means a security that is primarily serviced by the cash flows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period...

23. Common examples of asset-backed securities include mortgage backed securities (both commercial and residential), auto loans, credit card receivables, equipment lease contracts and student loans. For these examples, traditionally, the securitization occurs by grouping like assets, with securitization issuances split into tranches with differing levels of subordination.

24. The category of “other” asset-backed securities captures a variety of differing structures that do not fit the main categories. Per SIFMA, common subcategories include, cell phone contracts, consumer lending, franchise lending, insurance, timeshares and utility/stranded costs. It is noted that the ABS market continues to evolve, and new securitization arrangements will continue to occur.

25. Although the common categories of ABS generally include the grouping of like assets, collateralized loan obligations (CLOs) are distinctly different because they reflect a bundling of diverse business leveraged loans (senior secured below investment grade bank loans). Another key difference with CLOs is that the portfolio is actively managed over a fixed tenure (“reinvestment period”) during which time the manager of the CLO can buy and sell individual bank loans for the underlying collateral pool to create trading gains and mitigate losses.

26. The different tranches of ABS provide different levels of risk exposure. In a typical structure, there is a senior class with various levels of subordinated tranches. The senior level has the first claim on cashflows, with the subordinated tranches only receiving principal repayments after the more senior classes have been repaid in full. If the underlying asset pool becomes insufficient to make payments on the securities (e.g., an underlying loan supporting the securitization has defaulted), the loss is first absorbed by the subordinated tranches, and the more senior tranches are unaffected unless the losses are so great that
they exceed the entire amount of the subordinated tranches. The most junior class (lowest level tranche), often referred to as the “equity class” or “residual tranche” is the most exposed to default risk. This class receives the residual cash flow (if any) after all other tranches have been fully paid for a given period. Equity level tranches often do not have credit ratings and do not have a stated coupon during the duration of the CLO. These equity / residual tranches do not have a principal balance that is subject to a contractual obligation for return.

27. A variation of ABS is the formation of the “combination (combo) notes.” A combo note packages parts of multiple tranches from a securitization to form a new security. Often, this includes combining a part of a rated (higher-level tranche) with parts of the equity / residual class. By combining different parts of the CLO, the overall security is able to obtain an investment-grade rating for the entire investment, whereas if holding the equity class separately, the security would not be rated and would not be considered investment grade. By holding a combo note, an investor may continue to receive periodic payments representing the cash flows from the higher-level tranche, and not be aware (or not recognize) that the part of the security representing the equity class has experienced a default.

Overview of Key Concepts:

- The issue paper proposes use of the CFR definition for asset-backed securities as a general principle concept for determining scope of SSAP No. 43R. Securities that do not meet the CFR ABS definition will be required to be separately discussed and scoped into the Statement (as applicable).

- Use of the CFR ABS definition clarifies that the general premise of an ABS security is one that is satisfied primarily through receivables and financial assets held in trust that, by the terms of those assets, convert to cash over a finite time period. This definition prevents use of this classification as a means to convert equity instruments into debt instruments, as equity instruments could not be captured in a trust and used as the primary source of repayment for an issued “debt” security as it would not meet the requirements of the ABS definition.

Questions / Comments:

- Are there concerns with the use of the CFR ABS definition as the general principle concept for SSAP No. 43?

- It is expected that PPNs, CFOs and other instruments where the cash flows used to pay the ABS security are not fully contingent on interest and principal payments on assets held in trust would not be considered CFR ABS securities. Comments are requested on whether this assessment is correct, or if these items could qualify as CFR ABS securities.

- Comments are requested on the securities that have historically been captured within scope of SSAP No. 43R that will not meet the CFR ABS definition that should be considered for inclusion in scope of SSAP No. 43R. (Principle concepts for these securities are requested.)
Section 3 - Accounting and Reporting for Asset-Backed Securities

28. This issue paper proposes that ABS, with the exception of tranches that are considered “equity class” or “residual tranches” (this is generally the most junior tranche) and structures combined to include the equity or residual class (e.g. combo notes), will follow historical accounting and reporting provisions reflected within SSAP No. 43R. Historical accounting guidance detailed below:

   a. For reporting entities that maintain an Asset Valuation Reserve (AVR), asset-backed securities 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.

   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) shall be reported at amortized cost. ABS that are designated medium quality, low quality, lowest quality and in or near default (NAIC designations 3 to 6, respectively) shall be reported the lower of cost or fair value.

29. Although the historical accounting and reporting provisions are proposed, this issue paper clarifies that all ABS must be separately reported by tranche. As such, if an insurance reporting entity acquires more than one tranche from an ABS securitization, each tranche shall be separately reviewed for proper statutory accounting and reporting. Furthermore, acquisition of an ABS security that reflects the combination of different tranches from a single ABS securitization, or the combination of tranches from more than one ABS securitization (e.g., a combo note⁷) is required to be bifurcated for accounting and reporting purposes with each ABS securitization tranche reported individually.

   a. Separate tranche reporting is proposed as the combining of different ABS tranches into a new security does not impact the cash flows that would be received from the ABS. An insurer needs to know the cash flows received on each individual tranche to properly assess future cash flows under the provisions of SSAP No. 43R.

   b. In cases where a combo note (or other structure) reflects various rated (debt) tranche levels, each tranche shall be separately reported with the NAIC designation that is attributed to the rating for the specific tranche (not the rating for the overall combined instrument.) In cases in which the combo note includes a component of the non-rated equity class (residual tranche), after the separation of the tranches, the residual tranches shall be accounted and reported in accordance with the provisions of the SSAP for those specific tranches.

30. With the retention of the historical accounting and reporting provisions, this issue paper proposes to retain existing guidance requiring periodic (at least quarterly) assessments of cash flows, as well as guidance when cashflows are probable and the concept of accretable yield. As detailed within, this issue paper proposes revisions to ensure consistency in application when changes in case flows are expected and proposes to require use of the prospective method.

31. This issue paper proposes that equity class / residual tranches not be reported as a debt instruments on Schedule D-1. These tranches do not reflect debt instruments, as there are no contractual cash flows, and these instruments do not meet the definition of a “rated credit instrument” as these tranches of asset-backed securities are not rated instruments. This issue paper proposes the inclusion of new guidance in SSAP No. 43R to clarify that an insurer-holder of these instruments shall initially report them at acquisition cost, not to exceed fair value, in a new dedicated line on Schedule BA. Subsequent measurement would the lower of amortized cost or fair value. Admittance of these investments is proposed, but specific other-than-temporary impairment guidance is proposed to ensure timely realized loss recognition. In determining OTTI, as well as guidance in the recognition of investment income or return on investment, this issue paper proposes to

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⁷ Other examples could also include legacy collateralized debt obligations (CDOs)
require quarterly review of trustee and payment reports to assess the cash flows payments for the entire ABS securitization.

**NAIC Staff Note:** Reporting non-rated equity / residual tranches on Schedule D-1 is problematic as an NAIC designation is required for instruments reported (except for mandatory convertibles) on that schedule. The issuance of combo notes, which are attributed a general rating to the entire security was a mechanism used to capture these securities on Schedule D-1, with an NAIC designation, although the equity class is not a rated security and does not reflect a contractual obligation. By reporting this class outside of Schedule D-1, the instrument is no longer improperly classified as a debt instrument, the reporting does not require an NAIC designation, and appropriate RBC charges would occur. NAIC staff has discussed the reporting of equity class / residual tranches with a handful of interested party / investment representatives and it seems there is currently inconsistent application of how these tranches are being reported. Some responses have indicated that these tranches are already reported on Schedule BA, whereas other responses have indicated that since these are captured in SSAP No. 43R they are reported on Schedule D-1 as debt instruments. In response to inquiries on how they are reported on Schedule D-1 since they are not rated securities and do not have NAIC designations, it has been shared that companies self-designate the securities as either 5GI or 6*. For life entities, by self-designating as a “5” the entity is able to utilize an amortized cost measurement method. Use of an amortized cost measurement method is not appropriate for these securities, as they only receive funds after all other tranches have been fully satisfied.

**Overview of Key Concepts:**

- All CFR ABS (as defined) will be addressed in SSAP No. 43R.
- Each ABS rated debt tranche shall be separately reported for accounting and RBC. (This requires bifurcation of combination notes or other structures where ABS tranches have been combined to form a new security.)
- Tranches reflecting residual tranches / equity classes will be addressed in SSAP No. 43R, but the guidance will require reporting of these tranches on Schedule BA at the lower of amortized cost or fair value. Guidance is proposed to clarify the subsequent reporting of this tranche, particularly for OTTI, investment income, and return of investment.

**Questions / Comments:**

- Are there concerns with including all CFR ABS (as defined) in scope of SSAP No. 43R and allowing for the rated debt tranches of these instruments to generally follow historical accounting / reporting guidance? This guidance determines measurement method based on CRP rating (as permitted by the P&P Manual) translated to the equivocal NAIC designation.
- Should there be guidance that provides differing accounting and reporting treatment based on whether the CFR ABS is a “common” or “broadly syndicated” structure? Is the current collateral codes sufficient to identify new categories of SSAP No. 43R securities?
- From preliminary information received, all insurer-holders of combination notes should have the information necessary to bifurcate and separately report individual tranches. (As this is necessary to properly assess cash flows under the existing requirements of SSAP No. 43R.) However, specific investments details are requested if this is a concerning element.
- Are there concerns with guidance specifying that the residual / equity tranches shall be reported on Schedule BA, on a dedicated reporting line, with a lower of amortized cost or fair value measurement method?
Section 4 - Accounting and Reporting for Non-Asset-Backed Securities (outside CFR ABS definition)

32. This issue paper proposes to review securities that may have been previously reported in scope of SSAP No. 43R, that do not meet the CFR ABS definition, and assess whether the securities shall be retained in scope of that Statement. If retained in scope of SSAP No. 43R, the issue paper will consider whether the securities shall be subject to different accounting and reporting treatment.

33. Although specific types of securities may be reviewed, the issue paper proposes four key concepts in determining whether a securitization structure is principally similar to a CFR ABS and shall be provided similar accounting and reporting treatment in scope of SSAP No. 43R:

   a. Principle 1: Securitization and issuance of debt securities are from a trust / SPV that is separate and distinct as well as bankruptcy remote from the sponsoring organization.

   b. Principle 2: In order to serve as collateral backing issued debt instruments, the assets held in the trust / SPV shall predominantly represent contractual obligation to make payments. Only contracts such as leases, mortgages, loans, and agreements that define payment obligations create the contractual cash flows necessary for securitization. (“Hard” assets shall not serve as the primary collateral for securitizations. Although hard assets (real estate, airplanes, etc.,) may be ultimately available to repay the investor (if needed), these assets only provide secondary security.) For securities that are backed by leases, the repayment may be reliant on the residual value of the physical assets to the extent allowed under the CFR ABS definition. (This is currently detailed in 17 CFR 229.1101 (c)(2)(v).)

   c. Principle 3: The contractual obligations to make payments (assets held in trust / SPV) are owed by many diverse payers. (The term “many” is not defined, but is intended to reflect characteristics of traditional securitizations, in which a broad, diverse population safeguards the performance of the securitization. For this principle, the amount of cash flow generating assets and the payers should be commensurate with the type of securitization. For example, securitized airplane leases would likely meet the “many” requirement with fewer obligations and involved airlines then what would be expected in a securitization of credit card receivables.)

   d. Principle 4: Each securitization distributes periodic performance reports to investors that provide information about the underlying collateral composition, credit quality of obligors and payment performance. (Payment performance shall include the current cash flows and terms related to particular assets and whether payments terms change over time.)

34. If a securitization structure complies clearly with the four principles, it is proposed to be considered principally similar to a CFR ABS and the structure is proposed to be in scope of SSAP No. 43R. This issue paper proposes that the securities issued from the securitization follow the same accounting and reporting guidance as CFR ABS. This would include the specific guidance for tranches that reflect residual tranche / equity class securities and structures combined to include the equity or residual class (combo notes). This would also require that all securities be separately reported by tranche.

35. Securities issued from the securitization (excepting the residual / equity tranches and combo notes) are proposed to retain the ability for filing exempt, if permitted in accordance with the provisions of the P&P Manual, as long as the rating is issued from a CRP registered to provide designations for CFR ABS securities. If a tranche does not have a rating from a qualifying CRP, the security would be required to be filed with the NAIC SVO for a designation assessment.

Staff Note: As these securities are intended to be principally similar to CFR ABS securities, NAIC staff does not believe NRSROs/CRPs that are not SEC registered to provide ratings for ABS securities should be permitted to provide ratings for these securities for NAIC designation purposes.
Overview of Key Concepts:

- This proposes four principle concepts to identify securities that are principally-similar to CFR ABS securities. If the four principles are met, this guidance proposes to have the securities treated in SSAP No. 43R as if they were CFR ABS.

- The proposed guidance suggests restricting CRP ratings to these securities to the NRSROs that are SEC registered for CFR ABS. *(This change would have to be addressed by the VOSTF and captured in the P&P Manual.)*

- Similar to the CFR ABS, each rated debt tranche shall be separately reported for accounting and RBC. *(This requires bifurcation of combination notes or other structures where ABS tranches have been combined to form a new security.)*

- Also, similar to CFR ABS, the residual tranche / equity class will be addressed in SSAP No. 43R, but the guidance will require reporting of this tranche on Schedule BA at the lower of amortized cost or fair value. Guidance will be drafted to clarify the subsequent reporting of this tranche, particularly in the recognition of OTTI, investment income, and return of investment.

Questions / Comments:

- Are there comments with the four proposed principles and whether they will successfully identify securitizations that are principally-similar to CFR ABS?

- Will these principles capture a significant majority of the non-CFR ABS that reflect traditional securitizations? If not, what elements would disqualify those securities?

- Will these principles include securities that go beyond the intent for “traditional securitizations” and if so, what aspects would permit these securities?
Section 5 - Non-Traditional Securitizations

36. With the proposed guidance for CFR ABS and principally-similar securitizations, the next item for review is the appropriate accounting and reporting guidance for structures that do not fit these distinctions. The following general structures have been initially identified for discussion:

a. Structures that issue securities from a trust / SPV with one underlying obligor.

b. Structures that issue securities from a trust / SPV for which the contractual obligations collateralizing the security are not owed by many diverse payers.

c. Structures that issue securities from a trust / SPV where payments made on the issued security are partially impacted by the performance of equity assets held in trust. (For example, if the payment on the security reflects the interest from debt instruments (e.g., Treasury Strip), and the performance of equity investments (e.g., dividends, equity increase, appreciation, etc.) held in trust. (These structures may refer to the need to “harvest” or “liquidate” equity investments in order to access funds to make coupon payments or provide final payment at maturity.) *(This structure does not include PPNs as the debt instrument in trust will not satisfy the amounts owed under the issued security.)*

d. Structures that issue securities from a trust / SPV in which the amount of principal or interest to be returned to the holder is solely impacted by equity or derivative collateral or by reference to an equity index (e.g., S&P 500). (The reference to “equity” includes any type of fund as well as joint venture, LLCs, partnership or SCA interests.)

e. Structures that issue securities from a trust / SPV where a portion of the underlying assets is dedicated to ensuring the repayment of principal at maturity (principal protected notes.)

f. Structures that issue securities from a trust / SPV where the underlying collateral is neither a cash-generating debt instrument nor an equity security. (For example, a structure in which “art” is included in trust as collateral for the issued security.)

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<th>Overview of Key Concepts:</th>
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<td>• This section attempts to identify the types of structures that have been reported in scope of SSAP No. 43R.</td>
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<td>• Are there additional structures that are not captured in the noted categories?</td>
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NAIC Staff: General Comment on Certain Types of Investments:

From discussions on certain types of investments, concerns mostly arise due to the RBC charges that would be applied to the security if reported on Schedule BA. **Similar to past decisions, accounting and reporting that is not in line with the investment type is not proposed simply to obtain a more desirable RBC. Rather, the accounting and reporting shall be based on the type of investment. If the RBC is believed to be inappropriate for the underlying risks, the underlying issue should be identified with discussions / issues involving the Capital Adequacy (E) Task Force.** NAIC staff does not believe regulators expect equity-based investments to be reported as long-term bonds on Schedule D-1.
Section 5a - Structures with Issued Notes Collateralized from One Underlying Obligor

37. The general concept of a securitization is that the security is collateralized by cash flows generated from contractual obligations from many diverse payers. If the structure is one in which a note is issued from a trust / SPV, but the collateral has only one underlying obligor (and not many payers), then the structure does not fit the criteria for a traditional securitization.

38. For these situations, it is proposed that if the underlying obligation from the single obligor would qualify as a debt instrument in scope of SSAP No. 26R, and is not the result of a self-securitization, then the security issued from the trust structure shall also be captured as a debt instrument and retain historical accounting and reporting treatment from SSAP No. 43R. (Presumably, the structure has been captured in scope of SSAP No. 43R, and not SSAP No. 26R, as there is a trust / SPV that has issued the security.)

Staff Note: From info received, some entities may be classifying “equity-related” structures (captured in Sections 5c and/or 5d of this issue paper) as bonds in SSAP No. 26R even though the issued security is from a trust. NAIC staff suggests clarification that these items are excluded from SSAP No. 26R. If the Working Group ultimately concludes that these items can be reported as debt instruments, it is proposed that they be in scope SSAP No. 43R and not SSAP No. 26R. NAIC staff was initially under the impression that if a reporting entity had reported these instruments as debt items, then they would have been captured in SSAP No. 43R due to the presence of the trust structure, and the revisions adopted in 2009. However, it has been identified that this may not be the case and there is inconsistent application in industry.

39. In order to be captured within these provisions, the underlying instrument must fully comply with the requirements of a bond, as defined in SSAP No. 26R, and payments on the note must reflect principal and interest payments that are solely contingent on default risk of the one underlying payee. The following are examples (not all inclusive) of items that would not qualify within this guidance:

   a. Instruments that may resemble “notes” but for which payments of interest and principal are contingent on other factors other than default risk from the underlying payee. For example, structured notes, which are excluded from the scope of SSAP No. 26R, would not be permitted as a debt instrument under SSAP No. 43R simply because it was acquired from a SPV / trust structure.

   b. Instruments that do not meet the definition of a “security” pursuant to SSAP No. 26R. For example, a collateral loan that would be captured in scope of SSAP No. 21R—Other Admitted Assets, shall not be reported as a debt instrument simply due to the involvement of an SPV / trust structure.

40. If the trust / SPV issues more than one instrument (tranche), similar to the guidance for CFR ABS, this issue paper proposes to require separate reporting of each instrument acquired from the trust / SPV.

41. For the instruments that qualify within this section, this issue paper proposes continued use of historical SSAP No. 43R accounting and reporting concepts. Since the instruments in scope of this section are limited to one underlying obligor, it is anticipated that the reported NAIC designation will reflect the credit quality of the instrument from the obligor. The provisions from the NAIC P&P Manual shall be used in determining whether the underlying obligor and investment qualifies as filing exempt. (Staff Note: Since this issuance is intended to reflect a bond issued through a trust / SPV, it is anticipated that the use of the trust / SPV shall not impact the determination of filing exempt or the accounting and reporting guidance.)

   a. For reporting entities that maintain an Asset Valuation Reserve (AVR), asset-backed securities 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.
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) shall be reported at amortized cost. ABS that are designated medium quality, low quality, lowest quality and in or near default (NAIC designations 3 to 6, respectively) shall be reported the lower of cost or fair value.

42. If the investment with one underlying obligor would not separately qualify as a bond, it is proposed that the investment be captured in the applicable SSAP for the underlying investment. Pursuant to this guidance, if the investment from the trust / SPV was a structured note, the item would be in scope of SSAP No. 86—Derivatives. If the item acquired from the trust / SPV reflected an equity investment in a private equity fund or LLC, then the item would be in scope of SSAP No. 48—Joint Ventures, Partnerships and Limited Liabilities Companies. If captured in scope of another Statement, all elements of the applicable Statement shall be considered in determining measurement method and admissibility. (For example, investments in entities captured under SSAP No. 48 must have audited support for admittance. Acquiring an investment through a trust / SPV would not eliminate these admittance provisions.) It is proposed that the substance of the investment, and where it is reported if held individually, shall drive the accounting and reporting for items with one underlying obligor. The involvement of a trust / SPV and/or the presence of a CRP rating shall not be factors in making this determination.

43. If the investment with one underlying obligor is the result of a self-securitization, the guidance in paragraph ___ shall be followed. (Staff Note – This guidance is still under development.)

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**Overview of Key Concepts:**

- This section addresses items that are issued through a trust / SPV but that are collateralized by a single obligor.

- If the underlying investment held in trust would qualify as a bond if held directly, the proposed guidance would retain historical accounting and reporting guidance.

- If the underlying investment would not qualify as a bond if held directly, the guidance proposes to require the underlying investment to be reported under the applicable SSAP. With this guidance, use of a trust / SPV could not be used to capture non-qualifying items on the bond schedule (such as structured notes or collateral loans).

- Pursuant to comments received, some entities may consider investments from trusts / SPV that would be captured in Section 5c or 5d of this issues paper (impacted by performance of equity investments held in trust) as bonds. These items are not intended to be captured within this “one obligor” guidance and shall be captured in Section 5c or 5d.

**Questions / Comments:**

- Are there comments with the proposed guidance / scope of section?

- Is the guidance in paragraph 39a sufficient to exclude investments that rely on the performance of underlying equity investments (e.g., CFOs and other structures) from the scope of the “one-obligor” provisions?
Section 5b - Structures with Issued Notes Not Collateralized by Many Payers

44. As previously noted, the general concept of a securitization is that a security is collateralized by cash flows generated from contractual obligations from many diverse payers. If the structure is one in which the trust / SPV issued security is not collateralized by many diverse payers, then the structure does not fit the criteria of a traditional securitization.

   a. As detailed in paragraph 33.c., the term “many” is not defined, but is intended to reflect characteristics of traditional securitizations, in which a broad, diverse population safeguards the performance of the securitization. For this “many” principle, the amount of expected cash flow generating assets and the payers should be commensurate with the type of securitization. (For example, securitized airplane leases would likely meet the “many” requirement with fewer obligations and involved airlines then what would be expected in a securitization of credit card receivables.) Structures captured in this section would have more than one underlying obligor, but the underlying obligors would not meet the “many” threshold of a traditional securitization.

45. Diversification (cash flow generating collateral from many payers) is a key element in traditional securitizations because a fundamental benefit in acquiring securities through these structures is the reduction of risk exposure. If a structure has limited (not many) payers, questions are raised as to why the investment was acquired through a trust / SPV structure rather than acquired individually. Specifically, the following dynamics have been noted as potentially concerning when there are limited payers in a SSAP No. 43R structure:

   a. Payers are predominantly affiliates of the insurer investor, but the trust / SPV is a separate, bankruptcy remote structure and is not considered an affiliated entity.

   b. Highly-rated payers are coupled with a lower-rated payers to obtain an overall CRP rating that is used for the issued “tranche,” resulting with an improved RBC than what would have been received if the investments captured in the tranche were held separately and reported individually.

46. As the component of many payers is paramount in a traditional securitization for the reduction of risk and in determining the ultimate credit risk used for measurement and RBC, when this characteristic is not met, there are concerns that the accounting and reporting concepts historically reflected in SSAP No. 43R no longer represent the appropriate guidance. For these scenarios, it may be considered inappropriate to permit continuous amortized cost reporting or delay other-than-temporary impairment recognition simply because investments have been collectively captured in a trust / SPV structure and bundled together.

47. If the investment qualifies as a debt instrument, with interest and principal payments fully contingent on cash flow generating assets held in trust (similar to a CFR ABS or traditional securitization), this issue paper proposes that the item be retained within scope of SSAP No. 43R and reported on Schedule D-1. However, in order to ensure that the accounting and reporting properly reflects the risk of the underlying investments, and to mitigate inappropriate use of the trust / SPV structure to combine securities for RBC or other accounting / reporting benefits, this issue paper proposes consideration of the following accounting and reporting guidance:

   a. Regardless of NAIC designation, investments issued from a trust / SPV in which there are limited underlying payers (it does not qualify as “many”) shall be reported at the lower of amortized cost or fair value. (This excludes investments that qualify as a “underlying one obligor” detailed in the previous section and self-securitizations addressed in paragraph ___.)
b. It is proposed that the NAIC designation, which will be used for RBC, shall be determined by the NAIC SVO. (Meaning, these investments are proposed to not be filing exempt.) Or, as an alternative, the guidance could limit CRP ratings to the NRSROs that are approved by the SEC to provide designations on asset-backed securities.

48. Since guidance was already adopted in SSAP No. 25—Affiliates and Other Related Parties and SSAP No. 43R to clarify identification of affiliated investments, no further revisions on this aspect are considered necessary. This issue paper proposes to retain that recently adopted guidance, which clarifies that the inclusion of a non-affiliated intermediary (such as a trust / SPV) does not eliminate the identification of an affiliate investment.

49. The guidance in this section assumes that the investment is fully contingent on cash-flow generating assets held in trust (similar to CFR ABS or traditional securitization). If the security does not meet this criteria, then the investment shall follow the section that reflects the nature of the security:

   a. Section 5c: Structures that issue securities from a trust / SPV where payments made on the issued security are partially impacted by the performance of equity assets held in trust.
   
   b. Section 5d: Structures that issue securities from a trust / SPV in which the amount of principal or interest to be returned to the holder is solely impacted by equity or derivative collateral or by reference to an equity index.
   
   c. Section 5e: Structures that issue principal protected notes.
   
   d. Section 5e: Structures that issue securities from a trust / SPV where the underlying collateral is neither a cash-generating debt instrument nor an equity security.

**Overview of Key Concepts:**

- This section addresses items that do not qualify as a securitization due to the number of underlying payers. The key concern with these structures is that the use of a trust / SPV masks the underlying risk exposure. This is because the reduction of risk, which would generally be expected in a securitization with many payers, is not obtained.

- The proposed guidance would continue to permit the issued securities as debt instruments (if they qualify) in scope of SSAP No. 43R, but would require a lower of amortized cost or fair value measurement method regardless of the NAIC designation. Also, the guidance proposes to require the SVO involvement in determining the appropriate NAIC designation. (It also includes an alternative to permit only CRP ratings from NRSROs that are SEC approved to provide designations on asset-backed securities.)

**Questions / Comments:**

- The guidance proposed in this section is for all debt instrument securities that do not meet the “many” payee threshold. Are there securities that would not meet the “many” threshold, but would have more than a “limited” number of payees? Explicit examples of securities that would be characteristic of this dynamic are requested.

- Should amortized cost (and not LCOM) be permitted for certain investments that are captured in this section? Explicit examples and principle concepts to differentiate these securities are requested.
Section 5c - Structures with Issued Securities Where the Payment on the Issued Securities are Partially Impacted by the Performance of Equity Assets Held in Trust

50. The general concept of a securitization is that a security is collateralized by cash flows generated from contractual obligations from many diverse payers. If the structure is one in which a security is issued from a trust structure but the coupon payments, principal repayment and whether default occurs, is partially determined based on the performance of equity assets held in trust, then the structure does not fit the criteria for a traditional securitization. (As an example, the collateral within the trust includes a Treasury strip and equity instruments, and the trust-issued security includes a “coupon” to the holder that is greater than the amount that would be received from the Treasury instrument. By design, the coupon payments cannot be met if the underlying equity assets do not perform.)

51. The reporting within scope of SSAP No. 43R, reflected on Schedule D-1 as a long-term bond, is intended to reflect debt instruments. One of the key concerns of certain structures is that the issued security from the trust in substance “converts” an equity instrument into a debt instrument. Specifically, the following dynamics have been noted:

a. Although the trust has issued a “note” with stated interest and principal, the issuer is expecting to meet their note obligations through the realization (“harvesting”) of performance results or through the liquidation of equity investments held in trust (joint venture, LLC, other equity instrument or group of such securities.) (Note: The need to “harvest” equity returns to meet the trust/SPV issued security obligations is a key dynamic in considering whether these investments are characteristic of a debt instrument / bond.)

b. Although the trust has issued a “note” with a stated interest and principal, an event of default of the note does not reflect a default based on the credit-worthiness of an underlying asset payer. Rather, the act of default will depend on whether the underlying equity assets do not meet performance expectations that permit the trust to satisfy their obligation.

c. It is identified that some existing structures have established “safeguards” to prevent or defer an event of default. For example, the structure may provide a third-party guarantee to safeguard coupon payments for a limited number of years after origination. Such provisions do not transform the underlying equity instrument into a debt structure, as once the guarantee timeframe has passed the ultimate payment will still be contingent on the equity performance. (If the guarantor provides funds to satisfy coupon payments, guarantor may also receive first payment rights ahead of the security holders when the equity investments are ultimately harvested / liquidated. As such, payment to the security holders at maturity may depend on the balance remaining after the guarantors have been repaid.)

d. It has also been identified that these securities may be reviewed by CRPs and receive high-quality ratings. From what has been gathered, these ratings do not reflect the “credit-quality” of the underlying debt instruments, but rather whether the structure, by design, is likely to satisfy coupon payments. These assessments often focus on the strength of the liquidity facility (guarantor), the availability of a liquidity reserve as well as asset coverage ratios. It has been noted that the CRP ratings received may not come from an NRSRO that is SEC approved to provide ratings on asset-backed securities.

52. Although the instrument may be a “desirable” investment for insurers in terms of liquidity facility safeguards that protect initial coupon payments from equity instrument declines and with the potential equity returns to the insurer holders, the structure does not reflect a debt instrument holding. Although the issuance from the trust structure is a security in the form of a note, the actual investment and the underlying risk to the insurer holder, is contingent on equity holdings.
53. For instruments that meet these characteristics, this issue paper proposes alternative accounting and reporting treatment for these investment structures. Proposed accounting and reporting treatment alternatives are detailed below:

a. Accounting and reporting guidance in SSAP No. 48 (or a new SSAP).

b. Proposed reporting in a new reporting line on Schedule BA.

c. A fair value measurement method

d. Any reported NAIC designations, which would be used for RBC (and not measurement), be determined by the NAIC SVO. (Meaning, these investments are not proposed to be filing exempt.) The determination of any NAIC designation would be dependent on the SVO methodologies to review the instrument.

Staff Note: The issued security from the trust will always resemble a “debt instrument” as there would generally be a stated principal and coupon. However, if the assets held in trust do not provide principal and interest payments (or are not cash flow generating assets) to satisfy the obligation issued from the trust, the instrument issued from the trust is not an actual debt instrument. Rather, the use of the trust / SPV provides the appearance of a debt instrument although the return is contingent on equity instruments. Similar to existing SAP/VOSTF provisions, a CRP rating (whether public or private) does not impact the determination of the investment type or reporting schedule (e.g., a security does not become a “debt instrument” due to the issuance of an CRP rating).

NAIC staff notes (as detailed in the January 2020 interested parties’ response letter) that interested parties and rating agencies believe that, if structured properly (e.g., nonaffiliated and with sufficient overcollateralization), certain securities that are backed by equity assets are appropriate debt securities. As detailed in this issue paper, NAIC staff is currently obtaining a more thorough understanding of these types of securities, including SEC regulated 1940 Act Closed End Fund debt and is inviting further interested party comments on these types of securities.

If these structures are not considered debt instruments, there is no current SSAP guidance that would be applicable for these structures. Although we could point to SSAP No. 48, the structure is more of a commingling of a different equity investments (likely to include SSAP No. 48 entities) and not an explicit ownership interest in a single SSAP No. 48 entity. NAIC staff proposes the development of new guidance in SSAP No. 48 to explicitly include these structures, as well as other private equity fund structures within scope of the guidance. (The use of fair value as the measurement method is different from what would be captured under SSAP No. 48. However, as the underlying investments are a fund, or a commingling of different equity investments, the equity method (as it is based on ownership of a particular interest) would be difficult to apply.

As detailed earlier, some entities may be classifying these as bonds in SSAP No. 26R. NAIC staff would suggest revisions to clarify these items are excluded from SSAP No. 26R. If the Working Group ultimately concludes that these items shall be reported as debt instruments, it is proposed that they be in scope SSAP No. 43R and not SSAP No. 26R. NAIC staff was initially under the impression that if a reporting entity had reported such instruments as debt items, then they would have been captured in SSAP No. 43R due to the presence of the trust structure, and the revisions adopted in 2009, but it has been identified that this may not be the case and there is inconsistent application in industry.).

From discussions on these types of investments, use of a fair value measurement method is not a key concern. Rather, concerns arise due to the RBC charges that would be applied if reported on Schedule BA and not Schedule D-1. Similar to past decisions, accounting and reporting that is not in line with the investment is not proposed simply to obtain a more desirable RBC. If captured on a new reporting line on Schedule BA, a referral could be submitted to the Capital Adequacy (E) Task Force to determine whether...
an “asset coverage ratio” (or other factors) could impact the RBC factor. (Other reporting options could also be considered.)

NAIC staff recognizes that this bucket will likely be the focus of discussion, and it may be difficult to apply a straight-line test in assessing these structures as each of the different instruments have varying components and safeguards. To start the discussion, NAIC staff is recommending focus on instruments in which the principal/interest payment is contingent on the performance of the underlying equity instruments. **However, information on different structures, safeguards and aspects to consider are requested.**

### Overview of Key Concepts:

- This section addresses items where the coupon payments, principal repayment and whether default occurs, is partially determined based on the performance of equity assets held in trust.
- Guidance identifies that these may be desirable investments, but are not debt instruments.
- The proposed guidance suggests alternative accounting and reporting treatment for these securities, suggesting new guidance in SSAP No. 48 or in a new SSAP.
- The information identifies that RBC may be the driving factor in reporting these investments on Schedule D-1.

### Questions / Comments:

- Comments are requested on the different types of structures that would be captured within this category and if there are characteristics that are reflected in some structures that would support different accounting and reporting treatment from other structures in this category.
- Is there a different accounting / reporting approach that should be taken for these securities?
- If these items are excluded from Schedule D-1, what factors (e.g., asset coverage / over-collateralization, etc.,) could be considered in determining an appropriate RBC?
Section 5d - Structures with Issued Securities Where the Payment on the Issued Securities are Solely Impacted by Equity or Derivative Collateral or by Reference to an Equity Index

54. This section addresses securities issued from a trust in the form of a debt instrument, where the payment of interest and principal is solely impacted by the performance of equity instruments or derivative instruments held as collateral and/or reference to an equity index. These securities, although designed to resemble a debt instrument, are in essence equity instruments and are proposed to be excluded from SSAP No. 43R.

55. The focus of this section is on equity or derivative instruments held as collateral and/or specific references to equity indices as the sole determinant in determining the interest / principal that is provided for the issued security. In these scenarios, there are no debt instruments held in trust and the “payment” on the note issued by the SVP is contingent on the performance of the underlying equity / derivative instruments held in trust.

56. For securities captured in scope of this section, if the underlying asset is a single equity instrument or derivative, it is proposed that the instrument follow the accounting and reporting guidance for the underlying collateral held in trust. As such, if the performance is contingent on derivative instruments, the security shall be reported as a derivative. If the performance is contingent on equity collateral or reference to an equity index, the security shall be on Schedule BA.

   a. If the underlying collateral would be reported as a derivative instrument in scope of SSAP No. 86—Derivatives, then the underlying is a derivative instrument and the security is a derivative instrument.

   b. If the underlying collateral would be reported as a common stock, preferred stock, or in scope of SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies, then the underlying is an equity instrument and the security is an equity instrument.

   c. If the payment of interest or principal is contingent on the performance of an equity index, then the security is an equity instrument.

57. For other structures where the issued security is fully impacted by more than one equity instrument (e.g., a number of funds or LLC structures instead of a single fund / LLC), potentially with safeguards to prevent or defer an event of default, the structure is considered similar to Section 5c. Similar to the guidance in that section, instruments issued from these trust/SPV structures are not considered debt instruments as they are contingent on the “harvesting” of equity performance or the liquidation of equity investments in order to meet the trust/SPV’s issued note requirements. As detailed in Section 5c, this issue paper proposes alternative accounting and reporting treatment for these investment structures. Proposed accounting and reporting treatment alternatives include:

   a. Accounting and reporting guidance in SSAP No. 48 (or a new SSAP).

   b. Proposed reporting in a new reporting line on Schedule BA.

   c. A fair value measurement method

   d. Any reported NAIC designations, which would be used for RBC (and not measurement), be determined by the NAIC SVO. (Meaning, these investments are not proposed to be filing exempt.) The determination of any NAIC designation would be dependent on the SVO methodologies to review the instrument.

Staff Note: These scenarios are similar to the items discussed in 5.c, except there is no debt instrument held in trust. Similar to the discussion in 5.c, the issued security from the SPV/trust will always resemble a “debt
instrument” as there would generally be a stated principal and coupon. However, as the assets held in trust do not provide principal and interest payments (and are not cash flow generating assets) to satisfy the obligation issued from the trust, the instrument issued from the trust is not an actual debt instrument. Rather, the use of the trust / SPV has provides the appearance of a debt instrument although the return is contingent on equity instruments. NAIC staff does not believe that a CRP rating (whether public or private) should impact the determination of whether the issued security is a “debt instrument” under this guidance.

Similar to the discussion in 5c, there is currently no SSAP guidance that would be applicable for these structures. Although we could point to SSAP No. 48, the structure is more of a commingling of a different equity investments (likely to include SSAP No. 48 entities) and not an explicit ownership interest in a single SSAP No. 48 entity. From information received, some entities may be classifying these as bonds in SSAP No. 26R. NAIC staff would suggest revisions to clarify these items are excluded from SSAP No. 26R. If the Working Group ultimately concludes that these items shall be reported as debt instruments, it is proposed that they be in scope SSAP No. 43R and not SSAP No. 26R. NAIC staff was initially under the impression that if a reporting entity had reported such instruments as debt items, then they would have been captured in SSAP No. 43R due to the presence of the trust structure, and the revisions adopted in 2009, but it has been identified that this may not be the case and there is inconsistent application in industry.

NAIC staff notes (as detailed in the January 2020 interested parties’ response letter) that interested parties and rating agencies believe that, if structured properly (e.g., nonaffiliated and with sufficient overcollateralization), certain securities that are backed equity assets are appropriate debt securities. As detailed in this issue paper, NAIC staff is currently obtaining a more thorough understanding of these types of securities, including SEC regulated 1940 Act Closed End Fund debt and is inviting further interested party comments on these types of securities.

Overview of Key Concepts:

- This section addresses those items that are solely contingent on derivative or equity collateral and references to equity index performance. The proposed guidance would exclude these securities fully from SSAP No. 43R.

- NAIC staff believes the treatment is in line with the interested parties’ comment letter, and clarification has been included to reflect what is considered an “equity” instrument.

Questions / Comments:

- Is the guidance clear as to what should be considered an equity instrument and excluded from the scope of SSAP No. 43R?

- Are there structures that would be captured within this guidance that would reflect an unintended consequence of what is intended?

- Comments are requested on whether these structures would include differing types of investments (combinations of equity / derivative instruments) and if specific guidance requiring bifurcation should be captured.
Section 5e – Principal Protected Notes

58. A principal-protected note (PPN) is a form of security in which a portion of the underlying assets (or a guarantee) is dedicated to ensuring the repayment of principal at maturity. With this design, other assets are captured in the trust structure, but those assets do not impact the assessment of the performance of the security (e.g., ability to pay interest / principal, OTTI, CRP rating, etc.). The design effectively permits an insurance entity to hold alternative investments in their portfolio without recognizing the insurer entity’s exposure to those underlying assets.

59. It is anticipated that the final issue paper / SSAP guidance will reference the adopted definition of a principal protected note captured in the NAIC Purposes and Procedures Manual of the NAIC Investment Analysis Office. The following definition is being considered by the Valuation of Securities (E) Task Force:

Principal Protected Notes (PPNs) are a type of security that repackages one or more underlying investments and for which contractually promised payments according to a fixed schedule are satisfied by proceeds from an underlying bond(s) (including principal and, if applicable, interest, make whole payments and fees thereon) that if purchased by an insurance company on a stand-alone basis would be eligible for Filing Exemption, but for which: (i) a. the repackaged security structure enables potential returns from the underlying investments in addition to the contractually promised cash flows paid to such repackaged security according to a fixed schedule; OR b. the contractual interest rate paid by the PPN is zero, below market or, in any case, equal to or below the comparable risk-free rate; AND (ii) the insurer would obtain a more favorable Risk Based Capital charge or regulatory treatment for the PPN through Filing Exemption than it would were it to separately file the underlying investments in accordance with the policies in this Manual.

For the avoidance of doubt, PPNs shall not include defeased or pre-refunded securities which have separate instructions in this Manual; broadly syndicated securitizations, such as collateralized loan obligations (CLOs) (including middle market CLOs) and asset backed securities (ABS), except as described in the examples in this section; or CLO or ABS issuances held for purposes of risk retention as required by a governing law or regulation.

60. The Valuation of Securities (E) Task Force is currently proposing to not permit PPNs as filing exempt securities unless the SVO determines there are not any “Other Non-Payment Risks”. As such, these securities are expected to file with the NAIC SVO for assessment.

61. Although the Task Force is already addressing PPNs in terms of NAIC designation, the concept of PPNs does not work well with certain provisions of SSAP No. 43R. Particularly, the existing guidance that uses currently estimated cash flows, allowing both prospective or retrospective adjustment methodologies, in revaluing loan-backed and structured securities, guidance for the assessment of “intent and ability to hold” in determining OTTI, and the guidance permitting an amortized cost measurement method.

62. With regards to adjustment methodologies, under existing guidance if the expected cash flows is greater than original projections, reporting entities recognize the change in one of the following two ways:

a. Prospective Method: The entity utilizes their updated cash flow assessments to recalculate the effective yield for the anticipated future cash flows. For example, if the PPN security provides a 1% return, but the alternative investments held in trust provide greater returns, the reporting entity would recalculate their effective yield to reflect the higher anticipated cash flows. This approach revises the stated effective interest from origination.

b. Retrospective Method: The entity utilizes their updated cash flow assessments to change both the yield and the asset balance so that the future cash flows produce a return on the investment equal to the return expected over the life of the investment as measured from the date of acquisition. Under this method, the recalculated effective yield will equate the present value of the actual and anticipated cash flows with the original cost of the
investment. The current balance is then increased or decreased to the amount that would have resulted had the revised yield been applied since inception and investment income is corresponding decreased or increased.

63. The use of the retrospective approach, as it permits an increase in the asset value is particularly concerning for PPNs. With this approach, if the asset is reported in scope of SSAP No. 43R, an entity is permitted to increase the reported value based on the well-performing underlying assets. However, if the underlying assets were to diminish in value, the reported asset value would never go below the original acquisition cost as the debt security held in trust will ultimately provide a return of principal. This dynamic essentially allows reporting entities to report the “upside” of the alternative investments held in trust, without recognition of any “downside” while excluding the exposure of the alternative investments from all risk-based capital charges.

64. In reviewing the two methodologies, it is identified that the ability to permit optionality is inconsistent with the Statutory Statement of Concepts, and would recommend that a single approach be required for all SSAP No. 43R securities. In considering the two options, this issue paper proposes that the prospective method – as it does not revise the asset balance – would be the more appropriate of the two methodologies to retain for statutory accounting. With the prospective method, the change in estimated cash flows will revise the effective yield of the security on a going forward basis.

65. Although the Task Force is already considering how an NAIC designation should be determined for PPNs, there is continued questions on whether use of an amortized cost approach is appropriate for these securities and whether the other-than-temporary impairment guidance for the insurer’s “intent and ability to hold” was intended to capture these securities.

66. To provide a simple, general illustration of a PPN:

a. On day 1, the insurer provides $50K in funds to the SPV / trust structure in exchange for a debt instrument that provides 1% interest with a stated maturity of 75 years. The trust holds collateral comprised of a $25K AAA rated bond and $25K in cash. A rating of the held collateral focuses on the AAA rated bond, resulting in a 1FE designation from a CRP. If held separately the $25K bond would provide an 8% yield. However, over the time until maturity, the trust structure accumulates the excess bond interest so that at the time of maturity, the assets held in trust is guaranteed to return the acquisition cost ($50K) and the required 1% interest. *(NAIC staff note, all numbers and years are for illustration purposes only and do not necessarily mathematically compute.)*

b. On day 2, the trust uses the cash to acquire $25K in alternative investments. Under the current approach, these investments are not used to update the initial rating from the CRP, and regardless of the performance of the investments, there will be no OTTI recognized or a change in measurement method, as the AAA bond, over a significant number of years, will guarantee performance (return of principal and 1% interest).

67. This issue paper proposes consideration of the following for these securities:

a. PPNs shall always be reported at the lower of amortized cost or fair value. With this approach, the balance sheet will reflect the value of the underlying interests held in trust.

b. PPNs shall not be permitted to utilize the “intent and ability to hold” guidance in determining whether an OTTI has occurred and in determining the amount of an OTTI to recognize. Rather, if fair value has dropped below amortized cost, and the impairment would be other than temporary if it was not for the “securing” bond, then a realized loss shall be recognized.
Overview of Key Concepts:

- This section addresses principal-protected notes (or similar structures), in which only a portion of the assets held in trust ensures the repayment of principal at maturity.

- As detailed, the Valuation of Securities (E) Task Force is currently proposing to exclude these instruments from filing exempt, and require submission to the NAIC SVO in determining NAIC designations.

- In addition to the filing exempt exclusion, the issue paper proposes consideration of a lower of amortized cost or fair value measurement method, as well as restrictions in using the “intent and ability to hold guidance” in determining OTTI.

Questions / Comments:

- In addition to the PPNs, are there other instances in which SSAP No. 43R securities are issued with stated interest rates that would be substantially lower than if the debt instruments were held individually?

- Is the proposed lower of amortized cost or fair value measurement method and the OTTI provisions appropriate for PPNs?

- Should there be additional disclosures for PPNs in the financial statements?
Section 5f - Structures with Issued Securities Where the Underlying Collateral is Neither a Cash-Generating Debt Instrument nor an Equity Security

68. This section addresses securities issued from a trust in the form of a debt instrument where the underlying collateral held in trust does not reflect cash-generating assets or an equity security. One example, which has been noted in an actual SVO filing, is the capturing of artwork as collateral. However, this category can include any type of asset that is not cash-generating or an equity instrument. Other examples could be the inclusion of real estate (if the real estate was not producing cash flows), company-owned software, and company-owned airplanes.

69. A key concern with this structure is that the use of the trust structure to issue a security in scope of SSAP No. 43R mitigates the accounting and reporting provisions of the SSAP that would be applicable if the instrument(s) had been held individually. For example, artwork, software and airplanes are all subject to admittance restrictions. Real estate can also be subject to appraisal requirements.

70. For securities captured in scope of this section, it is proposed that the instruments held in trust follow the accounting and reporting guidance that would be applicable if the collateral assets were held directly. For example, if the underlying collateral asset includes company-owned software, the software shall be assessed and reporting in accordance with SSAP No. 16R—Electronic Data Processing, Equipment and Software. If the underlying collateral asset is artwork or company owned airplanes, the assets shall be accounted for and reported in accordance with SSAP No. 20—Nonadmitted Assets.

71. If the insurer only holds a partial percentage (less than 100%) of the issued SPV / trust securities, the reporting entity shall only reflect their percentage of ownership of the underlying collateral assets when reporting the asset.

72. This guidance does not apply to self-securitizations in which the company assets are legally sold and re-acquired through securitizations that comply with the ABS CFR guidance or a traditional securitization. However, pursuant to the ABS and traditional securitization guidance, the collateral held in trust must reflect cash-generating assets.

NAIC Staff: Further discussion on self-securitizations is expected in subsequent issue paper drafts.

Overview of Key Concepts:

- This section addresses structures where the collateral held in trust is neither a cash-generating debt instrument nor an equity security.
- The guidance proposes to exclude these structures completely from SSAP No. 43R. It is identified that such structures may be designed to circumvent reporting if the underlying collateral had been held directly.

Questions / Comments:

- Is the guidance clear enough to ensure that this only captures non-cash generating assets and non-equity securities?
- Are there structures that would be captured within this guidance that would reflect an unintended consequence of what is intended?
- It is anticipated that these structures are not overly common, but information would be requested on the prevalence of these instances.
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On January 7, 2020, the Statutory Accounting Principles (E) Working Group received the following four referrals from the Valuation of Securities (E) Task Force. Each referral is summarized herein and is accompanied with recommended actions/responses.

1) Retitling of the NAIC Money Market Mutual Fund List and the discontinuance of the NAIC Bond Fund List.

Summary:
This update retitles the “NAIC U.S. Direct Obligations/Full Faith and Credit Exempt Money Market Funds List” to “NAIC U.S. Government Money Market Fund List” and proposes to eliminate the “NAIC Bond Fund List,” which is currently referenced in SSAP No. 26R—Bonds.

Current Guidance:
The current NAIC U.S. Direct Obligations/Full Faith and Credit Exempt Money Market Funds List is not referenced in the AP&P manual, however the sole reference to the NAIC Bond Fund List is detailed herein.

As detailed in SSAP No. 26R, paragraph 4b, Bond Mutual Funds on the Bond List are within scope of this standard.

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

a. Exchange traded funds (ETFs), which qualify for bond treatment, as identified in Part Six, Section 2 of the Purposes and Procedures Manual of the NAIC Investment Analysis Office. (SVO-identified ETFs are reported on Schedule D – Part 1.)

b. Bond mutual funds which qualify for the Bond List, as identified in Part Six, Section 2 of the Purposes and Procedures Manual of the NAIC Investment Analysis Office. (SVO-identified bond mutual funds are reported on Schedule D – Part 1.)

Recommendation by NAIC staff:
NAIC staff recommends a new agenda item to remove reference of the Bond List in SSAP No. 26R. It is suggested that final action will not occur until the Valuation of Securities (E) Task Force finalized the agenda item. Although revisions are not needed in SAP to update the title of the noted money market mutual funds, NAIC staff notes that referrals to the Blanks (E) Working Group and the Capital Adequacy (E) Task Force will be needed to reflect the title change in Blanks and RBC.
2) Including Ground Lease Financing Transactions in scope of SSAP No. 43R—Loan-Backed and Structured Securities.

Summary:
A ground lease financing structure is materially similar to credit tenant loans, which are specifically referenced in SSAP No. 43R. The Task Force at the Fall National Meeting adopted an amendment to add ground lease financing as a newly defined asset class to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) effective January 1, 2020. The guidance provides SVO evaluation and filing criteria for ground lease financing and notes that they are not eligible to be treated as a filing exempt bond but must be filed with the SVO. In addition, the P&P revisions provides grandfathering of a GLF acquired prior to Jan. 1, 2020 based on the eligible CRP rating until sold or disposed.

The referral to the Working Group requests that ground lease financing investments which are SVO rated be noted in the accounting guidance as eligible for Schedule D, Part 1 reporting under the criteria adopted by the Task Force.

A credit tenant loan is issued to the owner of certain real property, however, is made primarily in reliance on the credit standing of the tenant on the long-term leased property. Such loans are typically structured with an assignment of the rental payments to the lender and with the real property pledged as collateral in the form of a first lien. These loans are generally structured in terms of the lease to require the tenant to continue to pay rent regardless of what occurs to the leased premises (e.g. casualty or condemnation). The leases are considered, with certain recognized variants in the P&P manual, to be “hell or high water” or “triple net” in nature. Due to this structure, the SVO can solely focus on the credit worthiness of the tenant in the determination of an applicable designation.

Similarly, a ground lease financing structure includes a long-term ground lease in which the lessee intends significant land development and intends to sublease to other long-term tenants for the operation of a business (e.g. warehousing or hangar space). Ground lease financing agreements also contain “hell or high water” or “triple net” clauses, which again allow the SVO to solely focus on the credit worthiness of the tenants in the determination of an applicable designation.

Current Guidance:
SSAP No. 43R establishes statutory accounting principles for investments for loan-backed and structured securities. A reference to credit tenant loans is currently captured in paragraph 27.b:

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

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

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**Recommendation by NAIC staff:**
Credit tenant loans are currently referenced as an example of an “all other” loan-backed and structured security. No other mention of this investment type is found in SSAP No. 43R. **NAIC staff does not believe statutory accounting revisions are necessary at this time.** Additionally, it is anticipated these investments will be covered in the current substantive project to revise SSAP No. 43R (Ref #2019-21), as directed by the Working Group on January 8, 2020.

However, if preferred by the Working Group, a new agenda item could be drafted to incorporate revisions to SSAP No. 43R, paragraph 26.b. to include a reference to ground lease financing as permitted if rated by the SVO pursuant to the *Purpose and Procedures Manual of the NAIC Investment Analysis Office*.

3) **Removal of the multi-step financial modeling instructions for RMBS/CMBS securities.**

**Summary:**
The current RMBS/CMBS multi-step modeling practice is the only remaining approach that utilizes breakpoints to determine final NAIC designations. In March of 2019, the elimination of MFE resulted in the production of a single NAIC Designation and NAIC Designations Category based on Eligible NAIC CRP Credit Ratings. Subsequently at the 2019 Fall National Meeting, this exposure was issued to consider removing the multi-step financial modeling instructions that utilize the book/adjusted carrying value price breakpoints and instead proposed financial modeling instructions that would determine a single NAIC designation and category.

**Current Guidance:**
The modeling of RMBS/CMBS securities is currently detailed in SSAP No. 43R, paragraphs 26-27.

26. Loan-backed and structured securities shall be valued and reported in accordance with this statement, the *Purpose and Procedures Manual of the NAIC Investment Analysis Office*, and the designation assigned in the *NAIC Valuations of Securities* product prepared by the NAIC Securities Valuation Office or equivalent specified procedure. The carrying value method shall be determined as follows:

a. For reporting entities that maintain an Asset Valuation Reserve (AVR), loan-backed and structured securities 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.

b. For reporting entities that do not maintain an AVR, loan-backed and structured securities designated highest-quality and high-quality (NAIC designations 1 and 2, respectively) 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.

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

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

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

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

Recommendation by NAIC staff:
During the 2019 Fall National Meeting, the SAPWG exposed agenda item 2019-41, which proposed revisions to SSAP No. 43R, as illustrated above, to eliminate the multi-step financial modeling designation guidance in determining final NAIC designations for residential mortgage-backed securities (RMBS) / commercial mortgage-backed securities (CMBS) securities. The Working Group noted that final action on this would not be taken until the Valuation of Securities (E) Task Force takes action on their related item. As the Working Group has already exposed revisions in anticipation of this referral, no further action is needed at this time.

4) Updates to interim instructions for Mortgage Reference Securities

Summary:
This update is to provide interim guidance for mortgage reference securities that were issued or acquired prior to the publishing of updated annual surveillance data. In effect, this update requires the most recent or available data be used for modeling, however if not available, a “Z” symbol will be used provided the security meets the criteria for a security that is in transition in reporting of filing status.

Current Guidance:
Valuation and reporting guidance of mortgage reference securities is notated in paragraph 26 of SSAP No. 43R—Loan-Backed and Structured Securities. Although current SSAP No. 43R guidance provides interim reporting guidance for RMBS and CMBS securities, this guidance is currently proposed to be eliminated in agenda item 2019-41 with the elimination of the financial modeling provisions.

26. Loan-backed and structured securities shall be valued and reported in accordance with this statement, the Purposes and Procedures Manual of the NAIC Investment Analysis Office, and the designation assigned in the NAIC Valuations of Securities product prepared by the NAIC Securities Valuation Office or equivalent specified procedure.

The following guidance proposed to be deleted in agenda item 2019-41:

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

28. The guidance in this paragraph shall be applied in determining the reporting method for residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS) acquired in the current year for quarterly financial statements. Securities reported as of the prior-year end shall continue to be reported under the prior-year end methodology for the current-year quarterly financial
statements. For year-end reporting, securities shall be reported in accordance with paragraph 27, regardless of the quarterly methodology used.

a. Reporting entities that acquired the entire financial modeling database for the prior-year end are required to follow the financial modeling methodology (paragraph 27.a.) for all securities acquired in the subsequent year that were included in the financial modeling data acquired for the prior year-end.

b. Reporting entities that acquired identical securities (identical CUSIP) to those held and financially modeled for the prior year-end are required to follow the prior year-end financial modeling methodology (paragraph 27.a.) for these securities acquired subsequent to year-end.

c. Reporting entities that do not acquire the prior-year financial modeling information for current-year acquired individual CUSIPS, and are not captured within paragraphs 28.a. or 28.b., are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate). Reporting entities that do acquire the individual CUSIP information from the prior-year financial modeling database shall use that information for interim reporting.

d. Reporting entities that acquire securities not previously modeled at the prior year-end are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate).

Recommendation by NAIC staff:
NAIC staff does not believe statutory accounting revisions are necessary to reflect the interim reporting guidance adopted by the Task Force. NAIC staff recommends that guidance on the reporting designation (use of the “Z” symbol), should be retained in the Purposes and Procedures Manual of the NAIC IAO.

(NAIC staff supports the continued deletion of the interim guidance for RMBS/CMBS securities as part of the removal of the financial modeling process from SSAP No. 43R.)
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MEMORANDUM

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

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

Cc: Charles Therriault, Director, NAIC Securities Valuation Office
    Julie Gann, Assistant Director, NAIC Financial Regulatory Services
    James Pinegar, Manager II, NAIC Financial Regulatory Services

DATE: January 3, 2020


1. **Summary** – The P&P Manual authorizes the SVO to maintain two special fund lists. The first is the NAIC U.S. Direct Obligations/Full Faith and Credit Exempt Money Market Funds List. This list of Money Market Funds (MMF) gets special treatment because they can be reported as a cash equivalent on Schedule E, Part 2. The SVO proposed simplifying the title of this list to “NAIC U.S. Government Money Market Fund List.” This is only a proposed title simplification change.

The second list is the NAIC Bond Fund List which is limited to funds that maintain the highest credit quality rating, maintain the highest market risk rating (a rating type that is no longer assigned), and invests 100% of its total assets in U.S. Government securities along with several other restrictive criteria. The SVO reported that only four funds qualify for this list and that four insurers invested in just one of the four qualify funds for a combined exposure of $11.8 million book adjusted carrying value (BACV) as of December 31, 2018. With the adoption of the Comprehensive Instructions for Fund Investments by the Task Force on April 7th that provides new instructions for Fixed Income-Like SEC Registered Funds and given the limited number of insurers investing in the funds on the NAIC Bond Fund List, the SVO proposed eliminating this list when the four funds come up for renewal in 2020 and migrating them over to the new NAIC Fixed Income-Like SEC Registered Funds list.

2. **The Referral** - The Task Force on the October 31st call requested a referral to the Working Group to consider and advise the Task Force on any issues or concerns it may have with adopting the amendment to: A) rename the “NAIC U.S. Direct Obligations/Full Faith and Credit Exempt Money Market Funds List” to the “NAIC U.S. Government Money Market Fund List” for cash equivalent reporting on Schedule E, Part 2; and B) eliminating the “NAIC Bond Fund List” that is referenced in SSAP No. 26R – Bonds in 2020 and migrating these funds over to the “NAIC Fixed Income-Like SEC Registered Funds List” that will be reported on Schedule D, Part 2 under SSAP No. 30R – Unaffiliated Common Stock.

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

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

FROM: Charles A. Therriault, Director, NAIC Securities Valuation Office (SVO)

CC: Marc Perlman, Investment Counsel, NAIC Securities Valuation Office (SVO)
Eric Kolchinsky, Director, NAIC Structured Securities Group (SSG) and Capital Markets Bureau


DATE: September 30, 2019

1. Summary – The P&P Manual authorizes the SVO to maintain two special fund list. The first is the NAIC U.S. Direct Obligations/Full Faith and Credit Exempt Money Market Funds List. This list of Money Market Funds (MMF) gets special treatment because they can be reported as a cash equivalent on Schedule E, Part 2. The SVO proposes simplifying the title of this list to “NAIC U.S. Government Money Market Fund List.” This is only a title change to simplify the title of the list.

The second is the NAIC Bond Fund List, where the SVO reviews that a fund maintains the highest credit quality rating, maintains the highest market risk rating (this rating type that is no longer assigned), and invests 100% of its total assets in U.S. Government securities along with several other restrictive criteria. Only four funds qualify for this list and the four insurers invested in the fund have a combined exposure of $11.8 million BACV in one of the four qualify funds as of December 31, 2018. With the adoption of the Comprehensive Instructions for Fund Investments on April 7th that provided new instructions for Fixed Income-Like SEC Registered Funds and given the limited number of insurers investing in the funds on the NAIC Bond Fund List, the SVO proposes eliminating this list when the four funds come up for renewal in 2020. The funds on the NAIC Bond Fund List would be eligible for NAIC Fixed Income-Like SEC Registered Funds List and the SVO would be willing to allow these fund issuers to apply to be on this new list at their renewal, if they were so interested. This change would require a referral to the Statutory Accounting Principles (E) Working Group as the NAIC Bond Fund List is referenced in SSAP No. 26R – Bonds.

2. Proposed Amendment – The text referencing these instructions for U.S. Direct Obligations/Full Faith and Credit Exempt Money Market Funds List and NAIC Bond Fund List is shown below, edits in red-underline, as it will appear in the 2019 P&P Manual format.

___________________________________________
_________________________________________
247. **Regulatory Treatment of Eligible Funds** — A money market mutual fund on the NAIC U.S. Government Money Market Fund List U.S. Direct Obligations/Full Faith and Credit Exempt Money Market Funds List is reported as a cash equivalent on Schedule E, Part 2 on the “Exempt Money Market Mutual Funds – as Identified by the SVO” line. These “exempt” money market mutual funds are reported at fair value and incur a zero percent (0%) risk-based-capital (RBC) charge. Other money market mutual funds are also reported as cash equivalents on Schedule E, Part 2 on the “All Other Money Market Mutual Funds” line. The “all other” money market mutual funds are also reported at fair value but incur an RBC charge similar to other cash equivalents.

248. **Required Documentation** — An insurance company or the sponsor of a money market mutual fund requests an SVO evaluation that a money market mutual fund is eligible to be listed on the NAIC U.S. Government Money Market Fund List U.S. Direct Obligations/Full Faith and Credit Exempt Money Market Funds List by submitting the following documentation to the SVO:

- The money market mutual fund application form.
- Authorization letter requesting review of the fund for the purpose of being added to the List.
- The most recent fund:
  - Prospectus;
  - Statement of Additional Information (SAI); and
  - Annual, and if available, the semi-annual report.
- Rating letter from an NAIC CRP dated in the year of the filing.

249. **Eligibility Criteria** — A money market mutual fund is eligible for inclusion on the NAIC U.S. Government Money Market Fund List U.S. Direct Obligations/Full Faith and Credit Exempt Money Market Funds List if the fund meets the following conditions:

- The fund maintains a money market mutual fund rating of AAAm from Standard & Poor’s or Aaa-mf from Moody’s Investor Services or an equivalent money market mutual fund rating from any NAIC CRP.
- The fund maintains a stable net asset value per share of $1.00.
- The fund allows a maximum of seven-day redemption of proceeds.
- The fund invests 100% of its total assets in securities that are direct obligations of the U.S. Government and/or in securities that are backed by the full faith and credit of the U.S. Government or collateralized repurchase agreements comprised of such obligations at all times.

**NOTE:** Please refer to text below for a list of securities considered to be direct obligations of the U.S. Government and entities that are entitled to the full faith and credit of the U.S. Government.

250. **Verification Procedure** — Upon receipt of the documentation, the SVO examines the prospectus, schedule of fund portfolio holdings and related materials to verify that the fund meets the established criteria.
The NAIC Bond Mutual Fund List

251. **Regulatory Treatment of Eligible Funds** — A bond mutual fund on the NAIC Bond Mutual Fund List is in scope of SSAP No. 26R, "Bonds," reported with an NAIC 1 designation on Schedule D, Part 1, Long Term Bonds on the "SVO Identified Funds — Bond Mutual Funds" line. The insurance company reports an NAIC 1 Designation in accordance with Annual Statement Instructions. These investments are reported at fair value unless the investment qualifies for and the reporting entity elects systematic value.

252. **Required Documentation** — An insurance company or the sponsor of a bond mutual fund requests an SVO evaluation that a bond mutual fund is eligible for inclusion on the Bond Mutual Fund List by submitting the following documentation to the SVO:
   - The bond fund application form.
   - Authorization letter requesting review of the fund for the purpose of inclusion on the Bond Mutual Fund List.
   - The most recent fund:
     - Prospectus;
     - Statement of Additional Information (SAI); and
     - Annual, and if available, the semi-annual report.
   - Rating letter from an NAIC CRP dated in the year of the filing.

253. **Eligibility Criteria** — A bond mutual fund is eligible for inclusion on the Bond List if the fund meets the following conditions:
   - The fund shall maintain the highest credit quality rating given by an NAIC CRP.
   - The fund shall maintain at least the highest market risk rating given by an NAIC CRP to a fund that invests in class 1 bonds that are issued or guaranteed as to payment of principal and interest by agencies and instrumentalities of the U.S. Government, including loan-backed bonds and collateralized mortgage obligations, and collateralized repurchase agreements comprised of those obligations.
   - The fund shall allow a maximum of seven-day redemption of proceeds.
   - The fund shall invest 100% of its total assets in the U.S. Government securities listed in the section below, class 1 bonds that are issued or guaranteed as to payment of principal and interest by agencies and instrumentalities of the U.S. Government, including loan-backed bonds and collateralized mortgage obligations, and collateralized repurchase agreements comprised of those obligations at all times.
   - The fund shall declare a dividend of its net investment income each day prior to calculating its net asset value per share.
   - The fund shall not invest in any derivative instruments, as that term is defined in the NAIC Accounting Practices and Procedures Manual.
   - The fund shall not invest in any bonds that receive some or all of the interest portion of the underlying collateral and little or no principal, or in any bonds with coupons which reset periodically based on an index and which vary inversely with changes in the index.
   - The fund shall not invest in the following types of securities: (a) leveraged or deleveraged notes that pay a multiple or fraction of an index or indices; (b) notes that pay principal or interest linked to foreign currencies, non-U.S. dollar interest rates, equity or commodities indices or any other index that is not composed of U.S. dollar denominated fixed-income instruments; or (c) notes that pay principal or interest linked to more than one index.
254. **Verification Procedure** – Upon receipt of the documentation, the SVO examines the prospectus, schedule of fund portfolio holdings and related materials to verify that the fund meets the established criteria.

...
MEMORANDUM

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

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

Cc: Charles Therriault, Director, NAIC Securities Valuation Office
    Julie Gann, Assistant Director, NAIC Financial Regulatory Services
    James Pinegar, Manager II, NAIC Financial Regulatory Services

DATE: January 3, 2020

RE: Referral to the Statutory Accounting Principles (E) Working Group Requesting Affirmation that Ground Lease Financing Transactions are included in SSAP No. 43R – Loan-Backed and Structured Securities

1. Summary – The Task Force adopted a P&P Manual amendment at the Fall National Meeting that included new definitions and guidance for ground lease financing (GLF) transactions. GLF transactions are similar to credit tenant loan (CTL) transactions but possess sufficient differences that the SVO recommended new instructions.

Credit Tenant Loans – CTLs are loans made to the owner of real property but made primarily in reliance on the credit standing of the tenant on a long-term lease of such property (generally highly rated by an NAIC CRP), structured with an assignment of the rental payments under such lease to the lender with such real property pledged as collateral in the form of a first lien. CTLs are generally structured around the terms of the lease which, in its strongest form, requires the tenant to perform all obligations related to the leased premises thereby obligating the tenant to continue to pay rent regardless of what occurs to the leased premises (e.g. casualty or condemnation). The leases are typically considered, with certain recognized variants in the P&P, to be “hell or high water” or “triple net” in nature. Therefore, the SVOs analytic focus is on the credit worthiness of the tenant (or its guarantor), and not the real property characteristics of the premises. Given these structural requirements, CTLs are not eligible the Filing Exempt (FE) process but are permitted to be reported on Schedule D only if the SVO determines they meet the eligibility requirements defined in the P&P Manual.

Ground Lease Financings – A GLF transaction typically has two components: (i) a ground lease for a long period (e.g. 99 years) between a ground lessor who owns the land and a ground lessee who attains a leasehold for the purpose of developing the land, and (ii) the subleasing of space or operation of a business such as a hotel, warehouse, intermodal facility, etc. in an existing or to-be-constructed building to one or more tenants (space tenants) under shorter (e.g. 5-15 year) leases (space leases) or to the operator of a business such as a hotel, warehouse, intermodal facility, etc. under a franchise agreement or other arrangement.

Both the ground lessor and ground lessee will typically finance their respective estates (i.e., the fee estate of the ground lessor and the leasehold estate of the ground lessee); (i) the ground lessor, typically, with the issuance of debt-like certificates or notes, and (ii) the ground lessee, typically, by borrowing from a financial institution or traditional mortgage lender. To secure the financing, the ground lessor will grant to the lender a mortgage on the fee property such ground lessor owns, and the ground lessee will pledge to the leasehold lender its leasehold estate and its rights under the ground lease and in the improvements which it owns and the space leases if any.

Typically, in a GLF transaction neither the ground lessor nor the ground lessee is an entity either (i) rated by an NAIC CRP or
(ii) whose credit worthiness can be evaluated by the SVO. Rather, they are special purpose vehicles (SPVs) intended to be bankruptcy remote.

Comparison of CTLs and GLFs – Due to the “hell or high water” or “triple net” nature of the lease in a CTL transaction or, in the instance where there are variances, their mitigation in accordance with the P&P CTL criteria, the SVO can focus its analysis on the credit worthiness of the credit tenant and not on an analysis of the underlying property. This type of lease eliminates the investor’s exposure to property risk as all payments owed to the investor ultimately come from the tenant. In a GLF transaction it is often the case that the terms of the ground lease itself (the first leg of the transaction) is structured with the same attributes as a lease in a CTL transaction (e.g. it is “hell or high water” or “triple net”). However, because the ground lessee is an SPV rather than an operating entity, there is no NAIC CRP credit rating or SVO credit analysis to rely on.

The SVO proposed a decision-tree approach to analyzing these transactions that looks at the nature of the space tenant leases and the rent payments of the space tenants or the operation of the business being conducted on such property. The analysis focuses on the credit worthiness of the space tenant (or its guarantor) or their cash flow generation, and not the real property characteristics of the premises. Given these structural requirements, GLFs are also not eligible the Filing Exempt (FE) process but would also be permitted to be reported on Schedule D only if the SVO determines they meet the eligibility requirements defined in the P&P Manual.

2. The Referral - The Task Force at the Fall National Meeting on December 8th adopted this jointly (SVO and industry) proposed amendment to add GLFs to the P&P Manual and requested a referral to the Working Group for affirmation that these investments are eligible for Schedule D, Part 1 reporting under the criteria proposed. GLF transactions have historically been reported under the Accounting Practices & Procedures Manual’s SSAP No. 43R – Loan-Backed and Structured Securities under Paragraph 26, b as a type of CTL. The SVO staff recommends either affirming that treatment or specifically inserting “ground lease financing (GLF)” into the list of example securities.

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

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

FROM: Charles A. Therriault, Director, NAIC Securities Valuation Office (SVO)  
       Marc Perlman, Investment Counsel, NAIC Securities Valuation Office (SVO)  
       Catholic Order of Foresters  
       CGA Capital  
       Mesirow Financial, Inc.  
       CTL Capital  
       Waterway Capital

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

RE: Joint Proposed Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) to Add Ground Lease Financing Transactions as New Asset Class

DATE: October 17, 2019

1. Introduction – Earlier in 2019 the SVO became aware that certain insurance company filers were submitting credit tenant loan (CTL) transactions and transactions which are herein defined as ground lease financing (GLF) transactions through the Filing Exempt (FE) process. The SVO subsequently explained to the market that (i) all CTL structures must be submitted to the SVO for review pursuant to Part One, Paragraph 106 and Part Three, Paragraph 4 of the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P), (ii) the SVO considered GLF transactions distinct from CTL transactions and (iii) the SVO identified that it would need to study the GLF transactions before they could make a recommendation to the Valuation of Securities (E) Task Force on whether NAIC Designations could be assigned to these structures and if they should be eligible for Schedule D reporting given their credit and legal risks. The SVO has now completed that study and a discussion of the SVO’s evaluation of the GLF asset class, its proposed approach to analyzing GLF transactions, and its recommended related amendments to the P&P follow.

2. Analytic Overview –

Credit Tenant Loans – CTLs are loans made to the owner of real property but made primarily in reliance on the credit standing of the tenant on a long-term lease of such property (generally highly rated by an NAIC CRP), structured with an assignment of the rental payments under such lease to the lender with such real property pledged as collateral in the form of a first lien. CTLs are generally structured around the terms of the lease which, in its strongest form, requires the tenant to perform all obligations related to the leased premises thereby obligating the tenant to continue to pay rent regardless of what occurs to the leased premises (e.g. casualty or condemnation). The leases are typically considered, with certain recognized variants in the P&P, to be “hell or high water” or “triple net” in nature. Therefore, the SVOs analytic focus is on the credit worthiness of the tenant (or its guarantor), and not the...
real property characteristics of the premises. As explained in the CTL section of Part Three of the P&P, the SVO recognizes four categories of CTLs as eligible for reporting on Schedule D (Bond Lease Based CTLs, Credit Lease Based CTLs, Acceptable CTL Variants (ACVs), and Multiple Property Transactions (MPTs)), each with varying degrees of landlord obligation and real estate risk exposure and varying legal and structural complexity. Pursuant to the P&P’s CTL criteria, each enumerated permitted landlord obligation or risk must be explicitly addressed with an enumerated mitigant. (CTLs are explained extensively in the P&P, Part Three, Paragraphs 71 – 91.)

**Ground Lease Financings** – A GLF transaction typically has two components: (i) a ground lease for a long period (e.g. 99 years) between a ground lessor who owns the land and a ground lessee who attains a leasehold for the purpose of developing the land, and (ii) the subleasing of space or operation of a business such as a hotel, warehouse, intermodal facility, etc. in an existing or to-be-constructed building to one or more tenants (space tenants) under shorter (e.g. 5-15 year) leases (space leases) or to the operator of a business such as a hotel, warehouse, intermodal facility, etc. under a franchise agreement or other arrangement.

Both the ground lessor and ground lessee will typically finance their respective estates (i.e., the fee estate of the ground lessor and the leasehold estate of the ground lessee); (i) the ground lessor, typically, with the issuance of debt-like certificates or notes, and (ii) the ground lessee, typically, by borrowing from a financial institution or traditional mortgage lender. To secure the financing, the ground lessor will grant to the lender a mortgage on the fee property such ground lessor owns, and the ground lessee will pledge to the leasehold lender its leasehold estate and its rights under the ground lease and in the improvements which it owns and the space leases if any.

Typically, in a GLF transaction neither the ground lessor nor the ground lessee is an entity either (i) rated by an NAIC CRP or (ii) whose credit worthiness can be evaluated by the SVO. Rather, they are special purpose vehicles (SPVs) intended to be bankruptcy remote.

**Comparison of CTLs and GLFs** – Due to the “hell or high water” or “triple net” nature of the lease in a CTL transaction or, in the instance where there are variances, their mitigation in accordance with the P&P CTL criteria, the SVO can focus its analysis on the credit worthiness of the credit tenant and not on an analysis of the underlying property. This type of lease eliminates the investor’s exposure to property risk as all payments owed to the investor ultimately come from the tenant.

In a GLF transaction it is often the case that the terms of the ground lease itself (the first leg of the transaction) is structured with the same attributes as a lease in a CTL transaction (e.g. it is “hell or high water” or “triple net”). However, because the ground lessee is an SPV rather than an operating entity, there is no NAIC CRP credit rating or SVO credit analysis to rely on. To determine whether the ground lessor will have sufficient funds to pay its ground lease obligations the SVO must look to the rent payments of the space tenants or the operation of the business being conducted on such property. The SVO, in conjunction with the NAIC Structured Securities Group (SSG) takes the position that the analysis of space leases and space tenants can be more akin to a commercial mortgage backed security (CMBS) analysis than the corporate analysis in a CTL transaction because the space leases may not meet the CTL criteria and can consist of several space tenants of differing credit profiles and each with differing space lease terms. We note that some of the NAIC CRPs which assign ratings to GLF transactions have utilized their CMBS models in their GLF ratings process, but their methodologies and criteria vary widely. The SVO understands that in most GLF transactions the certificate holder, the insurer as the investor, is in a “last loss”, or most senior, position. However, regardless of where they stand in the waterfall, unlike a traditional CTL transaction, ultimate payment on the GLF certificates is dependent not on a single credit tenant, but rather on payments by all the space tenants (which are not necessarily NAIC CRP rated or SVO analyzed entities) pursuant to space leases (which do not necessarily meet the CTL criteria).
Proposal – Recognizing that there are variances in how GLF transactions are structured the SVO proposes amending the P&P to institute a multi-pronged approach to analyzing these transactions. The proposed P&P amendments would include adding GLF transactions as a new asset class and would outline our GLF analytic process as follows:

a. The SVO would analyze the ground lease to determine if it meets the criteria for Bond Lease Based CTLs or Credit Lease Based CTLs in the P&P. We expect most ground leases to meet this test. Ground lease inconsistency with the Bond or Credit Lease Based CTL criteria would result in ineligibility for Schedule D reporting.

b. If the ground lease meets the Bond or Credit Lease Based CTL criteria and if three or fewer space tenants, each of which either (i) are rated by an NAIC CRP or (ii) whose credit worthiness can be evaluated by the SVO, when combined comprise 90% or more of the total space lease payment obligations, the SVO would analyze the space leases to determine if they meet the CTL criteria for one of the four CTL categories in the P&P. If so, the SVO could, in its sole discretion and based on its analytic judgement, analyze the transaction as akin to a CTL, based on the CTL-like nature of both the ground and space leases, the limited number of space leases and the credit profiles of the space tenants. We expect a small fraction of all GLF transactions to fall in this category.

c. If the ground lease meets the Bond or Credit Lease Based CTL criteria and there are four or more space tenants, or the SVO has determined that the transaction does not meet the criteria set forth in clause (b.) above or if there are no space tenants but one operator of a business on the leasehold such as a hotel, warehouse, intermodal facility, etc., the SVO may refer the space leases or the business operation to the SSG for possible financial modeling. If the SSG, in conjunction with its third-party modeling vendor, determines that the space leases or business operation can be modeled, the SSG would analyze the space leases or business operation, as the case may be, to determine whether they will provide sufficient cash flow to pay the ground lease rent payments and any additional costs which the ground lessee would be obligated to cover pursuant to the ground lease terms (e.g. taxes, utilities, maintenance, insurance).

d. If the SSG, in conjunction with its third-party modeling vendor, determines that it is unable to model the space leases or business operation, as the case may be, and if the transaction has been assigned an Eligible NAIC CRP Rating, public or private, the SVO may use the NAIC CRP analysis provided by the filer to assist the SVO in its own analysis. The SVO’s analysis will be entirely at the discretion of the SVO, and the SVO will be under no obligation to accept the NAIC CRP analysis, conclusions or ratings. Furthermore, upon completion of its analysis the SVO can decline to assign an NAIC Designation, in which case the security would be ineligible for Schedule D reporting.

e. Insurers that would like the SVO to review the GLF transactions prior to purchasing them may submit them through the Regulatory Treatment Analysis Service (RTAS) process. The SVO is willing to set up new RTAS processes for each of these three paths, at the request of the submitting investor: 1) SVO credit analysis, 2) SSG modeling and 3) SVO review of NAIC CRP analysis.

f. Additionally, the SVO would look for evidence that (i) the transaction is properly insured because, unlike a credit tenant in a CTL transaction, the ground lessee SPV will not have access to extra funds to cover costs such as repairs in the event of casualty, and (ii) that satisfactory Phase I and, if necessary, Phase II environmental reports have been delivered to provide comfort that there will be no expected environmental liabilities.

3. Recommended Amendment – The recommended changes to the P&P regarding the addition of Ground Lease Financing criteria are shown below in red, showing how it will appear in the 2019 P&P format. The SVO recommends that this amendment also be referred to the Statutory Accounting Principles (E) Working Group for affirmation that these investments are eligible for Schedule D, Part 1 reporting under the criteria proposed.
2019 P&P Manual

Part One – Policies of the NAIC Valuation of Securities (E) Task Force

POLICIES APPLICABLE TO SPECIFIC ASSET CLASSES

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GROUND LEASE FINANCING TRANSACTIONS

GLF Overview

107. A ground lease financing transaction (GLF) typically has two components: (i) a ground lease for a long period (e.g. 99 years) between a ground lessor who owns the land and a ground lessee who attains a leasehold for the purpose of developing the land, and (ii) the subleasing of space or operation of a business such as a hotel, warehouse, intermodal facility, etc. in an existing or to-be-constructed building to one or more tenants (space tenants) under shorter (e.g. 5-15 year) leases (space leases) or to the operator of a business such as a hotel, warehouse, intermodal facility, etc. under a franchise agreement or other arrangement.

108. The ground lease itself typically meets the Credit Tenant Loan (CTL) criteria for Bond Lease Based or Credit Lease Based CTLs in this Manual. Additionally, there can be one or several space tenants or business operators (which (i) may or may not be NAIC CRP rated entities or (ii) whose credit worthiness can or cannot be evaluated by the SVO) making lease payments under separate space leases (which may or may not meet the CTL criteria) or a business operation. As such, the SVO cannot rely solely on the CTL criteria for its analysis of GLF transactions and instead must rely on a combination, as necessary and available, of the CTL criteria, the CMBS criteria, the documented analysis of NAIC CRPs, and the SVOs own analytic judgement.

109. A GLF transaction reported as a CTL on transaction on Schedule D, acquired prior to January 1, 2020, and reported with an NAIC Designation produced under filing exemption, can continue to be reported on the basis of that Eligible NAIC CRP Rating until sold or disposed of.

NOTE: See “Ground Lease Financing Transactions” in Part Three for filing instructions, documentation requirements and methodology applicable to GLFs.

Part Three – SVO Procedures and Methodology for Production of NAIC Designations

PROCEDURE APPLICABLE TO FILING EXEMPT (FE) SECURITIES AND PRIVATE LETTER (PL) RATING SECURITIES

... 

FE SECURITIES

Specific Populations of Securities Not Eligible for Filing Exemption

4. The filing exemption procedure does not apply to:

... 

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• **Ground Lease Financing Transactions** – A Ground Lease Financing (GLF) transaction typically has two components: (i) a ground lease for a long period (e.g. 99 years) between a ground lessor who owns the land and a ground lessee who attains a leasehold for the purpose of developing the land, and (ii) the subleasing of space or operation of a business such as a hotel, warehouse, intermodal facility, etc. in an existing or to-be-constructed building to one or more tenants (space tenants) under shorter (e.g. 5-15 year) leases (space leases) or to the operator of a business such as a hotel, warehouse, intermodal facility, etc. under a franchise agreement or other arrangement. GLF transactions are not eligible for filing exemption. The GLF section in this Part provides further guidance on how the SVO analyzes GLF transactions for purposes of determining Schedule D eligibility and whether the SVO can assign an NAIC Designation.

**Part Three – SVO Procedures and Methodology for Production of NAIC Designations**

**Ground Lease Financing Transactions**

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

**Initial Filing Requirements**

305. For ground lease financing (GLF) transactions, the reporting insurance company shall submit a complete GLF Evaluation Form together with the documentation described in the GLF Evaluation Form and, if available, evidence of a current Eligible NAIC CRP Rating and related NAIC CRP analysis for (i) the GLF Transaction (including, but not limited to rating methodology used, model assumptions and stress test results) and (ii) each space lessee or its guarantor or business operator in the case of a hotel, warehouse, intermodal facility, etc. or other business operation.

**Subsequent Filing Requirements**

306. For GLF Transactions, the reporting insurance company shall submit evidence, if available, of a current Eligible NAIC CRP Rating and related NAIC CRP analysis for (i) the GLF Transaction (including, but not limited to rating methodology used, model assumptions and stress test results) and (ii) each space lessee or its guarantor or business operator. For purposes of this section, a current Eligible NAIC CRP Rating is defined as one issued or reviewed within the past 12 calendar months. If the GLF Transaction is modeled by the NAIC’s third-party modeling vendor, the reporting insurance company will submit the data required by the vendor in the form such vendor specifies. In the event a space lessee or its guarantor or business operator, as the case may be, is not rated by an NAIC CRP and a space lease or business operation is not modeled, the reporting insurance company shall file the Audited Financial Statements and other relevant credit information of the space lessee or its guarantor or business operator, as the case may require, consistent with all corporate bond filing requirements.

**SVO Procedure**
307. Upon receipt of a GLF Evaluation Form, the SVO analyst shall review the form and all documentation submitted with it and shall proceed with analysis in accordance with section “SVO Approach to GLF Transactions” below.

Ground Lease Financing Transaction – Definition and Overview

308. A ground lease financing (GLF) transaction typically has two components: (i) a ground lease for a long period (e.g. 99 years) between a ground lessor who owns the land and a ground lessee who attains a leasehold for the purpose of developing the land, and (ii) the subleasing of space or operation of a business such as a hotel, warehouse, intermodal facility, etc. in an existing or to-be-constructed building to one or more tenants (space tenants) under shorter (e.g. 5-15 year) leases (space leases) or to the operator of a business such as a hotel, warehouse, intermodal facility, etc. under a franchise agreement or other arrangement.

309. Both the ground lessor and ground lessee will typically finance their respective estates (i.e., the fee estate of the ground lessor and the leasehold estate of the ground lessee); (i) the ground lessor, typically, with the issuance of debt-like certificates or notes, and (ii) the ground lessee, typically, by borrowing from a financial institution or traditional mortgage lender. To secure the financing, the ground lessor will grant to the lender a mortgage on the fee property such ground lessor owns, and the ground lessee will pledge to the leasehold lender its leasehold estate and its rights under the ground lease and in the improvements which it owns and the space leases if any.

310. Typically, in a GLF transaction neither the ground lessor nor the ground lessee is an entity either (i) rated by an NAIC CRP or (ii) whose credit worthiness can be evaluated by the SVO. Rather, they are special purpose vehicles (SPVs) intended to be bankruptcy remote.

311. In a GLF transaction it is often the case that the ground lease (the first leg of the transaction) is structured with the same attributes as a lease in a CTL transaction (e.g. it is “hell or high water” or “triple net”). However, because the ground lessee is an SPV rather than a corporate entity, there is no NAIC CRP corporate credit rating or SVO corporate analysis to rely on. To determine whether the ground lessee will have sufficient funds to pay its ground lease obligations the SVO must look to the rent payments of the space tenants or the operation of the business conducted in such improvements (such as a hotel, warehouse, intermodal facility, etc.). Depending on the specifics of a GLF transaction, analysis of space leases and space tenants and business operations and business operators could be more akin to a commercial mortgage backed security (CMBS) analysis than the corporate analysis in a CTL transaction because (i) the space leases may not meet the CTL criteria and can consist of one or several space tenants of differing credit profiles and each with differing space lease terms and ultimate payment on the GLF is dependent on the space tenants making their rent payment on the space leases or (ii) in the event there is a business operation, ultimate payment on the GLF is dependent on the operation of such business to generate cashflow for ground rent and other expenses. For this reason, the SVO may refer certain GLF transaction space lease or business operations analyses to the NAIC Structured Securities Group (SSG) because of the SSG’s financial modeling capabilities and because, in accordance with this Manual, it analyzes and assigns NAIC Designations to CMBS transaction.

SVO Approach to GLF Transactions

312. All GLF transactions are ineligible for filing exemption and must be submitted to the SVO. The SVO will conduct GLF transaction review in the following manner:

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a. The SVO will analyze the GLF transaction structure and determine whether the ground lease meets the CTL criteria for Bond Lease Based or Credit Lease Based CTLs, except for not having a credit tenant. If the SVO, in its sole discretion, determines the ground lease does not meet the Bond Lease Based or Credit Lease Based CTL criteria, except for a credit tenant, the security would be ineligible for Schedule D reporting.

b. If the ground lease meets the CTL criteria, except for a credit tenant, and if three or fewer space tenants, each of which (i) are rated by an NAIC CRP or (ii) whose credit worthiness can be evaluated by the SVO, when combined comprise ninety percent (90%) or more of the total space tenant lease obligations, the SVO will analyze the space leases to determine if they meet the CTL criteria for one of the four CTL categories in this Manual. If so, the SVO can, in its sole discretion and based on its analytical judgment, analyze the transaction as akin to a CTL, based on the CTL-like nature (e.g. “hell or high water” or “triple net” features) of both the ground and space leases, the limited number of space leases and the corporate credit profiles of the space tenants.

c. If the ground lease meets the criteria for Bond Lease Based or Credit Lease Based CTLs and there are four or more space tenants, or the SVO has determined that it cannot apply the approach in (b.) above or the transaction does not meet the criteria set forth in clause (b) above, the SVO will refer the space leases or the business operation, as the case may be, to the SSG for possible financial modeling. If the SSG, in conjunction with its third-party modeling vendor, and in its sole discretion and analytical judgment based on factors including, but not limited to, availability of data, transaction structure and other transaction specific risks, determines that the space leases or business operation can be modeled, it will analyze the space leases or business operation, as the case may be, to determine whether they will provide sufficient cash flow to pay the ground lease rent payments and any additional costs which the ground lessee is required to cover pursuant to the ground lease terms (e.g. taxes, utilities, maintenance, insurance).

d. If the SSG, in conjunction with its third-party modeling vendor, and in its sole discretion and analytical judgment, determines that it is unable to model the space leases or business operation, as the case may be, and if the transaction has been assigned a public or private Eligible NAIC CRP Rating the SVO shall proceed with an analysis of the transaction guided by the available analyses of all NAIC CRPs that provided an Eligible NAIC CRP Rating on the transaction. For the avoidance of doubt, the SVO’s analysis will be entirely at the discretion of the SVO and the SVO is not obligated to accept or follow the rating methodology of any NAIC CRP and can, in its sole discretion and based on its analytical judgement, assign an NAIC Designation which differs from the correlated Eligible NAIC CRP Rating or choose not to assign any NAIC Designation. The SVO may, in its sole discretion, upon written request from the submitting investor, disclose its rationale as to why such transaction was not given a Designation correlated to the Eligible NAIC CRP Rating.

e. Should the SVO or, if applicable, SSG determine that it cannot assign an NAIC Designation to the GLF, the GLF would be ineligible for Schedule D reporting.

GLF Specific Considerations

313. The space lease payments or business operation, as the case may be, should be sufficient to cover any recurring costs the ground lessee is obligated to pay (e.g. taxes, utilities, maintenance, insurance) pursuant to the terms of the ground lease. All such ground lessee obligations will be factored into the SSG’s financial model of the space leases or business operations, if applicable.

314. To provide comfort that there will be no environmental liabilities, the filing documents shall include a Phase I environmental report showing no environmental problems and, if the Phase I report shows a
problem or the nature and prior used of the land indicates a substantial likelihood of preexisting environmental contamination, a Phase II environmental report.

315. Typically, a ground lease will require the ground lessee to hold the following insurance to protect the ground lease payments from potential shortfall due to the termination or abatement of space lease payments or reduction or termination of business operation upon the occurrence of condemnation or casualty or other insurable condition. Any of the insurable risks below that are not insured should be otherwise mitigated and evidence of such mitigant should be included in the filing documents.

a. Casualty insurance in an amount of coverage equal to 100% of the replacement value of the improvements with the fee lender named as the loss payee.

b. Rent loss insurance in an amount of coverage equal to at least 12 months of ground rent with the fee lender named as loss payee.

c. General liability insurance. The amount of coverage shall be sized appropriately, depending on the size and type of building (e.g. office, hotel, warehouse, intermodal facility, etc.).

d. Ground Lessor would be required to purchase special risk condemnation insurance in an amount of coverage equal to the principal amount of the GLF. This policy shall be prepaid and remain in place for the entire term of the GLF secured by the fee mortgage.

Note: All insurance must be issued by a carrier with an NAIC Designation equivalent rating of 1.G or better.

Part Four – The NAIC Structured Securities Group

Ground Lease Financing Transactions

Definition

36. Ground Lease Financing (GLF) transactions are defined and explained in “Ground Lease Financing Transactions” in Part Three of this Manual.

SSG Role and Process

37. On occasion the SVO may refer a GLF transaction to the SVO for financial modeling of the GLF space leases or business operation, as applicable, in accordance with the process set forth in “Ground Lease Financing Transactions” in Part Three of this Manual. Following an SVO referral the SSG and SVO will maintain open communication related to requests for additional data, analytical questions and analytical conclusions. Any GLF transaction NAIC Designation will be assigned by the SVO.
MEMORANDUM

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

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

Cc: Charles Therriault, Director, NAIC Securities Valuation Office
    Eric Kolchinsky, Director, NAIC Structured Securities Group
    Julie Gann, Assistant Director, NAIC Financial Regulatory Services
    James Pinegar, Manager II, NAIC Financial Regulatory Services

DATE: January 3, 2020

RE: Referral to the Statutory Accounting Principles (E) Working Group Requesting Comments on P&P Manual Amendment to Remove the Financial Modeling Instructions for RMBS/CMBS Securities and Direct IAO Staff to Produce NAIC Designations and NAIC Designation Categories for these Securities

1. Summary – The IAO staff suggested to the Task Force at the Summer National Meeting that at some point the NAIC should align the residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS) modeling to provide a single NAIC Designation for modeled RMBS/CMBS. This would be a change from the current practice of providing a series of book/adjusted carrying value price breakpoints that insurers use to determine the NAIC Designation for these securities for each book/adjusted carrying value price. At the Fall National Meeting on December 8th, the IAO staff submitted an amendment to the Task Force to consider removing the financial modeling instructions that determine these book/adjusted carrying value price breakpoints and instead proposed financial modeling instructions that would determine a single NAIC Designation and NAIC Designation Category for these securities. This change would be consistent with the recent elimination from the P&P Manual and AP&P Manual of Modified Filing Exempt (MFE), a process that used a combination of Eligible NAIC CRP Credit Ratings and book adjusted carrying value price breakpoints to determine an NAIC Designation. The elimination of MFE resulted in this group of securities coming under the filing exempt (FE) instructions and the production of a single NAIC Designation and NAIC Designation Category based on Eligible NAIC CRP Credit Ratings.

2. The Referral - The Task Force at the Fall National Meeting requested a referral be sent to the Working Group to consider how this proposed change would impact SSAP No. 43R – Loan-Backed and Structured Securities and advise the Task Force on any concerns or issues.

Attached is the memorandum and draft amendment prepared by the staff for this request. Please direct any questions to Charles Therriault of the SVO or Eric Kolchinsky of the SSG.

G:\SECVAL\DATA\Vos-tf\Meetings\2020\Referrals outbound\SAPWG\RMBS and CMBS NAIC Designations\VOSTF 2019 - RMBS and CMBS NAIC Designation Refer to SAPWG.docx
MEMORANDUM

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

FROM: Charles A. Therriault, Director, NAIC Securities Valuation Office (SVO)

CC: Marc Perlman, Investment Counsel, NAIC Securities Valuation Office (SVO)
Eric Kolchinsky, Director, NAIC Structured Securities Group (SSG) and Capital Markets Bureau

RE: Proposed Amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) to Remove the Financial Modeling Instructions for RMBS/CMBS Securities and Direct IAO Staff to Produce NAIC Designation and NAIC Designations Categories for these Securities

DATE: September 30, 2019

1. Summary – On Oct. 11, 2018, the Valuation of Securities (E) Task Force adopted an amendment to delete the Modified Filing Exempt (MFE) provisions from the P&P Manual and directed a referral to the Statutory Accounting Principles (E) Working Group recommending the deletion of the MFE provisions from Statement of Statutory Accounting Principles (SSAP) No. 43R—Loan-Backed and Structured Securities. The effect of these changes resulted in these securities coming under the filing exempt instructions in the P&P Manual, if they have an Eligible NAIC CRP Credit Rating assigned to them. This change eliminated using the book adjusted carrying value to determine the NAIC designation for these securities.

The IAO staff reported to the Task Force at the Summer National Meeting that at some point the NAIC should align the RMBS/CMBS modeling to provide a single NAIC Designation and NAIC designation category modeled assessment of credit risk for these securities. This would be a change from the current practice of providing a series of book adjusted carrying value price breakpoints to companies to determine the NAIC designation. Staff also reported that with the upcoming implementation of NAIC designation categories, the new 20 additional granular delineations of credit risk, the complexity and expense to the NAIC and insurers to produce and incorporate the needed price breakpoints would be high.

2. Recommendation – The IAO staff recommends that the NAIC move to a single NAIC designation and NAIC designation category modeled assessment of credit risk for RMBS/CMBS. This is a good time to make such a change prior to the NAIC and insurance companies making modifications to their systems for the NAIC designation categories. Such a change will produce a uniform and consistent credit risk assessment for these securities permitting insurers to report the same SSG determined NAIC designation. Given the impact of this change to SSAP 43R - Loan-Backed and Structured Securities, staff recommends a referral to the Statutory Accounting Principles (E) Working Group for a simultaneous exposure.


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PART FOUR
THE NAIC STRUCTURED SECURITIES GROUP
DEFINITIONS

1. The following terms used in this Part Four have the meaning ascribed to them below.

- **ABS** stands for asset-backed securities and means structured securities backed by consumer obligations originated in the United States.

- **CMBS** stands for commercial mortgage-backed securities and means structured securities backed by commercial real estate mortgage loans originated in the United States. The definition of CMBS may refer to securitizations backed by commercial mortgages, respectively, originated outside of the United States if and to the extent that the vendor selected by the NAIC to conduct the financial modeling: (a) has the necessary information about the commercial mortgage and commercial mortgage loans originated outside of the United States to fully model the resulting securities; and (b) can adapt the modeling process to account for any structural peculiarities associated with the jurisdiction in which the mortgage was originated.

- **Initial Information** means the documentation required to be filed with an Initial Filing of an RMBS or a CMBS CUSIP, pursuant to the section below and pertaining to Loan Information, Reps and Warranty Information and Structure and Formation Information for the transaction, where:
  - **Loan Information** means a review of the loan files by a third party to assess the sufficiency of legal title and other related issues.
  - **Reps and Warranty Information** means the actual representation and warranties in effect for the securitization given by the mortgage originator(s) to the Trust pertaining to loan origination processes and standards, compliance with applicable law, loan documentation and the process governing put backs of defective mortgages back to the originator(s).
  - **Structure and Formation Information** means the waterfall, as described in the definition of Ongoing Information, information and documentation in the form of legal opinions and documentation governing the formation of the securitization and its entities relative to issues such as bankruptcy remoteness, true sale characterization, the legal standards and procedures governing the securitization and other similar issues.

- **Legacy Security**, for the purposes of this section shall mean any RMBS and any CMBS that closed prior to January 1, 2013.
• **Official Price Grids** means and refers to those generated by the SSG and provided to an insurance company or insurance companies that own the security for regulatory reporting purposes.

• **Ongoing Information** consists of: (a) tranche level data; such as principal balance, factors, principal and interest due and paid, interest shortfalls, allocated realized losses, appraisal reductions and other similar information for the specific tranche; (b) trust level data, such as aggregate interest and principal and other payments received, balances and payments to non-tranche accounts, aggregate pool performance data and other similar information; (c) loan level performance information; and (d) a computerized model of rules that govern the order and priority of the distribution of cash from the collateral pool (i.e., the “waterfall”) to the holders of the certificates/securities—provided in the format and modeling package used by the NAIC financial modeling vendor.

• **Original Source**, with respect to a specific set of data, means the Trustee, Servicer or similar entity that is contractually obligated under the agreement governing the RMBS or CMBS to generate and maintain the relevant data and information in accordance with standards specified in applicable agreements or an authorized redistributor of the same.

• **Price Grids** means and refers to CUSIP-specific price matrices containing six price breakpoints; i.e., each price corresponding to a specific NAIC Designation category. Each breakpoint on a Price Grid is the price point that tips the NAIC Designation for the RMBS CUSIP into the next NAIC Designation (credit quality/credit risk) category. The plural is used because two Price Grids are generated for any CUSIP. This reflects the difference in RBC for those insurance companies that maintain an asset valuation reserve and for those insurance companies that do not.

• **Re-REMIC** is a securitization backed by: (a) otherwise eligible RMBS from one or two transactions; or (b) otherwise eligible CMBS from one or two transactions at closing. Re-REMICs cannot acquire any Underlying Securities after closing.
**RMBS** stands for residential mortgage-backed securities and means structured securities backed by non-agency residential mortgages originated in the United States, where the collateral consists of loans pertaining to non-multi-family homes. That includes prime, subprime and Alt-A mortgages, as well as home-equity loans, home-equity lines of credit and Re-REMICs of the above. Excluded from this definition is agency RMBS, where the mortgages are guaranteed by federal and federally sponsored agencies such as the Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA) or Federal Home Loan Mortgage Corporation (FHLMC) and loans against manufactured or mobile homes or collateralized debt obligations backed by RMBS. The exclusion covers bonds issued and guaranteed by, or only guaranteed by, the respective agency. Also not included are loans guaranteed by the U.S. Department of Veteran Affairs or the U.S. Department of Agriculture’s Rural Development Housing and Community Facilities Programs. The definition of RMBS may refer to securitizations backed by residential mortgages, respectively, originated outside of the United States if and to the extent that the vendor selected by the NAIC to conduct the financial modeling: (a) has the necessary information about the residential mortgage and residential mortgage loans originated outside of the United States to fully model the resulting securities; and (b) can adapt the modeling process to account for any structural peculiarities associated with the jurisdiction in which the mortgage was originated.

**Underlying Security** means the RMBS or CMBS backing a Re-REMIC. A Re-REMIC cannot be an Underlying Security.

**NOTE:** The definitions of RMBS and CMBS reflect limitations associated with the financial modeling process, NAIC credit rating provider (CRP) internal naming conventions and SSG processes, as more fully discussed below and may, therefore, be subject to a narrower or a broader reading in any reporting period. Please call the SSG with any concerns or questions about the scope of the definitions for a given reporting period. Also note:

- It is possible that the scope of the RMBS and CMBS definitions may be broadened because the financial modeling vendors indicate other collateral or waterfall structures can be modeled.
▪ NAIC CRPs may adopt different internal conventions with respect to what market or asset segments are within their rated populations of RMBS, CMBS or ABS. This could affect the application of the adopted NAIC methodology or require the NAIC to select which naming process it wishes to adopt.

▪ It is possible that the SSG will acquire analytical assessment capabilities that permit the assessment of existing, additional or different structured securities that cannot now be modeled or that are not currently rated.
ADMINISTRATIVE AND OPERATIONAL MATTERS

Certain Administrative Symbols

2. The following SVO Administrative symbols are used in the Valuation of Securities (VOS) Products to identify RMBS and CMBS that the NAIC vendor has confirmed will be subject to the financial modeling methodology described in this Part.

- **FMR** – Indicates that the specific CUSIP identifies an RMBS that is subject to the financial modeling methodology.

- **FMC** – Indicates that the specific CUSIP identifies a CMBS that is subject to the financial modeling methodology.

The use of these SVO Administrative symbols in the VOS Product and published in the AVS+ Products compiled by the SVO and SSG as the SVO List of Investment Securities means the insurer should not use the filing exempt process for the security so identified.

**NOTE:** The administrative symbols **FMR** and **FMC** are related to symbols that insurers are required to use in the financial statement reporting process. Under applicable financial statement reporting rules, an insurer uses the symbol **FM** as a suffix to identify modeled RMBS and CMBS CUSIPs. The symbol **FM** is inserted by the insurer in the financial statement as a suffix in front of the NAIC Designation category, i.e., **2FM**.

Quarterly Reporting of RMBS and CMBS

3. To determine the NAIC Designation to be used for quarterly financial statement reporting for an RMBS or CMBS purchased subsequent to the annual surveillance described in this Part, the insurer uses the prior year-end assigned NAIC Designation and NAIC Designation Category modeling data for that CUSIP (which can be obtained from the NAIC) and follows the instructions in contained under the heading “Use of Net Present Value and Carrying Value for Financially Modelled RMBS and CMBS” below or follows the instructions in “Publication of Final Results” below, subject to, and in accordance with, SSAP No. 43R—Loan-Backed and Structured Securities.
Limited Filing Exemption for RMBS and CMBS

4. **RMBS and CMBS that can be Financially Modeled** – RMBS and CMBS that can be financially modeled are exempt from filing with the SVO. NAIC Designations and **NAIC Designation Categories** for RMBS and CMBS that can be financially modeled are assigned by SSG determined by application of the methodology discussed in this Part, not by the use of credit ratings of CRPs.

5. **RMBS and CMBS securities that cannot be Financially Modeled**
   - **But Are Rated by a CRP** – RMBS and CMBS that cannot be financially modeled but that are rated by a CRP are exempt from filing with the SSG. The NAIC Designations and **NAIC Designation Categories** for these RMBS and CMBS are determined by application of the filing exemption procedures discussed in this Manual.
   - **But Are Not Rated by a CRP** – RMBS and CMBS that cannot be financially modeled and that are not rated by a CRP are not filing exempt and must be filed with the SSG or follow the procedures, as discussed below in this Part.

Filing Exemption for ABS

6. ABS rated by a CRP are exempt from filing with the SSG.

Review of Decisions of the SSG

7. Analytical decisions made through the application of financial modeling are not subject to the appeal process. In the absence of an appeal, the SSG shall provide whatever clarification as to the results of financial modeling is possible to any insurer who requests it and owns the security, provided that it is not unduly burdensome for the SSG to do so. Any decision made by the SSG that results in the assignment of a **NAIC Designation** (including **NAIC Designation Categories**) and does not involve financial modeling methodology, whether developed by the SSG on its own or in collaboration with the SVO, is subject to the appeal process.
**REQUIRED DATA AND DOCUMENTS FOR TRANSACTIONS SUBMITTED TO THE SSG**

8. The policy statement set forth in this section shall be applicable generally to any transaction filed with the SSG for an analytical assessment and, including, but not limited to, a Price Grid or for assignment of an NAIC Designations and NAIC Designation Categories. Any filing with the SSG is deemed to be incomplete unless the insurer has provided the information, documentation, and data in quantity and quality sufficient to permit the SSG to conduct an analysis of the creditworthiness of the issuer and the terms of the security to determine the requested analytical value. It is the obligation of the reporting insurance company to provide the SSG with all necessary information. It is the responsibility of the SSG to determine whether the information provided is sufficient and reliable for its purposes and to communicate informational deficiencies to the reporting insurance company.

**Documentation Standards**

9. In order for an insurer-owned RMBS or CMBS to be eligible for the year-end modeling process, conducted pursuant to this section below, the analysis must be based on information, documentation and data of the utmost integrity. A Legacy Security must meet the Ongoing Information requirements. An RMBS, CMBS or Re-REMIC that is not a Legacy Security must meet the Initial Information and Ongoing Information requirements. For the purposes of determining a Re-REMIC’s status as a Legacy Security, the closing date of the Re-REMIC (not the Underlying Security) shall be used. The SSG may, in its sole discretion, determine that the Initial Information and/or Ongoing Information is not sufficient and/or not reliable to permit the RMBS or CMBS CUSIP to be eligible for financial modeling. If the SSG determines that the Initial Information and/or Ongoing Information is not sufficient and/or not reliable to permit the RMBS or CMBS CUSIP to be eligible for financial modeling, it will communicate this decision to the insurer and invite a dialogue to ascertain whether alternative information is available that would be deemed sufficient and/or reliable by the SSG.

**Initial Information Requirements**

10. An RMBS or CMBS meets the Initial Information Requirements if the security meets one of the following three conditions:

- **RTAS** – The RMBS or CMBS was assigned a preliminary price grid or designation as described in this Part;

- **Initial Sufficiency Filing** – The RMBS or CMBS was reviewed by SSG through an Initial Sufficiency Filing; or
▪ **Safe Harbor** – The RMBS or CMBS meets the Safe Harbor requirements.

**Initial Sufficiency Information Filing**

11. An insurance company may file Initial Sufficiency Information with the SSG for the purpose of obtaining a determination that an RMBS or CMBS CUSIP is eligible for financial modeling under the annual surveillance process discussed below. Initial Sufficiency Information is only filed once for any given RMBS or CMBS. Reporting insurance companies are solely responsible for providing the SSG with Initial Information. A determination by the SSG that a given RMBS or CMBS CUSIP is eligible for financial modeling after an Initial Sufficiency Filing assessment is subject to the further and continuing obligation that the SSG obtain or the insurer provide the SSG with updated Ongoing Information close to the date of the annual surveillance.

12. **Required Documents for Initial Sufficiency Filing** – An insurer that owns an RMBS or a CMBS for which Initial Information is not publicly available shall provide the SSG with the following documentation.

13. **RMBS** – Unless otherwise specified by the SSG in a Modeling Alert, as further described below, an Initial Filing for an RMBS consists of submission of Initial Information and Ongoing Information in the form of the following documentation:

▪ Pooling and Servicing Agreement or similar
▪ Prospectus, Offering Memorandum or similar; Accountant’s comfort letter
▪ If applicable, ISDA Schedules and Confirmations or similar
▪ Legal opinions given in connection with the transaction
▪ Any other documents referenced by the above
▪ Third-Party Due diligence scope document and raw results. If less than 100% due diligence, detailed description of the loan selection process
▪ If applicable, loan purchase agreements or similar. Loan Tape

14. **CMBS** – Unless otherwise specified by the SSG in a Modeling Alert, as further described below, an Initial Filing for a CMBS consists of submission of Initial Information and Ongoing Information in the form of the following documentation:

▪ Pooling and Servicing Agreement or similar
▪ Prospectus, Offering Memorandum or similar; Accountant’s comfort letter
▪ If applicable, ISDA Schedules and Confirmations or similar
- Legal opinion given in connection with the transaction
- Any other documents referenced in the above
- Asset Summaries
- Loan Tape
- Loan documents, including reliable information about the terms of the transaction; including, but not limited to, financial covenants, events of default, legal remedies and other information about financial, contractual or legal aspects of the transaction in form and substance consistent with industry best practices for CMBS issuance.
- In certain cases, additional documents below will enable the SSG to verify and validate initial underwriting information of the property securing the CMBS. These documents may be required in form and substance consistent with best practices for typical CMBS issuance.
  - Historical operating statements and borrower’s budget
  - Underwriter’s analysis of stabilized cash flow with footnotes of assumptions used
  - Property type specific, rent roll information
  - Appraisals and other data from recognized industry market sources
  - Independent engineering report (Property Condition Assessment)
  - Environmental Site Assessment (ESA) – Phase I/Phase II
  - Documentation related to seismic, flood and windstorm risks
  - Franchise agreements and ground leases, if applicable
  - Management agreements

**SSG Modeling Alerts**

15. The SSG shall at all times have discretion to determine that differences in the structure, governing law, waterfall structure or any other aspect of a securitization or a class of securitization requires that insurance companies provide Initial Information and/or Ongoing Information additional to or different from that identified in this Part. The SSG shall communicate such additional or different documentation requirements to insurers by publishing a Modeling Alert on the NAIC website and scheduling a meeting of the VOS/TF to ensure public dissemination of the decision.
**Safe Harbor**

16. Safe Harbor options serve as proxies for the Initial Sufficiency filing. The options reflect publicly available information that a third party has analyzed the Initial Information. Because the structured securities market is quite dynamic, the list of Safe Harbor options may change frequently, with notice and opportunity for comment, as described in this section. An RMBS or CMBS meets the Initial Information requirement if:

- At least two Section 17(g)-7 reports issued by different CRPs are publicly available;

- A security that is publicly registered under the federal Securities Act of 1933.

**Ongoing Information Requirements**

17. An RMBS or CMBS meets the Ongoing Information Requirements if Ongoing Information is available to the SSG and the relevant third-party vendor from an Original Source. The SSG, in its sole discretion and in consultation with the relevant third-party vendor, may determine that the Ongoing Information is not sufficient or reliable to permit a given RMBS or CMBS CUSIP to be financially modeled. However, in making such a determination, the SSG shall take into account reasonable market practices and standards.

**Special Rules for Certain Re-REMICs**

18. Re-REMICs are generally simple restructurings of RMBS or CMBS. An Initial Sufficiency Filing for a Re-REMIC (a) which is not a Legacy Security itself but (b) where each Underlying Security is a Legacy Security shall not require submission of information regarding the Underlying Securities. In most cases, a prospectus for the Re-REMIC will be sufficient. If the SSG determines that additional information about the Re-REMIC structure or formation is required, it will communicate this decision to the insurer and invite a dialogue to ascertain whether additional information is available that would be deemed sufficient by the SSG.
ANALYTICAL ASSIGNMENTS

Annual Surveillance of RMBS and CMBS – Modeled and Non-Modeled Securities

Scope

19. This section explains the financial modeling methodology applicable to RMBS and CMBS (defined above) securitizations and the book/adjusted carrying value methodology applicable to modeled and non-modeled securities subject to SSAP No. 43R—Loan-Backed and Structured Securities. Please refer to SSAP No. 43R for a description of securities subject to its provisions. The VOS/TF does not formulate policy or administrative procedures for statutory accounting guidance. Reporting insurance companies are responsible for determining whether a security is subject to SSAP No. 43R and applying the appropriate guidance.

Important Limitation on the Definitions of RMBS and CMBS

20. The definitions of RMBS and CMBS above are intended solely to permit the SSG to communicate with financial modeling vendors, insurance company investors who own RMBS and CMBS subject to financial modeling and/or the book/adjusted carrying value methodology and their investment advisors to facilitate the performance by the SSG of the financial modeling methodology described below. The definitions contained in this section are not intended for use and should not be used as accounting or statutory statement reporting instructions or guidance.

NOTE: Please refer to SSAP No. 43R—Loan-Backed and Structured Securities for applicable accounting guidance and reporting instructions.

Analytical Procedures Applicable to RMBS and CMBS Securitizations Subject to Financial Modeling Methodology

Filing Exemption Status of RMBS and CMBS

21. RMBS and CMBS are not eligible for the filing exemption because credit ratings of CRPs are no longer used to set risk-based capital (RBC) for RMBS or CMBS. However, RMBS and CMBS are not submitted to the SSG.
Use of Financial Modeling for Year-End Reporting for RMBS and CMBS

22. Beginning with year-end 2009 for RMBS and 2010 for CMBS, NAIC Designations and NAIC Designation Categories probability weighted net present values will be assigned by SSG produced under NAIC staff supervision by an utilizing the NAIC-selected vendor's using its financial model output with defined analytical inputs selected by the SSG. The vendor will provide the SSG with a range of net present values with a risk profile for each RMBS or CMBS sufficient for SSG to assess the credit risk of these securities and assign an NAIC Designation and NAIC Designation Category corresponding to each NAIC Designation category. The NAIC Designation for a specific RMBS or CMBS is determined by the insurance company, based on book/adjusted carrying value ranges.

**NOTE:** Please refer to *SSAP No. 43R—Loan-Backed and Structured Securities* for guidance on all accounting and related reporting issues.

Analytical Procedures for RMBS and CMBS

23. The SSG shall develop and implement all necessary processes to coordinate the engagement by the NAIC of a vendor who will perform loan-level analysis of insurer-owned RMBS and CMBS using the vendor’s proprietary models.

RMBS and CMBS Subject to Financial Modeling

Setting Microeconomic Assumptions and Stress Scenarios

24. Not later than September of each year, the SSG shall begin working with the vendor to identify the assumptions, stress scenarios and probabilities (hereafter model criteria) the SSG intends to use at year-end to run the vendor’s financial model.

The Financial Modeling Process

25. Information about the financial modeling process can be found at [www.naic.org/structured_securities/index_structured_securities.htm](http://www.naic.org/structured_securities/index_structured_securities.htm).
Cashflow and Expected Losses

Use of Net Present Value and Carrying Value for Financially Modeled RMBS and CMBS

26. For each modeled RMBS and CMBS, the financial model determines the net present value in a number of macro-economic scenarios, at which the expected loss equals the midpoint between the RBC charges for each NAIC Designation; i.e., each price point, if exceeded, changes the NAIC Designation. Net present value is the net present value of principal losses, discounted using the security’s coupon rate (adjusted in case of original issue discount securities to book yield at original issue and in case of floating rate securities, discounted using LIBOR curve + Origination spread). Because of the difference in RBC charge, the deliverable is five values for each RMBS and CMBS security for companies required to maintain an asset valuation reserve (AVR) and five values for companies not required to maintain an AVR. This is illustrated in the chart below. SSG then maps the weighted net present value to NAIC Designations and NAIC Designation Categories.

<table>
<thead>
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<th>RBC charge / NAIC designation (pre-tax)</th>
<th>P&amp;C RBC</th>
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<table>
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</table>
27. The NAIC Designation for a given modeled RMBS or CMBS CUSIP owned by a given insurance company depends on the insurer's book/adjusted carrying value of each RMBS or CMBS, whether that carrying value, in accordance with SSAP No. 43R—Loan-Backed and Structured Securities, paragraphs 25 through 26a, is the amortized cost or fair value, and where the book/adjusted carrying value matches the price ranges provided in the model output for each NAIC Designation; except that an RMBS or CMBS tranche that has no expected loss under any of the selected modeling scenarios and that would be equivalent to an NAIC 1 Designation if the filing exempt process were used, would be assigned an NAIC 1 Designation regardless of the insurer's book/adjusted carrying value.

NOTE: Please refer to the detailed instructions provided in SSAP No. 43R.

Securities Not Modeled by the SSG and Not Rated by an NAIC CRP or Designated by the SVO

28. Securities subject to SSAP No. 43R—Loan-Backed and Structured Securities that cannot be modeled by the SSG and are not rated by an NAIC CRP or designated by the SVO are either: (a) assigned the NAIC administrative symbol ND (not designated), requiring subsequent filing with the SVO; or (b) assigned the NAIC Designation for Special Reporting Instruction [i.e., an NAIC 5GI or NAIC 6* (six-star)].
MORTGAGE REFERENCED SECURITIES

Definition

29. A Mortgage Referenced Security is a category of a Structured Note, as defined in Part Three of this Manual. In addition to the Structured Note definition, the following are characteristics of a Mortgage Referenced Security: A Mortgage Referenced Security’s coupon and/or principal payments are linked, in whole or in part, to prices of, or payment streams from, real estate, index or indices related to real estate, or assets deriving their value from instruments related to real estate, including, but not limited to, mortgage loans.

Quarterly Reporting for Mortgage Reference Securities (pending adoption)

30. To determine the NAIC Designation to be used for quarterly financial statement reporting for a Mortgage Reference Security purchased subsequent to the annual surveillance described in this Part, the insurer uses the prior year-end modeling data for that CUSIP (which can be obtained from the NAIC) until the annual surveillance data is published for the current year. For a Mortgage Reference Security that is not in the prior year-end modeling data for that CUSIP, the insurer may follow the instructions in Part Two of this manual for the assignment of the SVO Administrative Symbol “Z” provided the insurer owned security meets the criteria for a security that is in transition in reporting or filing status.

Not Filing Exempt

31. A Mortgage Referenced Security is not eligible for the filing exemption but is subject to the filing requirement.

NAIC Risk Assessment

32. In determining the NAIC Designation of a Mortgage Referenced Security, the SSG may use the financial modeling methodology discussed in this Part, adjusted to the specific reporting and accounting requirements applicable to Mortgage Referenced Securities.
THE RTAS – EMERGING INVESTMENT VEHICLE

Purpose

33. Price grids are generated for the exclusive use of insurance companies and the NAIC regulatory community. Insurance companies use official Prices Grids by following the instructions in SSAP No. 43R—Loan Backed and Structured Securities to derive a final NAIC Designation for the RMBS or CMBS, which they use to derive the RBC applicable for the RMBS or CMBS.

NOTE: Please refer to SSAP No. 43R for a full explanation of the applicable procedure.

Extension of Authority

34-32. The Regulatory Treatment Assessment Service – Emerging Investment Vehicle procedure is extended to the SSG, and the SSG is authorized to determine probable regulatory treatment for RMBS and CMBS pursuant to this Part or for other securities, where, in the opinion of the SSG, financial modeling methodology would yield the necessary analytical insight to determine probable regulatory treatment or otherwise enable the SSG to make recommendations to the VOS/TF as to regulatory treatment for a security.

Interpretation

35-33. To facilitate this purpose, wherever in the Regulatory Treatment Assessment Service – Emerging Investment Vehicle procedure reference is made to the SVO, it shall be read to also refer to and apply to the SSG, adjusting for differences in the operational or methodological context. The Regulatory Treatment Assessment Service – Emerging Investment Vehicle procedure shall also be read as authority for collaboration between SVO and SSG staff functions so as to encompass RTAS assignments that require the use of SVO financial, corporate, municipal, legal, and structural analysis and related methodologies, as well as of financial modeling methodologies.
Translation of Preliminary into Official Price Grids

36. Price Grids generated by the SSG pursuant to an RTAS are preliminary within the meaning of that term as used in the Regulatory Treatment Assessment Service—Emerging Investment Vehicle procedure and accordingly cannot be used for official NAIC regulatory purposes. Preliminary NAIC Designations are translated into official NAIC Designations by the SVO when an insurance company purchases and files the security and the SVO conducts an official assessment. However, this Manual does not require the filing of RMBS and CMBS subject to financial modeling methodology with the SSG. It is, therefore, necessary to specify a procedure for the translation of preliminary Price Grids into official Price Grids that can be used for NAIC regulatory purposes. Preliminary Price Grids generated by the SSG become an official Price Grid within the meaning of this section when an insurance company has purchased the security for which the Price Grid was generated and reported that security for quarterly reporting purposes using the SSG generated Price Grid. A Price Grid for a security reported by an insurance company for quarterly reporting is effective until the SSG conducts the next annual surveillance pursuant to this Part at which the time the Price Grids generated by the SSG at year-end shall be the official Price Grid for that security.
MEMORANDUM

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

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

Cc: Charles Therriault, Director, NAIC Securities Valuation Office
    Eric Kolchinsky, Director, NAIC Structured Securities Group
    Julie Gann, Assistant Director, NAIC Financial Regulatory Services
    James Pinegar, Manager II, NAIC Financial Regulatory Services

DATE: January 3, 2020


1. Summary – The SVO proposes an amendment to the P&P Manual to update guidance in Part Four under the NAIC Structured Securities Group, Mortgage Reference Securities section. The Structured Securities Group (SSG) is responsible for financially modeling this group of securities; however, they only review them during their annual surveillance process. Insurers currently do not have instructions to assign an NAIC designation to a newly issued or newly acquired mortgage reference security prior to the publication of the annual surveillance data. This proposal would provide that interim guidance.

2. The Referral - The Task Force on the October 31st adopted this amendment and requested a referral to the Working Group to review the amendment and inform the Task Force of any textual changes that may be necessary to align the language to any changes being considered by the Working Group for these mortgage reference securities.

Attached is the memorandum and the adopted for this referral. Please direct any questions to Charles Therriault of the SVO.

G:\SECVAL\DATA\Vos-tf\Meetings\2020\Referrals outbound\SAPWG\Mortgage Reference Securities\VOSTF 2019 - Mtg Reference Securities Refer to SAPWG.docx
MEMORANDUM

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

FROM: Charles A. Therriault, Director, NAIC Securities Valuation Office

CC: Eric Kolchinsky, Director, NAIC Structured Securities Group

DATE: July 2, 2019


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1. **Introduction** – The SVO proposes a non-substantive amendment to the P&P Manual to update guidance in Part Four under the The NAIC Structured Securities Group, Mortgage Reference Securities. The Structured Securities Group (SSG) is responsible to financially model this group of securities; however, they only review them during their annual surveillance process. Insurers currently do not have instructions to assign an NAIC designation to a newly issued or newly acquired mortgage reference security prior to the publication of the annual surveillance data. This proposal would provide that interim guidance.

2. **Proposed Amendment** – The proposed amendment is shown below in red-underline.

   **Part Four The NAIC Structured Securities Group**

   **MORTGAGE REFERENCED SECURITIES**

   **Definition**

   …

   **Quarterly Reporting for Mortgage Reference Securities**

   To determine the NAIC Designation to be used for quarterly financial statement reporting for a Mortgage Reference Security purchased subsequent to the annual surveillance described in this Part, the insurer uses the prior year-end modeling data for that CUSIP (which can be obtained from the NAIC) until the annual surveillance data is published for the current year. For a Mortgage Reference Security that is not in the prior year-end modeling data for that CUSIP, the insurer may follow the instructions in Part Two of this manual for the assignment of the SVO Administrative Symbol “Z” provided the insurer owned security meets the criteria for a security that is in transition in reporting or filing status.
2020 Spring National Meeting - Review of GAAP Exposures for Statutory Accounting:

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

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

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1. **Proposed Accounting Standards Update—Not-for-Profit Entities (Topic 958)**  
   **Comment Deadline: April 10, 2020**

**Information from FASB Exposure Draft:**

The proposed ASU primarily addresses the presentation and disclosure of nonfinancial assets in which are contributed to Not-for-Profit Entities. The amendment proposes reporting the contributed nonfinancial assets in a separate line in the Statement of Activities as well as disclosing additional information of such assets. Proposed disclosures include identification of the valuation methodology to arrive at a fair value measure and if the assets are donor restricted and expected to be monetized.

**Staff Review and Commentary:**

Comment deadline is April 10, 2020.  
Review ASU under the SAP Maintenance Process as detail in Appendix F—*Policy Statements.*
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