ROLL CALL

Dale Bruggeman, Chair
Jim Armstrong / Carrie Mears, Vice Chairs
Richard Ford
Kim Hudson
Kathy Belfi
Dave Lonchar
Eric Moser
Caroline Brock / Stewart Guerin
Ohio
Iowa
Alabama
California
Connecticut
Delaware
Illinois

Judy Weaver
Doug Bartlett
Tom Dudek
Joe DiMemmo
Doug Slape / Jamie Walker
Doug Stolte / David Smith
Amy Malm

Michigan
New Hampshire
New York
Pennsylvania
Texas
Virginia
Wisconsin

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

REVIEW AND ADOPTION OF MINUTES

1. Summer National Meeting Minutes - (Attachment 1)
2. Sept. 9, 2019 Conference Call Minutes - (Attachment 2)

REVIEW AND ADOPTION of NON-CONTESTED POSITIONS – SSAP REVISIONS

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

1. Ref #2019-19: SIRI – Equity Interests
2. Ref #2019-22: Wash Sale Disclosures
3. Ref #2019-23: Going Concern
4. Ref #2019-26: A-785 Updates for Covered Agreement
7. Ref #2019-29: ASU 2019-06, Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities

Summary:

During the Summer National Meeting, the Working Group exposed revisions that clarify what should be captured in SIRI Line 13: 10 Largest Equity Interests, noting that a look-through should only occur for non-diversified funds. The revisions also exclude Securities Valuation Office (SVO)-Identified Bond Exchange-Traded Funds (ETFs) and SVO-Identified investments with underlying characteristics of fixed-income investments from this equity interrogatory. With exposure, a referral was directed to the Capital Adequacy (E) Task Force with a request for clarification on the impact, if any, these changes may have to risk-based capital.

Pursuant to the proposed guidance, equity interests in all funds that are diversified in accordance with the Investment Company Act of 1940 do not need to be individually assessed and aggregated to determine the ten largest equity interests. For funds that are not diversified within the meaning of the Investment Company Act of

© 2019 National Association of Insurance Commissioners 1
1940, insurance reporting entities are required to identify underlying equity interests within the fund and aggregate those equity interests to determine their ten largest equity interests.

The agenda item further concludes that certain funds such as SVO-Identified U.S. Direct Obligations / Full Faith And Credit Exempt List of Money Market Mutual Funds, SVO-Identified Bond ETFs, SVO-Identified Bond Mutual Funds and SVO Identified fund investments with underlying characteristics of fixed-income instruments, that are outlined within the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* shall be excluded from the aggregation of equity interests.

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

**Recommended Action:**
NAIC Staff recommends that the Working Group adopt the exposed item to clarify what should be captured in the Supplemental Investment Risk Interrogatory Line 13: 10 Largest Equity Interests and sponsor a Blanks (E) Working Group proposal to incorporate the guidance for 2020 year-end application. The adoption of this agenda item will not result with any actual statutory accounting revisions.

Note: The Casualty Actuarial (E) Task Force exposed the referral on this item with comments due Nov. 8th. No comments were received by the Task Force on the exposure.

<table>
<thead>
<tr>
<th>Ref #</th>
<th>Title</th>
<th>Attachment #</th>
<th>Agreement with Exposed Document?</th>
<th>Comment Letter Page Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019-22 SSAP No. 103R (Jake)</td>
<td>Wash Sale Disclosures</td>
<td>4 Agenda Item</td>
<td>In Agreement</td>
<td>IP - 14</td>
</tr>
</tbody>
</table>

**Summary:**
During the Summer National Meeting, the Working Group exposed revisions to *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* to clarify the investments subject to the wash sale disclosure. The exposed revisions clarify that only investments which are sold prior to a reporting period end and repurchased after that reporting date would be subject to the wash sale disclosure. This clarification will eliminate the need to report transactions that meet the wash sale criteria that are sold and repurchased within the same reporting period.

**Interested Parties’ Comments:**
Interested parties support the proposed revisions.

**Recommended Action:**
NAIC staff recommends that the Working Group adopt the exposed revisions to *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* as final. With these revisions, only wash sales that cross reporting period end-dates would be subject to the wash sale disclosure.
Summary:
During the Summer National Meeting, the Working Group exposed revisions to SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities to expand language regarding the inadmissibility of an SCA in the event an unalleviated substantial doubt about the investee’s ability to continue as a going concern is notated anywhere in the audit report or audited financials. Current statutory language refers to the identification of unalleviated going concern in the audit opinion but does not specify nonadmittance if the going concern is identified in any other part of the audit report.

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

Recommended Action:
NAIC staff recommends adopting the exposed revisions to SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities as final. With these revisions, nonadmittance will be required when there is unalleviated substantial doubt about SCA’s ability to continue as a going concern identified in any part of the audit report, accompanying financial statements or notes to financial statements.

Summary:
During the Summer National Meeting, the Working Group exposed revisions to Appendix A—Excerpts of NAIC Model Laws to adopt the changes to incorporate the covered agreements into Appendix A-785. The NAIC EX and Plenary adopted revisions to the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) to incorporate the covered agreements with the EU and UK. This agenda item incorporates those new provisions into Appendix A-785.

Interested Parties’ Comments:
Interested parties note that on page 17 of the exposure, paragraph 13.b refers to “paragraph 12.g” and should be “paragraph 13.g”

Recommended Action:
NAIC staff recommends adopting the exposed revisions to Appendix A—Excerpts of NAIC Model Laws with the minor paragraph change recommended by interested parties to incorporate the covered agreements into Appendix A-785 as final. (As detailed, the paragraph reference will change from 12.g to 13.g.)
## Summary:
During the Summer National Meeting, the Working Group exposed editorial updates as follows:

- **SSAP No. 62R - Property and Casualty Reinsurance**
  A wording clarification to eliminate redundant phrases and improve the readability of paragraph 116.

- **SSAP No. 86—Derivatives**
  Update to the definition of a structured note in SSAP No. 86 by referencing the definition as described in SSAP No. 26R. This update will eliminate the duplication of definitions in both the aforementioned SSAPs and will now solely reference ‘structured notes’ as defined in SSAP No. 26R.

- **SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities**
  Update to add two new suffixes for SVO filings that have been carried over from the prior year.

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

### Recommended Action:
NAIC staff recommends adopting the exposed editorial changes as final.

## Summary:
During the Summer National Meeting, the Working Group exposed revisions to **SSAP No. 100R—Fair Value** to reject ASU 2019-05 for statutory accounting. This ASU provides an alternative accounting treatment for certain financial assets (excluding held-to-maturity debt securities) previously measured at amortized cost. Pursuant to statutory accounting, assets are required to be reported at the measurement method stipulated under the applicable SSAP. An election to utilize fair value in lieu of the stipulated measurement method (e.g., amortized cost) is not allowed under statutory accounting.

### Interested Parties’ Comments:
Interested parties support the conclusion reached.

### Recommended Action:
NAIC staff recommends adopting the exposed revisions to reject **ASU 2019-05, Targeted Transition Relief** in SSAP No. 100R as final. As detailed, this ASU is proposed to be rejected as elections to utilize a fair value measurement method in lieu of the measurement method identified in the applicable SSAP is not permitted under statutory accounting.
Summary:
During the Summer National Meeting, the Working Group exposed revisions to SSAP No. 68—Business Combinations and Goodwill and SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities to reject ASU 2019-06 for statutory accounting. This ASU provides alternative accounting treatments for the goodwill reported by not-for-profit Entities. The ASU allows not-for-profit entities the option to amortize goodwill over 10 years (or a lower deemed economic life) or continue with the current “testing for impairment” method. Current statutory guidance does not allow optionality, however SSAP guidance is similar in that goodwill shall be amortized over the period in which an acquiring entity benefits, not to exceed 10 years.

Interested Parties’ Comments:
Interested parties support the proposed revisions.

Recommended Action:
NAIC staff recommends adopting the exposed revisions to reject ASU 2019-06, Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities in SSAP No. 68 and SSAP No. 97 as final. As detailed, this ASU is proposed to be rejected as the “alternative” goodwill accounting option permitted for not-for-profit entities in the ASU is similar to the existing guidance required for all statutory filers in SSAP No. 68.
REVIEW AND ADOPTION of NON-CONTESTED POSITIONS – NONAPPLICABLE GAAP

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

1. Ref #2019-30: ASU 2019-03, Updating the Definition of Collections
2. Ref #2019-31: ASU 2018-08, Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made

<table>
<thead>
<tr>
<th>Ref #</th>
<th>Title</th>
<th>Attachment #</th>
<th>Agreement with Exposed Document?</th>
<th>Comment Letter Page Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019-30</td>
<td>ASU 2019-03, Updating the Definition of Collections</td>
<td>10 Agenda Item</td>
<td>No Comment</td>
<td>IP - 16</td>
</tr>
<tr>
<td>Appendix D (Jim)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Summary:
During the Summer National Meeting, the Working Group exposed revisions to reject ASU 2019-03, Updating the Definitions of Collections as not applicable to statutory accounting. This ASU was issued to more fully align the FASB Master Glossary of the term “collections” as it relates to works of art, historical treasures, or similar assets that meet certain criteria. This update was to improve the definition of collections by realigning it with the definition as used by the American Alliance of Museums.

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

Recommended Action:
NAIC staff recommends adopting the exposed revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2019-03, Updating the Definition of Collections as not applicable to statutory accounting.

<table>
<thead>
<tr>
<th>Ref #</th>
<th>Title</th>
<th>Attachment #</th>
<th>Agreement with Exposed Document?</th>
<th>Comment Letter Page Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019-31</td>
<td>ASU 2018-08, Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made</td>
<td>11 Agenda Item</td>
<td>No Comment</td>
<td>IP - 17</td>
</tr>
<tr>
<td>Appendix D (Fatima/Jim)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Summary:
During the Summer National Meeting, the Working Group exposed revisions to reject ASU 2018-08, Not-for-Profit Entities - Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made (Topic 958) as not applicable to statutory accounting. This ASU was issued to assist entities in evaluating whether transactions should be accounted for as contributions (nonreciprocal transactions) or exchange (reciprocal) transactions and in determining whether the contribution is conditional. This update was primarily written in response to government grants and contracts to respond when a contribution is conditional, especially when an entity receives assets accompanied by certain stipulations but with no specified return requirement for when the stipulations are not met.

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

Recommended Action:
NAIC staff recommends adopting the exposed revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2018-08, Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made as not applicable to statutory accounting.
REVIEW of COMMENTS on EXPOSED ITEMS – EXPECTING MINIMAL DISCUSSION
The following items received comments during the exposure period that are open for discussion. NAIC staff has separated these items as limited discussion is expected prior to considering action.

1. Ref #2018-26: SCA Loss Tracking – Accounting Guidance
2. Ref #2019-04: SSAP No. 32 – Investment Classification Project
3. Ref #2019-08: Reporting Deposit Type Contracts
4. Ref #2019-18: Other Derivatives

<table>
<thead>
<tr>
<th>Ref #</th>
<th>Title</th>
<th>Attachment #</th>
<th>Agreement with Exposed Document?</th>
<th>Comment Letter Page Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018-26</td>
<td>SCA Loss Tracking – Accounting Guidance</td>
<td>12 Agenda Item</td>
<td>Comments Received</td>
<td>IP - 3</td>
</tr>
</tbody>
</table>

Summary:
During the Summer National Meeting, the Working Group exposed revisions to SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities to update the existing reporting requirements for when a reporting entity has a negative equity value in an SCA investment and has provided a financial guarantee or commitment. With the most recent exposed revisions, the financial guarantee or commitment will be recognized under SSAP No. 5R and the SCA value will stop at zero under SSAP No. 97.

Interested Parties’ Comments:
Interested parties believe that additional clarifications are necessary regarding the proposed revisions to paragraphs 18 and 24 of SSAP No. 5R. Regarding paragraph 18, we believe a parent’s guarantee on behalf of an SCA entity with negative equity could result in the recognition of either an initial guarantee liability or a liability subsequent to the initial recognition. Therefore, we propose more general wording to the end of paragraph 18 as follows:

18. The following types of guarantees are exempted from the initial liability recognition in paragraphs 20-25, but are subject to the disclosure requirements in paragraphs 29-32. For the guarantees addressed in paragraphs 18f and 18g, recognition of a contingent guarantee may be required subsequent to initial recognition in accordance with paragraph 24a:

   a. Guarantee that is accounted for as a derivative instrument, other than credit derivatives within SSAP No. 86;
   b. Guarantee for which the underlying is related to the performance of nonfinancial assets that are owned by the guaranteed party, including product warranties;
   c. Guarantee issued in a business combination that represents contingent consideration;
   d. Guarantee in which the guarantor’s obligation would be reported as an equity item;
   e. Guarantee by an original lessee that has become secondarily liable under a new lease that relieved the original lessee from being the primary obligator;
   f. Guarantees (as defined in paragraph 16) made to/or on behalf of directly or indirectly wholly-owned insurance or non-insurance subsidiaries; and
   g. Intercompany and related party guarantees that are considered “unlimited” (e.g., typically in response to a rating agency’s requirement to provide a commitment to support).

The exemptions for items f and g above do not apply in situations in which a reporting entity has provided a financial guarantee or commitment to support a subsidiary, controlled or affiliated entity (SCA), and the SCA’s equity is negative (see paragraph 24).
We find the new paragraph 24 wording confusing in that it tells the preparer in the first sentence to recognize the greater of the guarantee liability or the negative equity of the SCA. However, the third sentence clarifies that the guarantee liability shall not exceed the maximum amount of the guarantee. We propose condensing these items into one sentence in our recommended revisions below, and also clarifying that the “greater” term actually refers to the greater negative impact to the reporting entity’s financial statements. We also recommend that the new proposed paragraph be a stand-alone paragraph (i.e., new paragraph 25, with re-numbering of all subsequent paragraphs):

“In situations in which a reporting entity has provided a financial guarantee or commitment to support a subsidiary, controlled or affiliated entity (SCA), and the reporting entity’s share of losses in the SCA exceed the equity method carrying amount of the SCA (resulting in a negative equity value in the SCA), the reporting entity shall adjust the initially recognized guarantee obligation to reflect the greater impact of (i) the then-current fair value liability or (ii) the negative equity position, limited to the maximum amount of the financial guarantee or commitment provided by the reporting entity. (For this guidance requires recognition of a guarantee liability for guarantees captured in paragraphs 18f and 18g this guidance requires recognition of a contingent guarantee when negative equity exists in an SCA.) The recognized guarantee liability shall not exceed the maximum amount of the financial guarantee or commitment provided by the reporting entity. The guidance in paragraphs 24 and 25 through 26 shall be followed for the recognition of recognizing a contingent liability and subsequent re-recognition of a noncontingent liability, as applicable.”

Recommended Action:
NAIC staff believes the proposed language submitted by interested parties reflects the intent of the language exposed during the Summer National Meeting. However, as we are close to year-end, NAIC staff recommends exposing the revisions with the modifications suggested by interested parties. Additionally, the exposure will also include the proposed Exhibit F, which was exposed during the Spring National Meeting, but not explicitly detailed in the Summer National Meeting.

The proposed edits, with the modifications from the interested parties, and the proposed Exhibit F are detailed in the agenda item.

As an overview of the agenda item and revisions, it was identified that the existing guidance in SSAP No. 97, which requires negative SCA reporting when there are negative equity losses that go below “zero” and the insurer has provided a financial commitment or guarantee could result with double-counting when the guarantee has also been reported under SSAP No. 5R. After a number of exposures and discussion, the current revisions proposed in the agenda item would eliminate the guidance from SSAP No. 97 and instead address the issue with an expansion of guidance involving financial guarantees in SSAP No. 5R. With the revisions, all SCAs would stop at “zero” regardless of the equity method losses and guarantees. (The SCA on the investment schedules would not be shown negative.) Instead, the negative loss position (liability) would be recognized, to the extent there is a financial guarantee or commitment, under the provisions of SSAP No. 5R. The revisions to SSAP No. 5R specifically scope in SCAs that would normally be excluded from the financial guarantee recognition guidance when the SCA is in a negative equity position and the insurer has provided a financial guarantee.
Summary:
During the Summer National Meeting, the Working Group exposed an issue paper to revise the definitions, measurement guidance and impairment guidance for preferred stock pursuant to the investment classification project regarding SSAP No. 32—Preferred Stock.

Interested Parties’ Comments:
Interested parties substantially agree with the objectives of the proposal to:

a. Improve preferred stock definitions, with inclusion of information from U.S. generally accepted accounting principles (GAAP) for classifying preferred stock as redeemable or perpetual. The revisions also incorporate a new exhibit to capture various terms prevalent in preferred stock.

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

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

Interested parties have the following comments related to the issue paper:

Overall:
The issue paper refers to preferred stock throughout the document, at times the paper references the instruments as securities. For purposes of definitional clarity, we do not believe the use of the term security is interchangeable as it pertains to preferred stock. As such, we recommend that all references to security be changed to interest or directly reference the type of stock under discussion.

Scope:
Interested parties note that the scope retains, albeit edited, the guidance that preferred stock of subsidiary, controlled and affiliated entities is included and therefore accounted for under the guidance for preferred stock regardless of their SCA character. Interested parties also note that preferred stock in SCAs other than preferred stock issued by domestic insurance entities is required to be filed with the NAIC pursuant to paragraph 50 of SSAP No. 97 Exhibit A – SCA Reporting Process. For the avoidance of doubt, interested parties suggest a clarifying sentence in double underline below. The existing wording in SSAP No. 32 and the exposed language for SSAP No. 32 is below with interested parties suggested clarifying sentence (underlined).

Existing language in SSAP No. 32

SCOPE OF STATEMENT
1. This statement establishes statutory accounting principles for preferred stock.

2. Investments in preferred stock of subsidiaries, controlled or affiliated entities, including preferred stock interests of certified capital companies (CAPCO) per INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO) are included within the scope of this statement.

Exposed language in SSAP No. 32 and interested parties’ suggested clarifying sentence in underlined.
SCOPE OF STATEMENT

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

2. Investments in preferred stock of entities captured in SSAP No. 97—Investments in subsidiaries, controlled or affiliated entities or SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies, as well as preferred stock interests of certified capital companies per INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO) are included within the scope of this statement. The requirement to file investments in preferred stock of certain subsidiaries, controlled or affiliated entities with the NAIC pursuant to SSAP No. 97 does not affect the application of the accounting under this statement.

Definitions:

The proposed definitional guidance could potentially change the scope of what is considered redeemable preferred stock vs perpetual preferred stock and create an inconsistency as to how the preferred stock would be treated. Under the previous guidance, redeemable preferred stock included stock that was mandatorily redeemable or redeemable at the option of the holder. This definition was consistent with how GAAP distinguishes between debt and equity security classification under ASC 321, Investments – Equity Securities. We believe the intention of the Staff was to align the definitions with the treatment under GAAP. However, using the language from ASC 480, which addresses the accounting from the issuer’s perspective, does not align with how the investor in the security accounts for the asset under GAAP. As such we propose the following revisions (indicated with edit marks) to the definitions:

3. Preferred stock shall include:
   a. Redeemable preferred stock, which is preferred stock subject to mandatory redemption requirements or whose redemption is outside the control of the issuer. Redeemable preferred stock is any stock which 1) the issuer undertakes to redeem at a fixed or determinable price on the fixed or determinable date or dates, whether by operation of a sinking fund or otherwise; 2) is redeemable at the option of the holders; or 3) has conditions for redemption which are not solely within the control of the issuer, such as stock which must be redeemed out of future earnings. Preferred stock which meet one or more both of these three criteria would be classified as redeemable preferred stock regardless of other attributes such as voting rights or dividend rights. (Staff Note – this definition comes from FASB ASC 480-10-S99, modified to eliminate reference to conversion features as mandatory convertible preferred stock has special treatment under this SSAP.) ; and to be consistent with the description of redeemable preferred stock for a holder in the ASC Master Glossary definition of debt security. ;
   b. Perpetual preferred stock, which is preferred stocks which are not redeemable or are redeemable other than solely at the option of the issuer (non-redeemable preferred stock). Perpetual preferred stock is any preferred stock which does not meet the criteria to be classified as redeemable preferred stock pursuant to paragraph 3.a. Staff Note – this definition comes from FASB ASC 480-10-S99 modified to be made consistent with the description of redeemable preferred stock for a holder in the ASC Master Glossary definition of debt security. ;

Fair Value Cap for Callable Perpetual Preferred Stock:

The issue paper broadly requires fair value measurement for redeemable preferred stock, perpetual preferred stock, mandatory convertible preferred stock and dividends (paras 16.a-d, para 18), depending on the quality rating expressed as an NAIC designation. Interested parties note that these assets may not have readily determinable fair values, and as such, fair value techniques using the cost approach, Level 3 inputs and practical expedients may be prevalent and necessary for these assets.
The issue paper discusses carrying perpetual preferred at fair value capped by any call price. However, it did not provide guidance on timing for application of the cap. Because the call may not be effective for a period of time, we propose the language be modified to state that “the measurement for these preferred stocks reflects fair value, not to exceed any currently effective buy back rates (call prices) that the issuer can utilize to redeem the stock.” These provisions would ensure that purchases of perpetual preferred stock could still be carried at values greater than par (assuming market values remain above par).

Other Than Temporary Impairment (OTTI):

For perpetual preferred stock, if the intent of the clarification is to provide OTTI guidance when the asset is already recorded at fair value then we would suggest OTTI language consistent with SSAP No. 30R, revised for preferred stock as follows:

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

Recommended Action:

NAIC staff recommends that the Working Group expose a revised Issue Paper and a draft SSAP proposing substantive revisions to SSAP No. 32—Preferred Stock.

NAIC staff has reviewed the comments received from interested parties on the initial Issue Paper exposure and has incorporated a variety of revisions into the document. NAIC staff has not incorporated all industry’s proposed changes as NAIC staff is proposing to maintain consistency between U.S. GAAP and SAP on the definitions of redeemable and perpetual preferred stock. Although NAIC staff understands that some aspects of the U.S. GAAP definitions are written from the perspective of the issuer, the holder of preferred stock would need to consider these elements in classifying preferred stock. As such, for consistency and to prevent confusion on whether there is an intent to have different definitions, the U.S. GAAP definition of preferred stock is proposed to be retained.

The revised issue paper includes discussion on aspects noted by interested parties in paragraphs 5-6 of the discussion section and changes to the draft SSAP (included as an exhibit in the issue paper) from the last exposure are shaded for identification. (The proposed SSAP provided as a stand-alone document is a clean version of the proposed statement.)

<table>
<thead>
<tr>
<th>Ref #</th>
<th>Title</th>
<th>Attachment #</th>
<th>Agreement with Exposed Document?</th>
<th>Comment Letter Page Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019-08 SSAP No. 51R SSAP No. 52 (Julie)</td>
<td>Reporting Deposit Type Contracts</td>
<td>15</td>
<td>Comments Received</td>
<td>IP - 7</td>
</tr>
</tbody>
</table>

Summary:
During the Summer National Meeting, the Working Group exposed this agenda item to gain further clarification regarding circumstances when guaranteed investment contracts (GICs), or other deposit-type contracts, are reported in Exhibit 5, Life Contracts or Exhibit 6, Accident and Health Contracts, instead of Exhibit 7, Deposit Type Contracts. Questions were directed to industry and state insurance regulators, and directed notifications of
the exposure with a request for comments were sent to the Financial Stability (EX) Task Force and the Life Actuarial (A) Task Force on the reporting of insurance contracts that do not have a mortality or morbidity risk.

**Interested Parties’ Comments:**

Before responding to the questions raised, interested parties note that the comments from the FSTF anticipates a classification system based on degree of risk. This is entirely new. The current classification is based strictly on mortality guarantees (Exhibit 5), morbidity guarantees (Exhibit 6), or neither (Exhibit 7). There is no concept of degree of risk in the current statutory classification. If the benefits of such fundamental changes to Exhibits 5, 6, and 7 were demonstrated to outweigh the costs, this would be a significant undertaking and companies would need significant lead time to implement systems changes. Please see the questions and interested parties (IP) responses below:

1. **Classification at Issuance** – The interested parties noted that because a contract was life-contingent at issue, it is reported in Exhibit 5, and then it remains in Exhibit 5 after the death of the annuitant.

   **Question** – Is it appropriate to classify products based on original issuance when the original risks are no longer present in the contract? Is this simply past industry practice, or is there direction that prevents reclassification to the category that most appropriately reflects the risk? Preliminary information received from the Financial Stability (EX) Task Force (FSTF) staff has noted that this practice will make it more difficult to properly aggregate and assess deposit-type contracts, and that this assessment is important as the payouts for deposit-type contracts are significantly different than payouts generated by an insured event. The Task Force has identified that information on liabilities, particularly those that can be called quickly with little or no surrender penalty, is of critical importance to liquidity assessments.

   **IP Response** - Tradition and SSAP No. 50 generally classify contracts with any life contingencies as life contracts. In practice, this “any life contingencies” is interpreted as those that are guaranteed.

   SSAP No. 50, Paragraph 5, includes the statement, “Such classification shall be made at the inception of the contract and shall not change.” In practice, if there is a new contract, such as a supplementary contract to a life insurance benefit, the contract is re-evaluated as to whether it contains life contingency guarantees. For policyholder election of a payout benefit from a deferred annuity contract, re-evaluation varies depending on the Company’s valuation and risk policies. (For example, two-tiered policies are priced for annuitization, and the election of an annuitization option may be treated as a continuing contract and may not create a re-evaluation.)

   For payout contracts issued as life contingent with a minimum guaranteed certain period, death of the original annuitant does not cause a change in contract. It is a change in payee for the remainder of the guaranteed certain period.

2. **State Approval** – The interested parties noted that state insurance departments have the discretion to approve or require a contract to be classified as a life or A/H insurance contract.

   **Question** – If a state directs reporting differently than what is stipulated in the AP&P Manual, is that being captured as a permitted or prescribed practice? (The provisions in SSAP No. 1 require permitted / prescribed practice reporting when it results in different statutory reporting. Examples included in SSAP No. 1 include gross or net presentation, financial statement reporting lines, etc.)

   **IP Response** - In our observation and experience, discretion exercised by state insurance departments on product classification is rare. When it happens, it is generally in the product filing process, generally applies to group products (e.g., association group), and where there is judgement as to whether the benefits should be classified as Exhibit 5 or Exhibit 6.
3. **Annuity Guidance** – The interested parties cited existing annuity guidance in paragraph 20 of *SSAP No. 50 - Classifications of Insurance or Managed Care Contracts*. Per this guidance, contracts containing well-defined class-based (e.g., age / gender) annuity purchase rates used in defining either a specific or maximum purchase rate guarantee would constitute an annuity contract containing a life contingency that would require it to be classified as a life contract.

**Question** – NAIC staff agrees with the citation from interested parties on annuities in paragraph 20 of *SSAP No. 50 - Classifications of Insurance or Managed Care Contracts*. However, with the intent to have more explicit product breakouts to allow for better assessment, is it time to clarify / revise this guidance to result with the appropriate breakouts created by FSTF? It was noted that the current concepts were established a long time ago and there is a focus on non-traditional insurance liabilities (which includes funding agreements) for liquidity risk assessment as they can have higher run risk.

**IP Response** – We believe the current guidance supports the classification of life annuity contracts within Exhibit 5 regardless of payout status. While we acknowledge the conceptual distinction noted by NAIC Staff with respect to a single life annuity contract for which the life status has changed, we do not believe this represents a significant change in the risk profile of a given block of annuity contracts, for which the majority may not reach term-certain status.

We would also highlight the administrative burden of the proposed changes. As a practical matter, it would be necessary to convert life annuity contracts to new plan codes on the death of the annuitant in order to capture the appropriate information in the Summary of Operations by Line of Business. This change must be implemented at the policy administration system level and would require significant time and effort on the part of industry. We do not believe the perceived benefits of this change justify the cost, particularly given recent significant annual statement changes for product reporting. Rather than implementing additional product granularity at this time, we suggest that regulators and staff work with industry to review the new Note 32 and Note 33 disclosures, which are specifically designed to communicate liquidity risk. We believe these disclosures will fulfill the regulatory objective in a more cost-efficient manner.

4. **Materiality of Issue** – Although the interested parties cite a “common” scenario, without information in the financial statements, there is no current ability to identify the extent contracts with no remaining mortality or morbidity risk are reflected as life contracts.

**Question** – To what extent are deposit-type contracts captured in an exhibit other than Exhibit 7? Is it possible to receive information from companies regarding this population for assessment purposes?

**IP Response** - We contend that by the guidance identified in SSAP No. 50, paragraph 20, a certain and life annuity, or a refund annuity, that continues payments to a surviving beneficiary after the death of the primary annuitant is not re-classified as a deposit-type contract. It is a life annuity contract where additional information on the life-status of the annuitant has become known.

Many deferred annuities contemplated by SSAP No. 50, paragraph 20a, are ultimately surrendered rather than electing a guaranteed lifetime income. These annuities are treated as investment contracts under US GAAP and re-evaluated at the time of election to annuitize. On the other hand, it is becoming more common for deferred annuities to include guaranteed minimum income benefits, minimum death benefits, or similar benefits (collectively GMxBs). A policyholder no longer has to annuitize for the contract to be subject to life contingent risks.

**Recommended Action:**
After discussing with NAIC staff for the Financial Stability (EX) Task Force, the SAPWG NAIC staff does not suggest revising the fundamental SAP concepts for classification in *SSAP No. 50—Classification of*
Insurance or Managed Care Contracts. Instead, NAIC staff recommends exposing agenda item 2019-08 to:
1) request feedback on the inclusion of a footnote excerpt for Exhibit 5 to disclose cases when a mortality risk is no longer present or a significant factor – i.e. due to a policyholder electing a payout benefit, 2) request feedback on circumstances where a morbidity risk is no longer present or a significant factor for Exhibit 6 items and whether a similar footnote disclosure would be appropriate, and 3) industry input for instruction clarifications regarding the classifications of deposit-type contracts captured in Exhibit 7.

With the current recommendation, there are no proposed edits planned for statutory accounting. Rather, the proposed edits would be limited to blanks reporting and annual statement instructional revisions. Although it is recommended that the revisions be exposed by Working Group, NAIC staff suggests a concurrent exposure at Blanks to allow for the changes to be considered in time for 2020 year-end reporting.

In response to interested parties’ comments, just to clarify, the intent of collecting this information is to identify the amount based on risk type. This is a different assessment than a collection based on the “degree of risk.” The goal is to provide information that allows regulators to fully accumulate the reported reserves that do not have mortality or morbidity elements.

<table>
<thead>
<tr>
<th>Ref #</th>
<th>Title</th>
<th>Attachment #</th>
<th>Agreement with Exposed Document?</th>
<th>Comment Letter Page Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019-18 SSAP No. 86 (Julie)</td>
<td>Other Derivatives</td>
<td>16 Agenda Item</td>
<td>Comments Received</td>
<td>IP - 11</td>
</tr>
</tbody>
</table>

Summary:
During the Summer National Meeting, the Working Group re-exposed revisions to clarify that “other” derivatives not used in hedging, income generation or replication transactions shall be reported at fair value and do not qualify as admitted assets. Per existing guidance in SSAP No. 86, derivatives used for purposes other than hedging, income generation or asset replication do not qualify as admitted asset.

Interested Parties’ Comments:
Interested parties are still concerned about potential unintended consequences of the cliff effect (potential non-admission of a bond with a trivial embedded derivative) as capital markets develop. If and when problems develop, interested parties may re-examine this issue.

Recommended Action:
NAIC staff recommends adopting the exposed revisions to SSAP No. 86—Derivatives to include recognition and measurement guidance for derivatives that do not qualify as hedging, income generation or replication transactions, as final. As the guidance clarifies existing practice, this revision is proposed to be adopted as a nonsubstantive change and effective immediately. NAIC staff encourages information on evolving investments, and the impact of statutory accounting, therefore interested parties are always welcome to provide additional information or scenarios that are subsequently identified for review.
REVIEW of COMMENTS on EXPOSED ITEMS

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

1. Ref #2017-28: Reinsurance Credit – Informal Life and Health Reinsurance Drafting Group
2. Ref #2018-38: Prepaid Providers
3. Ref #2019-12: ASU 2014-17, Business Combinations, Pushdown Accounting
4. Ref #2019-14: Allocation of Goodwill
5. Ref #2019-20: Rolling Short-Term Investments
6. Ref #2019-24: Levelized and Persistency Commission

<table>
<thead>
<tr>
<th>Ref #</th>
<th>Title</th>
<th>Attachment #</th>
<th>Agreement with Exposed Document?</th>
<th>Comment Letter Page Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017-28</td>
<td>Reinsurance Credit – Informal Life and Health Reinsurance Drafting Group Recommendations</td>
<td>17 Agenda Item</td>
<td>Comments Received</td>
<td>IP - 1</td>
</tr>
<tr>
<td>2018-38</td>
<td>Prepaid Providers</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2019-12</td>
<td>ASU 2014-17, Business Combinations, Pushdown Accounting</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2019-14</td>
<td>Allocation of Goodwill</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2019-20</td>
<td>Rolling Short-Term Investments</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2019-24</td>
<td>Levelized and Persistency Commission</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Summary:

During the Summer National Meeting, the Working Group exposed for comment the following items which were recommended by the informal life and health reinsurance drafting group:

1. SSAP No. 61R—Life and Health Reinsurance Disclosures, (previously exposed) and concurrent with the exposure, directed notification to the Financial Analysis (E) Working Group of the exposure as the disclosures were originally developed at their request.

2. A-791 – Life and Health Insurance Question and Answer update to clarify the phrase “certain non-proportional contracts” to assist in determining which nonproportional reinsurance contracts are subject to under the A-791 guidance. This QA was previously exposed with only minor comments which were reviewed and not incorporated by the drafting group as the yearly renewable term (YRT) reinsurance discussion is ongoing.

3. A-791 – Life and Health Insurance Question and Answer regarding business that has a statutorily required medical loss ratio or similar refund / rebate. This item was previously exposed, and no questions were received. The drafting group did not recommend any additional revisions.

4. A-791 – Life and Health Insurance Question and Answer, regulator proposed revisions to add A-791 question and answer under paragraph 2c regarding group term life YRT reinsurance contracts. As noted at the Summer National Meeting, industry member and regulators members had different views regarding the proposed revisions and after discussion, the regulator and industry members of the drafting group could not come to agreement.

   o The industry members prefer to seek ways to explicitly allow the group term life YRT reinsurance contracts to exceed the amount of the underlying direct proportionate premium. The most recent industry proposal was to allow this, provided the ceding entity establishes a liability for the amount of reinsurance premium in excess of the direct premium. Industry discussed the commercial reasoning and argued that risk would still be transferred.

   o The regulator members continued to question whether such group term life YRT contracts appropriately transferred risk if a reinsurer could charge premiums in excess of the underlying direct proportionate premium. It was noted that these contracts generally included other risk limiting features such as loss carry forward provisions and would typically not pass risk transfer requirements under GAAP. They also noted concerns that codifying the industry proposed...
exception in statutory accounting could result in unintended consequences and appeared to be designed address a commercial concern. Therefore, the regulator members proposed to accept the Q&A drafted by the industry but without wording that would allow reinsurers to charge premiums in excess of the underlying direct proportionate premium. The regulator members of the drafting group have requested exposure of the guidance to allow for specific concerns to be raised and addressed. This guidance provides that group term life YRT contracts which exceed the underlying direct premium are unreasonable and violate the provisions of paragraph 2c of A-791, and therefore, would not be subject to reinsurance accounting.

**Interested Parties’ Comments:**
Interested parties appreciate the outreach the NAIC has made to the industry through the informal SSAP No. 61R Life and Health reinsurance drafting group. We believe the drafting group has allowed us to better understand the issues raised by regulators.

In summary, we do not have any concerns with the re-exposed disclosures and the two Q&A’s regarding short-duration health reinsurance treaties and offer the following comments.

With respect to the group term life YRT exposure, in general interested parties believe this draft exposure language addresses the concerns expressed by regulators in the drafting group and in prior exposures, and we would support this Q&A being added to 2.c in Appendix A-791, as long as the guidance does not impact contracts that do not raise such concerns as described below.

The proposed Q&A would deny risk transfer for specific group term life YRT reinsurance transactions if the reinsurer has the right to charge reinsurance premiums higher than the premiums received by the ceding company on the business reinsured. However, SSAP 61R and Appendix A-791 specifically exempt YRT reinsurance arrangements from paragraph 2.e of Appendix A-791, which denies risk transfer if the reinsurance agreement charges reinsurance premiums greater than the direct premiums collected by the ceding company.

There are specific circumstances where YRT reinsurance agreements do have reinsurance premiums greater than direct premiums, yet reinsurance accounting is appropriate, and this 2.e exemption has allowed those circumstances to meet risk transfer regulations. Examples of such reinsurance agreements include:

1. High level excess YRT agreements. High amount policies have higher volatility in claims. It is reasonable and appropriate for a reinsurer to charge a higher amount to cover these claims.
2. Level term premiums, where a true one-year risk premium in later years is likely to exceed the level premium.
3. In force business, where a ceding company has realized they are not charging sufficient premiums for the true risk. The ceding company may have to accept higher reinsurance premiums than they charge to appropriately discharge the risk going forward.
4. YRT for universal life. YRT premiums often will not have a direct or proportional relationship to either the premiums or cost of insurance rates charged by the ceding company.

The concerns about group term life YRT reinsurance raised by regulators are focused on reinsurance agreements with risk limiting features. As the exposure is phrased, the guidance here would be limited to group term life YRT reinsurance agreements where future experience refunds can be offset against current and prior year losses. Reinsurance agreements such as those in the examples above are unlikely to have such a loss carryforward provision, and thus should not be impacted by this guidance.

Additionally, we would like to comment on the implementation/timing of the proposed exposure, when it is finalized. We believe that there are reinsurance transactions in place today which meet current regulations for risk transfer that would not meet risk transfer under this new guidance. This new Q&A may impact some company’s
financial statements. Consideration should be given to grandfathering these transactions, or to establishing a prospective effective date that would provide enough time for these companies to make appropriate changes to their reinsurance agreements or to otherwise prepare for this impact. If a prospective effective date is the approach chosen, we recommend an effective date of 1/1/2021.

**Recommended Action:**
NAIC Staff recommends that the Working Group take the following actions regarding the exposed items:

1. **Adopt the exposed SSAP No. 61R disclosures** with paragraph number updates as reflected in the agenda item and with an initial effective date of year end 2020 reporting. Proposed effective date language for the disclosures is illustrated below.

   **86–92** The disclosure for compliance with Model #787 or AG 48 shall be effective for reporting periods ending on or after December 31, 2015. The revisions adopted in November 2018 to expand liquidity disclosures are effective year-end 2019, concurrent with the inclusion of data-captured financial statement disclosures. The disclosures captured in paragraphs 78-84 which help to identify certain reinsurance contract features are effective for reporting periods ending on or after December 15, 2020.

2. **Adopt the exposed revisions to A-791 question and answer regarding contracts with medical loss ratios.**

3. **Refer to the informal life and health reinsurance drafting group the exposed revisions to the A-791 question and answer update to clarify the phrase “certain non-proportional contracts” with informal questions received by NAIC staff regarding: 1) the application of the exposed language regarding measurement period and settlement period and, 2) the application of substantially less likely than not.** During the interim the informal questions were distributed to the drafting group. Based on informal input from with various drafting group members, more discussion is needed regarding this question and answer item and this is an issue that the drafting group can lend some useful expertise.

4. **Provide direction on the A-791 question and answer, regarding the paragraph 2c exposed regulator language.** As noted in the summary section above, regulator and industry members of the drafting group could not come to agreement. Industry comments received still indicate opposition on the topic of limiting group term life YRT reinsurance contracts to being not greater than the amount of the underlying direct proportionate premium reinsurance premium for the contract to receive reinsurance accounting. **If preferred, the Working Group could have further discussion and provide direction at a subsequent meeting as the drafting group has noted that the regulators and the industry members are not in agreement on this topic. NAIC staff recommends that the Working Group send a referral to the Life Actuarial (A) Task Force to receive their insight on this issue as part of their YRT project.**

<table>
<thead>
<tr>
<th>Ref #</th>
<th>Title</th>
<th>Attachment #</th>
<th>Agreement with Exposed Document?</th>
<th>Comment Letter Page Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018-38 SSAP No. 55 (Robin)</td>
<td>Prepaid Providers</td>
<td>18 Agenda Item</td>
<td>Comments Received</td>
<td>IP - 18</td>
</tr>
</tbody>
</table>

**Summary:**
During the Summer National Meeting, the Working Group exposed revisions emphasizing existing guidance that loss and loss adjusting expense liabilities are established regardless of payments to third parties (except for capitated health claim payments). The liabilities are not recognized as paid until the losses are paid to claimants or claims are adjusted. Prepayments to third party administrators, which are not for claims or loss adjusting expense, are “miscellaneous underwriting expenses.” The revisions also added a reference to SSAP No. 84 regarding
prepayments to providers. Revisions indicate that liabilities for unpaid losses and claims shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims on non-capitated payments under managed care contracts shall be established in an amount necessary to pay the losses/claims irrespective of payments made to third-party administrators.

**Interested Parties’ Comments:**
Interested parties note that there are differences in the treatment of loss and loss adjusting expenses by different sectors of the industry. However, the current exposure removes important clarification from the 2019 Spring National Meeting exposure draft. To address these noted concerns, interested parties proposes the following changes which are highlighted in yellow to the 2019 Summer National Meeting exposure draft – these changes incorporate industry specific guidance to address the differences in accounting by industry. Interested parties also propose moving exposed item 4.c. back to the last sentence of paragraph 4, along with proposed wording for the treatment of prepaid loss and loss adjusting expenses by specific sector of the industry. As reflected in the drafting note, there is already existing guidance which will remain unchanged; the additional clarifying guidance is proposed to be added to existing guidance.

**Interested Parties’ Proposed Edits to the Summer National Meeting Exposure are in the comment letter.**

**Recommended Action:**
NAIC Staff recommends that the Working Group expose revisions incorporating the majority of interested parties’ comments as reflected below as tracked changes to SSAP No. 55 (rather than as reflected as changes to the Summer 2019 exposure). Interested parties’ comments primarily delete the exposed guidance and move the same or similar concepts into the broad product guidance for property and casualty, life and health or health in SSAP No. 55. These revisions are to reinstate annual statement references by entity type and to adjust scoping language and make the SSAP No. 29 prepaid guidance consistent. Note that shading reflects staff proposed variations in wording from the interested parties proposed wording that accomplishes a similar intent.

**Unpaid Claims, Losses and Loss Adjustment Expenses SSAP No. 55**

**SUMMARY CONCLUSION**

4. Claims, losses, and loss/claim adjustment expenses shall be recognized as expenses when a covered or insured event occurs. In most instances, the covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs. For claims-made type policies, the covered or insured event is the reporting to the entity of the incident that gives rise to a claim. Until claims payments and related expense payments are made subsequent to the occurrence of a covered or insured event, and in order to recognize the expense of a covered or insured event that has occurred, it is necessary to establish a liability. Liabilities shall be established for any unpaid claims and unpaid losses (loss reserves), unpaid loss/claim adjustment expenses (loss/claim adjustment expense reserves) and incurred costs, with a corresponding charge to income. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related to extra contractual obligations and bad-faith lawsuits.

5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts for which – The liability for claims adjustment expenses on non-capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third-party administrators, etc. The liability for claims adjustment expenses on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers.
Drafting Note - No changes to paragraphs 6a-c. Only revised guidance shown below for brevity.

**Property/Casualty**

6. The following are types of future costs relating to property and casualty contracts, as defined in SSAP No. 50, which shall be considered in determining the liabilities for unpaid losses and loss adjustment expenses:

   d. The contractual terms for arrangements (i.e., variable, fixed or bundled amounts) to third party administrators, management companies, or other entities for unpaid claims, losses and losses/claims adjustment expenses, shall be evaluated to determine if the arrangement meets the criteria to be reported as a prepaid asset and nonadmitted in accordance with SSAP No. 29—Prepaid Expenses. These payments shall not be offset against any amounts required to be reported in accordance with paragraphs 4 or 5 within this guidance. Only when loss/claim and related adjusting expense payments which are made by the third-party administrators, management companies or other entities to the policyholder or claimant, shall the insurer’s liability (loss/claim or loss/claim adjustment expense reserves) be reduced.

   c. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as aggregate write-in for miscellaneous underwriting benefits in the Underwriting and Investment exhibit Part 3.

**Drafting Note - No changes to paragraph 7a-d. Only revised guidance shown below for brevity**

**Life, Accident and Health**

7. The following future costs relating to life and accident and health indemnity contracts, as defined in SSAP No. 50, shall be considered in determining the liability for unpaid claims and claim adjustment expenses:

   c. In cases where insurers advance funds to third-party administrators, management companies or other entities prior to the occurrence of the claim who then, on behalf of the insurer, adjudicate the claim and make payments to insureds or other claimants, the guidance in paragraph 9 applies.

**Drafting Note - No changes to paragraph 8 a-d. Only revised guidance shown below for brevity**

**Managed Care**

8. The following costs relating to managed care contracts as defined in SSAP No. 50 shall be considered in determining the claims unpaid and claims adjustment expenses:

   e. In cases where insurers advance funds to third-party administrators, management companies or other entities prior to the occurrence of the claim who then, on behalf of the insurer, adjudicate the claim and make payments to insureds or other claimants, the guidance in paragraph 9 applies.

**Managed Care and Accident and Health**

Drafting Note: New guidance is issued within par. 9, which is underlined. Existing par 9 is renumbered to par. 10, and all other pars within existing guidance (i.e., pars. 10 – 23, will be renumbered to 11 – 24, respectively.
In some instances, insurers advance funds to third-party administrators, management companies or other entities prior to the occurrence of the claim who then, on behalf of the insurer, adjudicate the claim and make payments to insureds or other claimants. In such cases the following guidance applies:

a. For capitated payments under managed care contracts, the liability for claims and claim adjusting expenses shall be established in an amount necessary to adjudicate and pay all unpaid claims irrespective of payments to third-party administrators, management companies or other entities, and is reported net of capitated payments to providers.

b. For non-capitated advance payments, the liability for unpaid losses/claims and related adjustment expenses shall be established regardless of any payments made to third-party administrators, management companies or other entities, and such payments shall be reported by the insurer as prepayments. All prepayments (i.e., variable, fixed or bundled amounts) to third party administrators, management companies, or other entities for unpaid claims, losses and losses/claims adjustment expenses, shall be initially reported as a prepaid asset and nonadmitted in accordance with SSAP No. 29—Prepaid Expenses. These payments shall not be offset against any amounts required to be reported in accordance with paragraphs 4 or 5 within this guidance. Only when loss/claim and related adjusting expense payments which are made by the third-party administrators, management companies or other entities, to the policyholder or claimant, shall the insurer’s liability (loss/claim or loss/claim adjustment expense reserves) be reduced.

c. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as (1) Aggregate write ins for expenses - Life/ Health (Exhibit 2 – General expenses) or (2) Aggregate write ins for expenses (General Administrative Expenses) - Health (Underwriting and Investment Exhibit Part 3)

Note that this guidance in paragraph 9 does not alter existing guidance regarding the admissibility of loans and advances to providers which apply to health insurance and managed care contracts which is addressed in SSAP No. 84—Health Care and Government Insured Plan Receivables.

<table>
<thead>
<tr>
<th>Ref #</th>
<th>Title</th>
<th>Attachment #</th>
<th>Agreement withExposed Document?</th>
<th>Comment Letter Page Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019-12</td>
<td>ASU 2014-17, Business Combinations, Pushdown Accounting</td>
<td>19 Agenda Item</td>
<td>Comments Received</td>
<td>IP – 10 AICPA/NAIC Task Force – 25 TIAA - 31</td>
</tr>
<tr>
<td>2019-12 SSAP No. 68 SSAP No. 97 (Fatima/Julie)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Summary:**
During the Summer National Meeting, the Working Group exposed revisions to assess ASU 2014-17, Business Combinations – Pushdown Accounting for statutory accounting with a request for comments on whether pushdown shall be rejected, permitted for noninsurance entities, or permitted only for U.S. Securities and Exchange Commission (SEC) registrants. The exposure also clarifies that goodwill resulting from an insurance reporting entity’s acquisition of an SCA when pushdown is applied shall be captured in the existing goodwill 10% admittance limitation.

**Interested Parties’ Comments:**
Interested parties reviewed the options exposed by the Working Group for consideration regarding pushdown accounting in Ref #2019-12. We do not recommend option 1 (“complete rejection of pushdown accounting”). With regard to the second and third options exposed for Working Group consideration, interested parties need...
additional time to evaluate whether these options are feasible. In our discussions, it was apparent that the proposed changes involve significant changes to insurers’ reporting and the complexities of the reporting mechanics of the annual statement will need to be addressed in applying the 10% goodwill admittance limitation and pushdown accounting. These complexities include the application of an aggregate 10% admittance limitation when multiple SCA entities carry GAAP goodwill on their individual balance sheets, as well as application to an acquired SCA holding company with subsidiaries (or layers of subsidiaries). Because annual statement reporting and disclosure includes considerable details on each investment in an SCA entity, specific guidance will likely be needed to address reporting issues such as presentation on the annual statement balance sheet and the related investment schedules, as well as interpretation related to current disclosures (including the proposed disclosures in Ref #2018-14). We believe these operational complexities need to be addressed before any proposal is considered for adoption by the Working Group.

Interested parties request additional time to evaluate various approaches for allowing pushdown accounting and working through the operational mechanics of a goodwill admittance limitation as well as evaluating the impact on insurers’ capital and surplus. Our goal is to present a recommendation for Ref # 2019-12 to the Working Group during the 2020 Spring National NAIC Meeting that addresses these complexities. Because the proposed disclosures in Ref #2019-14 includes specific SCA entity goodwill and admitted value amounts, interested parties would include those proposed disclosures in our evaluation and recommendation and, therefore, also request additional time to respond to that agenda item.

Given the need to work out clear examples that address the reporting complexities and the need for transition guidance, interested parties do not believe the proposed changes in Ref #2019-12 and Ref # 2019-14 are non-substantive nor do we believe these proposed changes can be applicable to year end 2019 reporting.

**AICPA NAIC Task Force Informal Comments:**
Consistent with our comments submitted June 14 on the draft exposed at the 2019 Spring National Meeting, the Task Force believes the proposed revisions could be a significant change to current SAP and requests clarification as to what is meant by "audited reconciliation" and "audited support" in the proposed new paragraph 20 of SSAP 97. Would this be similar to adjustments made to the audited U.S. GAAP carrying value for par. 8.b.ii and 8.b.iv entities? For these adjustments, there is no "audited reconciliation" included in any financial statements. An insurance entity prepares a schedule to determine the required adjustments for purposes of its carrying value of the SCA, which is subject to audit procedures in relation to the insurer's financial statements taken as a whole, but there is no reconciliation included in the audited financial statements of the SCA.

In the re-exposed document we note that the working group clarified, for companies that receive approval from their domiciliary commissioner to continue to admit the existing goodwill that has been pushed down on or before December 31, 2019, that this goodwill would be subject to the 10% of surplus limitation. We suggest that specific transition guidance be provided for companies that have not previously included this goodwill in the goodwill limitation calculation. We also suggest that the working group clarify whether this GAAP goodwill is subject to amortization under SSAP 68 (as it is not amortized under U.S. GAAP). We also request that specific transition guidance be added for companies that do not obtain approval from their domiciliary regulator to continue to admit goodwill pushed down from acquisitions prior to January 1, 2020. Given the proximity of these discussions to year-end 2019, the SAP Working Group may also want to consider whether it is too near year-end to adopt any changes for 2019, since a December 2019 adoption would likely not provide adequate time for capital planning for affected companies.

**Teachers Insurance and Annuity Association of America (TIAA) Comments:**
TIAA strongly encourages the NAIC to thoroughly engage with the industry on Exposure Draft Ref. #2019-12 Business Combinations – Pushdown Accounting and the classification of the proposal as substantive or non-substantive.
We note that the NAIC classifies as “substantive listings” those items that require a new issue paper and SSAP to address the issue. Once items are placed on this listing, they are prioritized and the formal maintenance policy is followed. Conversely, “nonsubstantive listings” are those items that are considered editorial or technical in nature and for which a new SSAP will therefore not be developed. In other words, a revision to a SSAP for these items will not be deemed to modify its conclusion or original intent.

While the NAIC categorized the revisions in the Exposure Draft as “nonsubstantive,” without industry analysis and further clarity in application, we believe the proposed changes to SSAP No. 68, paragraph 9, which would apply a 10% limitation on goodwill, could represent a substantive change in accounting. Without conducting an impact assessment and publishing a more thorough issue paper, we feel it is difficult for the NAIC to conclude that the proposed revisions do not modify the conclusion or original intent of the guidance with regards to all admitted Subsidiary, Controlled and Affiliated Entities (“SCAs”).

We acknowledge the NAIC staff’s concerns with goodwill; however, we believe staff can gain insight through deeper engagement with the industry regarding the structure of insurance entities, and the creation, accounting, and reporting of goodwill. Additionally, while we understand there are concerns with regards to goodwill treatment to non-insurance entities, we believe the NAIC can more thoroughly consider the purpose of those entities and their support of the insurance parent as these entities typically provide operational support as well as dividends that directly support policyholder obligations.

**TIAA supports pushdown accounting Option 2 as proposed by the NAIC.**
TIAA does not support a complete rejection of pushdown accounting (Option 1), nor do we believe that pushdown should be permitted if elected by SEC registrants (excluding non-insurance entities) (Option 3), as we predict this approach would create competitive disadvantages and unnecessary inconsistencies in the treatment of goodwill among entities owned by an insurer. We recommend that the NAIC continue allowing pushdown for all non-insurance entities (Option 2).

**TIAA recommends the NAIC partner with industry to conduct an impact assessment.**
Given the potential substantive nature of the proposal, we recommend that industry participants partner with the NAIC to evaluate the Exposure Draft, including conducting an industry impact assessment. The assessment will include an analysis of the types of insurance entities impacted by the NAIC’s proposal and the potential effects on these entities’ organizational structure and domicile. The information gathered as a result of the impact assessment can assist in preventing the formation of competitive disadvantages and other unintended negative consequences among the affected entities. We welcome the opportunity to assist the NAIC in identifying, evaluating and driving such assessment.

**TIAA encourages the NAIC to discuss transitional guidance with the industry, and consider responses to FASB’s proposed treatment of goodwill.**
As noted above, given the potential substantive nature of the NAIC’s proposed accounting changes, and in light of our view that an industry impact assessment be conducted before these changes are finalized, we believe transitional guidance, in any form (i.e., disclosure, prospective, effective dates, etc.), be carefully discussed with all interested parties before proposal.

Additionally, we recognize that the Financial Accounting Standards Board (“FASB”) is also considering the treatment of goodwill and, as such, we recommend that NAIC consider the responses to the FASB Invitation to Comment on File Reference No. 2019-720, Identifiable Intangible Assets and Subsequent Accounting for Goodwill. As many of the SCAs within scope of the NAIC proposal report goodwill on a GAAP basis, any future changes to GAAP could impact or potentially address the NAIC’s concerns.
Conclusion
TIAA applauds the NAIC’s continued focus on this issue, and we appreciate the opportunity to comment on the Exposure Draft. We recommend that the NAIC classify Exposure Draft Ref. #2019-12 Business Combinations – Pushdown Accounting as substantive and work with the industry to perform an impact assessment that would inform an issue paper. We welcome the opportunity to discuss our views and recommendations in greater detail and any questions you have.

Recommended Action:
NAIC staff recommends that the Working Group discuss and consider whether to adopt the exposed edit to SSAP No. 68—Business Combinations and Goodwill, as detailed below, to require goodwill resulting from the acquisition of an SCA by the insurance reporting entity to be subject to the 10% admittance limit based on the insurer’s capital and surplus. If the Working Group considers adoption, it is recommended that the clarification be required for year-end 2019. NAIC staff highlights that the exposed edit only clarifies existing guidance and is intended to prevent situations in which pushdown has occurred to prevent nonadmittance. NAIC staff highlights that only reporting entities that would exceed the 10% limit for goodwill from insurer acquired SCAs and have not previously nonadmitted the excess goodwill would be impacted by this change.

After considering adoption of the proposed edit to SSAP No. 68, NAIC staff recommends re-exposure of the remainder of the agenda item to allow additional time for specific examples to be provided by interested parties and consider comments received on pushdown. It is anticipated that the discussion of whether pushdown should be permitted under statutory accounting will occur after this exposure.

Additional Discussion on Proposed Edit:
The proposed edit is considered a clarification change as the guidance in SSAP No. 68 already restricts aggregated goodwill to 10% of the acquiring entity’s adjusted capital and surplus. With the proposed edit, the guidance is simply clarified that all goodwill from an insurance entity’s acquisition of SCAs, regardless whether pushdown accounting is applied, is subject to the existing 10% admittance limitation. (This will address the situations recently noted in which entities have acquired SCAs and have elected pushdown accounting to prevent nonadmitting goodwill that exceeds the 10% limitation.)

As a reminder, the 10% admittance limitation is an aggregate calculation of all goodwill, therefore there is no need to consider retrospective, prospective or “grandfathering” provisions with adoption. If as of a reporting date an entity’s total goodwill exceeds 10% of the calculated capital and surplus, then the goodwill that exceeds the 10% provision shall be nonadmitted. (The edit simply clarifies that the goodwill captured in the calculation includes insurance entity acquisitions of SCAs in which pushdown has been applied.)

NAIC staff appreciates the informal comments from the AICPA representatives, but does not believe the proposed edit, which is specific to goodwill from an acquisition by the insurance reporting entity, should be delayed for the items identified. NAIC staff agrees that further discussion may be necessary to better define “goodwill from all sources” (which is existing guidance in SSAP No. 68) and to clarify whether pushdown goodwill should be amortized under the provisions of SSAP No. 68 (instead of “tested for impairment” under U.S. GAAP), but both of those discussions could occur as part of the project to review the permissibility of pushdown. NAIC staff believes the immediate concern is whether goodwill from insurance company acquisitions is being admitted beyond the 10% limit through the use of pushdown accounting, and this is the clarification intended to be addressed in the minimal edits.

It is important to highlight that the clarification edit proposed for adoption consideration is specific to insurance entity acquisitions of SCAs. As such, if an acquisition occurred downstream from the insurance company (by a non-insurance holding company), and the holding company applied pushdown accounting, so that
the goodwill was reported at the holding company’s acquired SCA, the proposed edit would not require that push
down goodwill to be brought up to the insurance entity’s level and included in the 10% limit.

Exposed Clarification Edit to SSAP No. 68—Business Combinations and Goodwill:

8. 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.

9. Positive goodwill recorded under the statutory purchase method of accounting shall be admitted
subject to the following limitation: Positive goodwill from all sources, including life, accident and
health, and deposit-type assumption reinsurance and goodwill resulting from the acquisition of an
SCA by the insurance reporting entity that is reported on the SCA’s financial statements (resulting
from the application of pushdown accounting), is limited in the aggregate to 10% of the acquiring’s
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. 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.

If there is concern that the proposed edit will inadvertently require amortization of pushdown goodwill,
then NAIC staff would recommend separating paragraph 9 into two separate paragraphs as illustrated
below. (Although amortization may be the proper approach, NAIC staff believes this should be further
discussed as part of the project to review the permissibility of pushdown.)

9. Positive goodwill recorded under the statutory purchase method of accounting shall be admitted
subject to the following limitation: Positive goodwill from all sources, including life, accident and
health, and deposit-type assumption reinsurance and goodwill resulting from the acquisition of an
SCA by the insurance reporting entity that is reported on the SCA’s financial statements (resulting
from the application of pushdown accounting), is limited in the aggregate to 10% of the acquiring’s
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

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 20 of SSAP No. 97.

3. 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.
SCA or partnership, joint venture and limited liability company is nonadmitted. When negative goodwill exists, it shall be recorded as a contra-asset.

9.10. Positive or negative goodwill resulting from the purchase of an SCA, joint venture, partnership or limited liability company shall be amortized to unrealized capital gains and losses on investments over the period in which the acquiring entity benefits economically, not to exceed 10 years. Positive or negative goodwill resulting from life, accident and health, and deposit-type assumption reinsurance shall be amortized to operations as a component of general insurance expenses over the period in which the assuming entity benefits economically, not to exceed 10 years. Goodwill shall be evaluated separately for each transaction. (INT 01-18)

Response to TIAA Comments:

Although NAIC staff recommends deferring the discussion of pushdown until examples are received from interested parties, the following comments are provided in response to TIAA’s comments:

- NAIC staff does not believe that the clarification of the 10% goodwill limitation is a substantive change. As detailed in SSAP No. 68, the guidance is explicit that goodwill from all sources shall be limited to 10% of an adjusted capital and surplus calculation. This percentage limitation has been in place since the codification of statutory accounting principles. As detailed in the original issue paper, the limitation placed on goodwill is based on the conservatism and recognition concepts – which focus on policyholder protection and the existence of readily marketable assets available for current and future obligations. (There was also a 10% limit prior to codification. However, at that time, the goodwill amount over the 10% capital & surplus threshold was required to be written off immediately and not just nonadmitted.) NAIC staff also highlights that at least three states have prescribed practices that do not allow any admittance of goodwill. Expanding the admittance of goodwill in SSAP No. 68 – by allowing full admittance of goodwill through pushdown accounting – would be a substantive change. Clarifying the 10% admittance limitation, which has been place since codification, is not a substantive change.

- NAIC staff does not believe that the complete rejection of pushdown or the ability for pushdown to be applied solely by SEC registrants would create competitive disadvantages or unnecessary inconsistencies. As a reminder, prior to the FASB revisions, pushdown was only required for SEC registrants acquiring more than 95% of an SCA, (and it was only optional for SEC filers acquiring over 80% of an SCA), therefore, historically, pushdown has not been available for most insurance reporting entities. All non-SEC filers and SEC filers acquiring less than 80% of an SCA that are currently electing pushdown are applying new FASB provisions. As such, the restriction of pushdown is not the new SAP concept. Rather, the new concept is whether the application of pushdown for non-SEC entities and SEC entities with less than 80% acquisition should be permitted.

- NAIC staff has been monitoring the FASB discussions on goodwill. The recent FASB exposure is considering whether the amortization approach (which is already used by SAP) should be re-implemented under U.S. GAAP for public entities. (The 10-year amortization approach was used prior to the “testing for impairment” approach that is currently in place for public entities under U.S. GAAP.) NAIC staff supports the amortization approach and is supportive of FASB moving back to this approach. As detailed in the most recent FASB exposure, the application of the goodwill impairment test is a costly exercise and may not be worth the benefits in lieu of the standard amortization approach. NAIC staff notes that recent U.S. GAAP changes have permitted amortization of goodwill in not-for-profit and private entities instead requiring those entities to test goodwill for impairment. (As detailed in the earlier discussion, the minor

---

4 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 20 of SSAP No. 97.
Summary:
During the Summer National Meeting, the Working Group exposed revisions to SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, to clarify that the “assignment” of goodwill is a disclosure element, with revisions to the disclosure requirements for downstream holding companies. The revisions did not dictate method of assignment, but rather the allocation of goodwill to acquired subsidiaries shall be disclosed upon acquisition and cannot change once assigned. The revisions also reflect a change in terminology from “allocation” to “assignment.”

Interested Parties’ Comments:
Interested parties reviewed the options exposed by the Working Group for consideration regarding pushdown accounting in Ref #2019-12. We do not recommend option 1 (“complete rejection of pushdown accounting”). With regard to the second and third options exposed for Working Group consideration, interested parties need additional time to evaluate whether these options are feasible. In our discussions, it was apparent that the proposed changes involve significant changes to insurers’ reporting and the complexities of the reporting mechanics of the annual statement will need to be addressed in applying the 10% goodwill admittance limitation and pushdown accounting. These complexities include the application of an aggregate 10% admittance limitation when multiple SCA entities carry GAAP goodwill on their individual balance sheets, as well as application to an acquired SCA holding company with subsidiaries (or layers of subsidiaries). Because annual statement reporting and disclosure includes considerable details on each investment in an SCA entity, specific guidance will likely be needed to address reporting issues such as presentation on the annual statement balance sheet and the related investment schedules, as well as interpretation related to current disclosures (including the proposed disclosures in Ref #2018-14). We believe these operational complexities need to be addressed before any proposal is considered for adoption by the Working Group.
Interested parties request additional time to evaluate various approaches for allowing pushdown accounting and working through the operational mechanics of a goodwill admittance limitation as well as evaluating the impact on insurers’ capital and surplus. Our goal is to present a recommendation for Ref #2019-12 to the Working Group during the 2020 Spring National NAIC Meeting that addresses these complexities. Because the proposed disclosures in Ref #2019-14 includes specific SCA entity goodwill and admitted value amounts, interested parties would include those proposed disclosures in our evaluation and recommendation and, therefore, also request additional time to respond to that agenda item.

Given the need to work out clear examples that address the reporting complexities and the need for transition guidance, interested parties do not believe the proposed changes in Ref #2019-12 and Ref #2019-14 are non-substantive nor do we believe these proposed changes can be applicable to year end 2019 reporting.

Recommended Action:
NAIC staff identifies that the comments received on the proposed disclosure enhancement under this agenda item are limited, but generally request additional time before adoption. NAIC staff believes the disclosure information requested under this agenda item will be necessary regardless of the decision involving pushdown accounting. As a reminder, the proposed disclosure only details the amount of goodwill recognized from the acquisition of a downstream holding company and the assignment of the goodwill to the entities owned by the holding company. This information is necessary in determining the amount of goodwill that would need to be nonadmitted, or derecognized, if an underlying company in the downstream holding company was nonadmitted or sold.

However, NAIC staff recognizes that there would be limited time to complete the new disclosure before year-end 2019, therefore NAIC staff supports re-exposure of agenda item 2019-14 at the Fall National Meeting. (As noted in the proposed disclosure and example Annual Statement illustration, this disclosure was not proposed to be data-captured.) NAIC staff also recommends that the Working Group direct revisions to the Sub-1 filing template to capture this information for new SCA acquisitions. (NAIC staff notes that this direction can occur even if the agenda item is re-exposed.) There are no changes from the prior exposure. The proposed revisions are detailed in the agenda item.

### Summary:
During the Summer National Meeting, the Working Group exposed revisions to SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments to incorporate additional principle concepts in classifying investments as cash equivalents or short-term investments. As detailed in the exposure, the proposed revisions will restrict the classification as a cash equivalent or short-term investment for all affiliated SSAP No. 26R—Bond investments, all affiliated and nonaffiliated investments in scope of SSAP No. 43R—Loan-backed and Structured Securities and all affiliated and non-affiliated investments that would be reported on Schedule BA in the event that 1) the reporting entity does not reasonably expect that the investment will actually terminate or mature within the timeframe permitted for cash equivalent or short-term investment classification, 2) the investment was previously reported as a cash equivalent / short-term investment and the initial maturity timeframes have passed, 3) the investment was sold or matured and the same or substantially similar investment was reacquired within a 1-year timeframe.
As a reminder, this agenda item has been drafted to consider statutory accounting guidance for short-term investment structures that are being purposely designed to mature at or around 364 days (often with affiliates), with the full expectation that the investment structure would be renewed (rolled) continuously for subsequent years. **These structures occur because reporting as short-term investments (or cash equivalents) results with the following benefits: 1) More-desirable risk-based capital (RBC) charge, 2) to avoid filing with either the SVO or to avoid obtaining a rating from a credit rating provider, or 3) limited affiliate reporting.**

**Illinois Department of Insurance Comments:**
The IDOI agrees with attempting to correct issues where certain investments now reported as short-term items or cash equivalents should be reported elsewhere; however, we are concerned that companies which are now properly utilizing affiliated liquidity pools may be negatively affected by the current proposal. Illinois Insurance law allows the use of such pools and has at least one large domestic group that uses one.

If the investments held in such a pool consist only of cash, cash equivalents and short-term investments as defined by SSAP 2R, it appears the proposed changes would require these companies to report these items on Schedule BA. This would result in erroneous reporting of actual invested assets, RBC calculations and distortions to the Liquidity and other FAST/IRIS Ratio results. IDOI would recommend additional language or other clarification be added to SSAP 2R that would allow use of investment pools by companies via looking through the pool to the actual underlying assets for determination of where such investments should be reported on the statement. Please let us know if there are further questions.

**Interested Parties’ Comments:**
Interested parties have concerns about the proposal to prohibit the reporting of certain short-term investments and cash equivalents as such. Certain short-term / cash equivalent investment structures have been identified by industry that are utilized in order to facilitate efficiencies and gain economies of scale and we believe they should continue to be reported as short-term or cash equivalents. While these investments may be regularly renewed, the risk profile continues to be commensurate with that of short-term investments or cash equivalents. Interested parties disagree with the broad-based language of the current exposure and believe there are more direct approaches to addressing concerns about inappropriate investment classification. We welcome the opportunity to discuss alternative approaches with staff.

**Short-Term Cash Pooling Arrangements:**
Many entities maintain short-term cash pooling arrangements. These arrangements have been instituted at insurance entities in order to more effectively invest enterprise cash, gain economies of scale, and reduce transaction costs; they have not been instituted in order to circumvent reporting requirements. Through the use of these arrangements, entities are able to generate higher returns for subsidiaries while reducing cost and personnel time required for investing on a short-term basis for all affiliated companies in an organization. These arrangements are often held within separate legal entities in which each participant invests or withdraws funds as needed on a short-term basis (sometimes daily), with their ownership interest in the arrangement fluctuating accordingly. However, participants maintain some level of interest in the pool for an extended period of time. These cash pooling arrangements have been permitted by model investment law; in addition, many insurers have received guidance from state regulators to report these investments as either short-term investments or cash equivalents depending upon the character of the underlying investments in the pool. We believe, although an insurer may own interest in the pools for longer than 3 months or a year, their investments in the short-term pools should continue to be reported as either short-term or cash equivalents, depending on the maturity dates of the underlying assets in the pool, because the risk of repayment is commensurate with the risk of repayment for the underlying assets.

In addition to the specific structures noted above, interested parties are concerned that the exposed guidance would result in misclassified assets on the balance sheet (e.g., BA asset for short-term pool arrangements instead of a cash equivalent), which would distort the level of cash, impacting liquidity ratios, RBC charges and presentation of cash flows. Thus, for these reasons, interested parties believe that short-term investment / cash
equivalent reporting should continue for investments made at fair market terms with contractual maturities within the applicable time periods.

**Short-Term Lending:**
Regarding short-term lending, interested parties believe that the reporting of the investment should continue to follow the form of the legal agreement, including the contractual maturity. These loans are structured for several important business reasons and have contractual maturities of less than one-year, often with the ability to renew. Upon initial evaluation, lender considerations include borrower repayment ability, value of any collateral provided, current market conditions and the presence of subordinated capital. Diligent underwriting and structuring are performed, with the completed loan agreement representing a binding contract with an unconditional obligation to repay upon contractual maturity (<12 months). Neither lender nor borrower has an obligation to extend the loan; however, at maturity, both lender and borrower have the ability to re-evaluate the transaction. If either or both parties wish to extend, the lender re-evaluates the financial position of the borrower, current value of existing collateral, and terms of the loan. If the lender decides to renew the loan, the terms are reviewed and renegotiated/re-underwritten with new terms reflecting then current market rates, consistent with the provisions of SSAP 25. Therefore, any extension should be considered a new loan transaction with a new maturity date. If extension is not mutually agreed upon, repayment to the lender is contractually required. Further, for short-term lending with affiliates over certain thresholds, prior regulatory approval may be required, providing additional opportunity for regulatory oversight. Thus, as long as these short-term loans have been made at fair market rates and with fair market conditions (which is required for loan admittance in accordance with SSAP No. 25 paragraph 9, if applicable), the economics and risk of the investment is commensurate with short-term investment reporting.

Interested parties recommend that the scope of the issue be identified prior to proposing any changes to the SSAPs. This should include identification of specific problematic investment structures, under which the economics of the transaction are not commensurate with the current classification. Once the scope and magnitude are identified, a decision can be made whether the targeted issue is widespread or limited to a few companies and whether a more direct approach may also have the desired result.

**Security Benefit Comments:**
We agree that SSAP No. 2R – Cash, Cash Equivalents, Drafts and Short-Term Investments should not be utilized to mischaracterize long-term investments as short-term investments. We thus support revisions to exclude from SSAP No. 2R short-term investment structures purposely designed to mature at or around 364 days (often with affiliates) with full expectation that the investment structure will be renewed (rolled). We propose modest modifications to the recommendation, however, that we believe will support eliminating abuses of SSAP No. 2R while also ensuring that legitimate short-term investment activity continues under SSAP No. 2R.

The exposure sets forth “an overall principle that investments are permitted for short-term and cash equivalent reporting only if the reporting entity reasonably expects the investment duration to be realized (e.g., terminate / mature) on the designated maturity date” (the “overall principle”). We fully support the overall principle and believe it is essential that it be preserved. We believe, however, that certain elements of the exposure are not fully consistent with the overall principle – namely, commentary and scoping around 1) all affiliated SSAP No. 26R - Bonds investments and 2) the reacquisition of the same or substantially similar short-term investment immediately after maturity of a prior short-term investment. We address each of these items in greater detail below.

**Item 1 - all affiliated SSAP No. 26 investments**

The exposure states that: “by excluding all non-affiliated ‘bonds’ from the new guidance, the ‘normal’ recurring short-term / cash equivalent investments are not expected to be impacted.” This implies that “normal” recurring short-term / cash equivalent investments can only occur between unaffiliated entities. We disagree; we believe that the overall principle should apply to all investments, not just those that are affiliated. We also believe the concern that including unaffiliated investments would inadvertently scope in U.S. Treasury-bills, commercial paper, certificates of deposit, etc., where a reporting entity may continuously reacquire the same or a substantially
similar short-term investment of such nature immediately after maturity of such a prior short-term investment, can and should be addressed otherwise (see below).

Item 2 - the reacquisition of the same or substantially similar short-term investment immediately after maturity of a prior short-term investment

The exposure states that “the sale or maturity of an investment, with a reacquisition of the same or substantially similar security within a 1-year timeframe, would preclude the reporting entity from reporting the currently held security as a cash equivalent or short-term investment regardless of the maturity date. (This one-year timeframe prevents reporting of recurring ‘re-acquisitions’ as cash equivalents or short-term investments.) (This provision is similar to the one regarding ‘rolled’ securities but clarifies that the ‘settlement’ of a security with a reacquisition does not prevent application of the new concepts in determining cash equivalent or short-term reporting.) (NAIC staff highlights that this restriction is necessary particularly with the use of “net settlement” structures with affiliates in which no cash is exchanged.)

The reacquisition of the same or a substantially similar short-term investment immediately after the maturity of a prior short-term investment should be permitted as long as the following proposed conditions are met that substantiate and evidence that the overall principle has been factually satisfied:

1. The prior short-term investment / cash equivalent has been fully, contractually settled in cash on or prior to a maximum original maturity date of 364 days (this provision would exclude “net settlement” structures from being eligible under SSAP No. 2R).

2. The cash used to satisfy the prior short-term investment / cash equivalent cannot have been directly or indirectly (i.e., through a separate entity) provided by the same reporting entity.

We believe that incorporating the above elements would effectively exclude unaffiliated cash equivalent / short-term investments such as U.S. Treasury bills, commercial paper, certificates of deposits, and other legitimate short-term investment activity from the exposed provisions, but in a manner consistent with the overall principle and the application of SSAP No. 2R.

Recommended Action:
NAIC staff recommends that the Working Group expose this agenda item (Ref #2019-20) with limited revisions to exclude qualifying cash pools in scope of SSAP No. 2R from the short-term rolling provisions. As detailed in the Meeting portion of the agenda, there is a new agenda item (Ref # 2019-42) that proposes to capture cash pools in scope of SSAP No. 2R. NAIC staff highlights that an exception was not included for cash pools in the original Short-Term Rolling agenda item as cash pools are not currently in scope of SSAP No. 2R. From what NAIC staff has learned, most cash pools are established as LLCs, and under existing SSAP guidance, LLCs are in scope of SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies and captured on BA – Other Long-Term Invested Assets. NAIC staff recognizes that cash pools have been included by insurers as cash equivalents or short-term investments, and the new agenda item has proposed revisions to include cash pools that meet certain provisions in scope of SSAP No. 2R.

With re-exposure, NAIC staff would request comments from industry and regulators on the comments received to permit short-term lending structures, eliminate the “unaffiliated” exclusion from SSAP No. 26R, and permit reacquisition of a similar investment if certain criteria is met. NAIC staff does not initially support some of these proposed modifications, so additional information and feedback from regulators would be beneficial in determining whether further modifications should be considered. NAIC staff has provided some initial commentary on each of these items:

- **Short-Term Lending** – NAIC staff identifies that interested parties have proposed allowing “short-term lending” to be renewed without moving the short-term lending agreement from the cash equivalent or short-term investment schedule. The comments received have presented a position that if the loan has
been re-evaluated (and not just renewed), then it should be considered a new short-term loan. NAIC staff disagrees with this position and highlights that short-term lending, particularly with affiliates, is a key situation that is proposed to be captured in the short-term rolling agenda item. NAIC staff also believes a process to distinguish between renewals that have been “re-underwritten” and those that have not been re-underwritten would not be easily discernable by auditors or regulators.

NAIC staff was contacted by interested party representatives to discuss their proposal, and two different scenarios were presented:

- **Collateral Loans** – Industry presented a position that renewed non-affiliated short-duration collateral loans should continue to be reported as cash equivalents or short-term investments. In considering these comments, **NAIC staff does not support the industry proposal, and suggests that in all situations in which a short-term collateral loan is renewed beyond the original short-duration maturity date (regardless if with an affiliate or nonaffiliate), it should be captured on the distinct reporting line for collateral loans on Schedule BA.** NAIC staff notes that collateral loans receive a low RBC charge (5%) on BA, therefore there is very little RBC difference between reporting a collateral loan as a cash equivalent or short-term investment. As there is very little difference in RBC, the main motivation in including collateral loans as cash equivalents or short-term investments seems to be reducing the amount of assets reported on Schedule BA. **(NAIC staff would also support a position that all collateral loans be captured on schedule BA regardless of maturity date. This would eliminate collateral loans from ever being reported as cash equivalents or short-term assets and would ensure that all collateral loans are reported on the designated BA reporting line. This would allow a complete picture of all collateral loans held by a reporting entity regardless of maturity date.)**

- **Affiliate Non-Collateral Loans** - Industry presented a position that renewed affiliated non-collateral loans that have been re-underwritten should continually be reported as cash equivalents or short-term assets. **NAIC staff distinctly disagrees with this proposal and highlights that renewing affiliated non-collateral loans and continually reporting such loans as cash equivalents or short-term investments are the types of arrangements that were the original basis for this overall agenda item.** As previously noted, NAIC staff does not believe it is feasible to successfully distinguish between a “re-underwritten” and “non-re-underwritten” affiliate loans. With the industry discussion, it was highlighted that the main motivation for this proposal was that these non-collateral loans are captured at a high RBC charge (either 20% or 30% based on type of insurer), therefore reporting as a cash equivalent or short-term investment achieves a much-more desirable 3% charge. **NAIC staff notes that non-collateral loans are required to be nonadmitted under SSAP No. 20, but SSAP No. 25 permits loans to related parties to be admitted if the parameters of SSAP No. 25 are met.** If admitted, these non-collateral loans receive the higher RBC charge. NAIC has concerns with the desire to receive a lower RBC charge on these affiliate loans as 1) there is no collateral, and 2) the transaction is with a related party and subject to a higher degree of risk. **(Particularly with related party transactions, the reporting entity may be compelled to continue renewing the transaction rather than terminate the loan and receive back their cash.)** **(Similar to the proposal above, NAIC staff would support a position that all affiliate loans be captured on Schedule BA regardless of maturity date. This would eliminate affiliate loans from ever being reported as cash equivalents or short-term investments and would ensure that all non-collateral affiliate loans are reported on the designated BA reporting line. This would allow regulators to have a complete picture of all such loans regardless of the maturity date.)**

- **Non-Affiliated SSAP No. 26R Investments** – NAIC staff identifies that Security Benefit has suggested that the provisions in the exposed agenda item be expanded to include all non-affiliated SSAP No. 26R investments. This comment letter indicates that this approach would be more consistent with the overall
principle intent of the guidance. **NAIC staff does not oppose this proposal and agrees that concerns with the rolling of investments could occur with affiliated and related-party investments.**

- **Reacquisition Provisions** – NAIC staff identifies that Security Benefit has suggested that investments that have been settled in cash and reacquired shall be permitted to continually reported as cash equivalents or short-term investments. These comments highlight that the noted provisions would effective allow Treasury Bills, commercial paper, CDs and other legitimate short-term activity. With this proposal, Security Benefit proposes the inclusion of the following provisions:
  
  o Requirement that the original short-term investment / cash equivalent be fully, contractually settled in cash on or prior to the original maturity date. This provision would exclude “net settlement” structures from being eligible for subsequent reporting under SSAP No. 2R.
  
  o Requirement that the cash used to satisfy the short-term investment / cash equivalent cannot have been directly or indirectly (e.g., through a separate entity) provided by the reporting entity.

In reviewing the proposal from Security Benefit, **NAIC staff thinks this could result with churning of investments with affiliates - resulting in the same net effect of renewing investments. However, comments from regulators and other interested parties are requested during the exposure period.**

<table>
<thead>
<tr>
<th>Ref #</th>
<th>Title</th>
<th>Attachment #</th>
<th>Agreement with Exposed Document?</th>
<th>Comment Letter Page Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019-24</td>
<td>Levelized and Persistency Commission</td>
<td>22 Agenda Item</td>
<td>Comments Received</td>
<td>IP – 14 Acadia – 24 Greenberg Traurig - 26</td>
</tr>
<tr>
<td>SSAP No. 71</td>
<td>(Robin)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Summary:**
During the Summer National Meeting, the Working Group exposed revisions to SSAP No. 71—Policy Acquisition Costs and Commissions to provide clarifications to the existing levelized commissions guidance and provide additional guidance regarding commission that is based on policy persistency. The revisions clarify that a levelized commission arrangement (whether linked to traditional or nontraditional elements) requires the establishment of a liability for the full amount of the unpaid principal and accrued interest payable to a third party at the time the policy is issued. Additionally, persistency commission shall be accrued proportionately over the policy period in which the commission relates to and is not deferred until fully earned.

The exposed recommendations are intended to be consistent with the original intent of SSAP No. 71 as well as the Statutory Statement of Concepts focusing on Recognition (excerpts from Preamble, paragraphs 37 and 38) stating that liabilities require recognition as they are incurred and accounting treatments which tend to defer expense recognition do not generally represent acceptable SAP treatment.

**Interested Parties’ Comments:**
The proposal as written will be a substantive change to the current guidance and to our industry, despite being categorized as nonsubstantive. The proposed changes do not merely clarify the current SSAP 71 regarding commissions, but substantially change a key point regarding persistency. During the SAP formulation process, there were two Issue Papers issued in 1996 (January and final paper in September 1996), the latter of which introduced the last sentence of paragraph 5 of the current SSAP 71. The addition of this sentence in the final issue paper from 1996 makes a distinction between the levelized commissions described as funding agreements and those which are based on persistency and other traditional elements. The effect of removing that distinction is substantive and requires the protocol of a substantive change. Additional comments and details are as follows:
1. The proposal makes substantive changes to the accounting paradigm for levelized commissions. As written, the proposed changes may have serious unintended consequences to statutory accounting. The nature of the exposed substantive changes separates the issue of “persistency” as a key element of the levelized commission payment mode of operation. This practice is engaged in by several insurers, specifically companies issuing variable life and annuity products. For example, per the exposed language, a liability for trail commissions over possibly decades would be required at policy issuance although not formally due. Persistency is a critical insurance risk. (See proposed language that the only obligating event is initial sale of a policy.) Ignoring persistency runs directly counter to various other principles of statutory accounting, most notably the definition of principle risks for reinsurance consideration in A-791.

2. The newly installed Principles-Based Reserving (“PBR”) methodology allowed by regulators now includes the commission element. The effects of the proposal on PBR have not been reviewed or analyzed to determine if there are any unintended consequences, possibly double-counting, that inure to the proposal.

3. The effects of the proposal relative to reinsurance transactions have not been reviewed and analyzed inasmuch as reinsurance transactions must transfer risk, including persistency risk. (See note above regarding A-791.)

4. The issuance of a policy or contract is not the sole triggering event of a commission liability under a levelized commission mode of operation. Persistency requirements under the actual terms of the contract between the payor (the insurer) and the payee (the agent or broker receiving the levelized commission) is a key determinant as to when a liability is incurred. If a policy is issued but the persistency requirement is not met, then no commission liability is due.

5. The current accounting mode is standard in the industry, preceding the formulation of current SAP (reference the Accounting Practices and Procedures Manual-Life which was in force prior to the effective date of current SAP and which includes the same wording as current SSAP No. 71).

6. The proposal does not address policy fees, which can possibly be interpreted in a similar vein as commissions.

7. The proposal’s paradigm could possibly be applied to other items reflecting estimated predictable expenses that have yet to be incurred or for which benefits have not been received.

8. The proposal seems to be at odds with GAAP accounting rules as to the establishment of liabilities, specifically how GAAP treats commissions tied to persistency. Required persistency is deemed a “future” event negating the need for recording a current liability. This is differentiated where payments are merely extended (payment due solely based on passage of time) versus payments requiring ongoing commitments, persistency.

**Acadia Capital Solutions Comments:**

We have reviewed the proposed changes to SSAP No. 71 – Policy Acquisition Costs and Commissions as outlined in Ref. #2019-24. We question several elements of the proposal and strongly object to the revisions for the following reasons:

1. This is very much a **substantive** change to existing policy, contrary to the characterization in the published exposure draft.

2. The proposal dramatically alters the fundamental premise of statutory accounting by creating a situation in which certain historically period expenses, trail commission payments, are to be treated differently from other period expenses by way of an accrual methodology. This leads to:
a. A hybrid of statutory, GAAP and tax accounting.

b. Fundamentally and permanently different economics for products designed with trail commission payments, leading to the need for significant effort at primary writers to **redesign and/or reprice** such products, presumably at a cost to the consumer.

c. Guaranteed renewable products, like Long Term Care Insurance, could be exposed to further rate increases if the fundamental profit dynamics of the products change as a result of the new reserving practices.

d. New uncertainty within the statutory accounting framework as to which other period expenses should also be accrued or might be targeted for similar treatment.

e. A situation whereby trail commission expenses have a greater impact on statutory capital than other, similar expenses.

f. A disincentive for primary writers to align the interests of the writer, broker/agent and policyholder through trail commissions because of the unique treatment and resulting capital implications.

3. Should the proposed changes be adopted, primary writers will be exposed to new and substantial accounting and actuarial workload relating to the determination of accrual methodologies for each effected product and the related periodic ‘true-up’ required to adjust the new statutory reserves for actual performance. All this with no apparent benefit for the consumer, primary writer, investment community, or regulatory bodies.

_Greenberg Traurig on behalf of DRB Insurance Solutions, LLC Comments:_

SSAP No. 71 provides that leveled commissions occur in situations in which a third party, such as a funding agent, pays agents non-levelized commissions and the reporting entity pays the third party by levelized payments. The Working Group notes that it is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third-party would ultimately be repaid to the third-party from the reporting entity. SSAP No. 71 identifies such arrangements as “funding agreements” between the reporting entity and the third-party. SSAP No. 71 further provides that the use of a commission arrangement where commission payments are not linked to traditional elements (such as premium payments and policy persistency) requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which may be paid to a third-party in the future based upon the occurrence of defined events outside the control of the parties involved. However, the persistency commission expense should be accrued proportionately over the policy period to which the commission relates, and it should accrue only when fully earned and unavoidable, specifically since the payments to the funding agent are theoretically avoidable until the policy passes the anniversary year-end date.

The accounting issue is whether levelized commission arrangements that are linked to traditional elements (such as premium payments and policy persistency) should require the establishment of a liability for the full amount of the unpaid principal and accrued interest which may be paid to a third-party in the future based upon the occurrence of defined events outside the control of the parties involved. However, the persistency commission expense should be accrued proportionately over the policy period to which the commission relates, and it should accrue only when fully earned and unavoidable, specifically since the payments to the funding agent are theoretically avoidable until the policy passes the anniversary year-end date.

NAIC Staff indicates that this proposal is to recommend clarifications to the existing levelized commissions guidance and provide additional guidance regarding commission obligations that are based on policy persistency. Questions received by NAIC staff relate to the use of levelized commission arrangements and when the liability for a commission structure that is based on annual persistency is required to be recorded as a liability in accordance with **SSAP No. 5R-Liabilities, Contingencies and Impairments of Assets.** Staff made the following recommendations:
1. A levelized commission arrangement (whether linked to traditional or nontraditional elements) require the establishment of a liability for the full amount of the unpaid principal and accrued interest payable to a third-party at the time the policy is issued.

2. The persistency commission is accrued proportionately over the policy period in which the commission relates to and is not deferred until fully earned.

However, we respectfully suggest that requiring the expensing at policy issuance of future levelized commission payments that are contingent upon policy persistency will likely establish a dangerous precedent requiring the accrual of liabilities for other predictable future expense payments for services or other benefits that are not yet payable. Examples may include payroll costs, commissions and expense allowances on reinsurance assumed, non-vested postemployment benefits and compensated absences and/or lease obligations.

Further, in accordance with SSAP No. 5R, key characteristics of a liability include: (1) a present duty or responsibility that entails settlement by probable future transfer of assets, (2) with little or no discretion to avoid the future sacrifice, and (3) the obligating event has already occurred. With respect to recognition of commission expense, the proposed revisions to SSAP No. 71 include the justifying statement that “The issuance of the policy is the obligating event under SSAP No. 5R.” However, this statement is factually inaccurate. The insurance company is not contractually obligated to pay future levelized commissions if the policy does not persist. No subsequent levelized commission ever becomes due unless the policy remains in-force through each subsequent anniversary date. Until the policy reaches each anniversary date, the insurance company is not obligated and has no present duty or responsibility to pay the commission.

Statutory Accounting and Principle-Based Reserving

The fundamental objective of statutory accounting is to measure solvency, as expressed in the Preamble to the Accounting Practices and Procedures Manual. Statutory Accounting Principles require expensing current amounts that are no longer available to pay policyholder claims in the future or that will have no value in liquidation. However, probable future levelized commission payments are payments that have not yet been made. Accordingly, the insurance company still has the cash or other assets that will ultimately be used to make those payments should the policies persist. Therefore, required accrual of levelized commissions appears inconsistent with the fundamental objective of measuring solvency.

Principle-Based Reserving (PBS) is a new shift in reserving approach and is expected to include consideration of commission payments within policy reserves. The addition of an accrual for levelized commissions would duplicate expenses on the Statement of Operations and again, function inconsistently with the assumptions contained in PBR.

Non-Substantive Change

Levelized commission programs began over thirty years ago, before the 1998 publication of Statutory Issue Paper No. 71 and the January 1, 2001 codification of Statutory Accounting Principles. The primary objectives of a levelized commission structure include aligning the interests of the customer, the agent, and the company and improved persistency from providing ongoing customer service. There is a duty to act in the best interests of the policyholder, as well as a compensation incentive, to make sure policies are well serviced so they stay in-force.

The proposed revisions to SSAP No. 71 are designated as non-substantive and deemed to be a clarification of intent of the codified statutory guidance. However, levelized commission programs were implemented more than a decade before the codification in 2001. Therefore, this is a material change to historical accounting practices and not a clarification of original intent. Even after codification, levelized commission programs continued for years and were not identified as applying statutory accounting incorrectly.
In conclusion, the proposed revision to SSAP 71 is clearly not “non-substantive” and would have substantial unintended consequences only some of which I have mentioned here. Accordingly, the proposal requires further substantive and policy analysis prior to consideration by the Working Group. Additionally, the expansive effect of this policy decision should be subject to open deliberation and public comment as the Working Group considers further action. Thank you for the opportunity to comment.

**Recommended Action:**

NAIC staff recommends that the Working Group expose the agenda item with NAIC staff modifications regarding persistency and funding to allow for further discussion. NAIC staff provides the following points in response to key aspects of the comments received.

1. **Issue Paper Intent** – *Issue Paper No. 71—Policy Acquisition Costs and Commissions*, paragraph 10 identifies the pre-codification statutory accounting guidance which is the basis for the existing SSAP No. 71 guidance. The pre-codification guidance also notes the same concerns (reiterated in the current agenda item) if reporting entities use levelized commission arrangements which operate as funding agreements to inappropriately enhance surplus. *Issue Paper No. 71—Policy Acquisition Costs and Commissions* (bolding added for emphasis):

   10. Chapter 17, Other Liabilities, of the Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies contains the following guidance on levelized commissions:

   Levelized Commission

   **The accounting treatment for certain transactions, characterized as levelized commissions, which results in enhancement of surplus, has been determined to be inappropriate for statutory reporting.**

   These transactions are, in fact, funding agreements between an insurer and a third party. Agents receive normal (non-level) commissions with payments made by the third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents would ultimately be repaid (with interest explicit or implied) to the third party by “levelized” payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the insurer. The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of premium payment or the maintenance of the agents license with the insurer is not maintained with respect to the payment stream.

   The use of an arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency but rather are linked to the repayment of an advanced amount requires the establishment of a liability in the full amount of the unpaid principal and accrued interest.

   The intent of SSAP No. 71 for levelized commissions is that repayment of an advance, even if it has been labeled as a commission, requires the establishment of a liability for the full amount of unpaid principal and accrued interest.

2. **Multi-Year comments** - NAIC staff agrees that the exposed language would benefit from additional edits to address industry concerns that the exposed guidance could be interpreted to require a traditional persistency commission to be accrued for multiple years up front. NAIC staff has proposed edits for possible exposure. NAIC staff notes that there is a distinction between a true persistency commission and the use of a levelized commission arrangement that functions as a funding agreement as described in
SSAP No. 71. The intent of the exposed guidance was not to change the annual accrual of normal persistency commission, but rather to require accrual of levelized commission arrangements which are being termed persistency. Summary of proposed edits for exposure

Paragraph 2 - Removed previously exposed revisions as unneeded.
Paragraph 3 - Added clarifying phrases regarding persistency commission accrual. The concept is that normal persistency commission is accrued for the period it relates unless the policy is cancelled.
Paragraph 4 - Added two clarifying phrases to assist with identifying levelized commission funding agreements.
Paragraph 5 - Added clarifying phrases regarding funding agreements.
Footnote 1 - Redrafted to remove double negative wording.

3. **Levelized Commission Funding Agreement** - The levelized commission arrangements described to NAIC staff had the following key elements:

a. A third party (referred to as a “super-agent”) is paying sub agents upfront, large commission amounts for business directly written on behalf of the reporting entity in the year of policy issuance. These amounts are similar to normal initial sales commission policy acquisition costs.

b. Reporting entity repays the super-agent through a levelized commission arrangement which spreads out the commission repayment over a period of multiple years with an explicit or implicit interest charge payable to the super-agent over time. Similar to the guidance in SSAP No. 71, paragraph 4, this levelized commission arrangement is repaying the super-agent amounts “which are less than the normal first year commissions but exceed the normal renewal commissions.”

c. The super-agent was deemed to assume lapse risk in that if the policy was cancelled, the remaining levelized commission due by the reporting entity would no longer be payable by the insurance reporting entity to the super-agent. This reduction in commission payment for policy cancellation is not materially different than direct agreements with agents that have commission “claw back” features. This aspect is consistent with the levelized commission guidance in SSAP No. 71, paragraph 4, which notes that, “It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity.”

d. Reporting entity is asserting that even though commission has been paid by the super-agent to the sub agent, that no commission should be accrued by the reporting entity until after the end of each policy year when the policy has persisted past its anniversary. However, SSAP No. 71, paragraph 4, notes, “The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract.” SSAP No. 71, paragraph 5 also states:

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

e. To provide an illustration to the steps above:

   i. Sub agent writes direct business for the reporting entity
   ii. Super-agent pays sub agent $8,000 year one.
iii. Reporting entity owes super-agent eight $1,000 payments (plus interest) annually for 8 years. Reporting entity can forgo remaining repayment to the super-agent if policy is cancelled during that time period.

The insurance reporting entity is trying to assert that until the policy anniversary passes, (the fully earned date for “persistency” on what is in essence a funding agreement) that zero should be accrued as payable to the super-agent. In trying to define accrual accounting, we do think that some wordsmithing on the exposure is in order. In the case of true persistency where the agent is being paid annually, we are not advocating accruing more than is being paid to the agent each year. Rather, if an annual persistency commission is payable it shall be accrued annually. The reporting entity example is trying to shift their expense recognition to defer commission cost recognition. In this case it is commission that a third party has already paid on the insurance entity’s behalf and the insurance entity wants to defer recognition for years into the future.

Consistent with the guidance in SSAP No. 71, the amounts that the super-agent has paid to sub agents should be recognized as a funding agreement and be accrued for the balance to be repaid plus interest to date. To the extent that an individual policy is cancelled, the liability would be reduced. In the example provided, money has been paid by the super-agent and there is a clear intent that the super-agent will be repaid plus interest. Delaying repayment does not change the incurred date. NAIC staff recommendations are that the levelized commission repayment amount is owed to the super-agent who made the advance on the insurer’s behalf unless the policy has lapsed. Delaying payment does not delay expense recognition. Waiting to accrue the commission owed until it is “earned” or unavoidable to the super-agent is making what amounts to a 100% lapse assumption until proven otherwise. This assumption would not be consistent with the other financial statement assertions that the company is making as the policy is in force and revenue is being recognized. Waiting until the lapse risk had fully passed would be closer to a cash basis accounting method instead of the accrual accounting method that statutory accounting requires.

The fact that the super-agent has already paid the sub agent is what makes this approach different from a typical persistency commission. A typical persistency commission is usually a small annual commission. An argument that these “commission” amounts due should be recognized like a normal persistency commission when the amount has already been paid by a third party does not acknowledge that the use of the third party is a funding agreement. SSAP No. 71 clearly intends to identify funding agreements as such, even if they are labeled differently. If this approach is permitted under statutory accounting, it is presumed that all reporting entities would move to using third parties to make commission payments as it would delay expense recognition and result with increased net income in the financial statements until there is no potential risk for the policies to lapse.

4. Comments were received regarding Principles-Based Reserving (“PBR”) methodology which takes commission into account when projecting future cash flows. However preliminary discussion with LATF staff note that the projected future cash flows would not double count if there is an existing liability. However, comments are requested on if there is specific Valuation Manual language in VM-20 and VM 21 that needs to be addressed in the coordination process.

The comment letters are included in Attachment 23 (36 pages).

g:/frs/data/stat acctg/3. national meetings/a. national meeting materials/2019/fall/closed/12-2019 - closed hearing_agenda.doc'
The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met in New York, NY, Aug. 3, 2019. The following Working Group members participated: Dale Bruggeman, Chair (OH); Jim Armstrong, Vice Chair (IA); Richard Ford (AL); Kim Hudson and Susan Bernard (CA); Michael Estabrock, Kathy Belfi and William Arfanis (CT); Rylynn Brown (DE); Carrie Mears (IA) Eric Moser, Kevin Fry, and Cindy Anderson (IL); Stewart Guerin and Caroline Fletcher (LA); Judy Weaver (MI); Doug Bartlett and Patricia Gosselin (NH); James Matheson (NY); Joe DiMemmo, Kimberly Rankin and Melissa Greiner (PA); Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI).

1. **Adopted its May 29 and 2019 Spring National Meeting Minutes**

Ms. Walker made a motion, seconded by Ms. Malm, to adopt the Working Group’s May 29 (Attachment One-A) and April 6, 2019 minutes (see NAIC Proceedings – Spring 2019, Accounting Practices and Procedures (E) Task Force, Attachment One). The motion passed unanimously.

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

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

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

   a. **Agenda Item 2017-28**

Mr. Bruggeman directed the Working Group to agenda item 2017-28: SSAP No. 62R - Reinsurance Credit. Robin Marcotte (NAIC) stated that the Working Group exposed Issue Paper No. 162—Property and Casualty Reinsurance Credit to document for historical purposes the revisions to SSAP No. 62R—Property and Casualty Reinsurance adopted in November 2018. Ms. Marcotte stated that no comments were received from interested parties. (Attachment One-C)

   b. **Agenda Item 2018-03**

Mr. Bruggeman directed the Working Group to agenda item 2018-03: SSAP No. 43R - Reporting NAIC Designations as Weighted Averages. Julie Gann (NAIC) stated that this item was originally considered during the 2018 Spring National Meeting, but discussion was subsequently deferred until agenda item 2018-19: Elimination of Modified Filing Exempt (MFE) was addressed. With revisions to eliminate MFE adopted during the 2018 Fall National Meeting, this item was re-introduced at the 2019 Spring National Meeting and exposed revisions to SSAP No. 43R. Ms. Gann stated that the revisions require securities with differing NAIC designations by lot to be reported in aggregate at the lowest (worst) NAIC designation or separately by lot. Ms. Gann stated that with the elimination of MFE, the expected volume of these items should be minimal and that no comments were received from interested parties on the proposed edits. (Attachment One-D)

   c. **Agenda Item 2019-11**

Mr. Bruggeman directed the Working Group to agenda item 2019-11: Reinsurance Credit Effective Date. Ms. Marcotte stated that this agenda item clarifies the effective date of reinsurance credit guidance adopted in agenda item 2017-28, noting application was for contracts in effect as of Jan. 1, 2019. She stated that no comments were received from interested parties. (Attachment One-E)

   d. **Agenda Item 2019-15EP**
Mr. Bruggeman directed the Working Group to agenda item 2018-15EP: Editorial Updates. Jake Stultz (NAIC) stated that this agenda item covered five editorial revisions exposed from the 2019 Spring National Meeting and that no comments were received from interested parties. (Attachment One-F)

3. **Adopted Revisions to Reject U.S. GAAP as Not Applicable to Statutory Accounting**

Mr. Fry made a motion, seconded by Mr. Smith, to revise Appendix D—Nonapplicable GAAP Pronouncements to reject the following U.S. Generally Accepted Accounting Principles (GAAP) Accounting Standard Updates (ASUs) as not applicable. The motion passed unanimously.

- ASU 2019-02, *Accounting for Costs of Films and License Agreements for Program Materials* (Agenda Item 2019-17 - Attachment One-H)

4. **Reviewed Comments and Considered Action on Exposed Items with Minimal Discussion**

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

a. **Agenda Item 2016-02**

Mr. Bruggeman directed the Working Group to agenda item 2016-02: Leases. Mr. Stultz stated that during the 2019 Spring National Meeting, the Working Group exposed *Issue Paper No. 161—Leases*, and proposed substantive revisions to SSAP No. 22—*Leases* in response to ASU 2016-02, *Leases*. He stated that guidance was incorporated from the ASU, however, the ASU was modified to maintain the operating lease concept for statutory accounting. Mr. Stultz stated that the substantively revised SSAP No. 22 (SSAP No. 22R) is proposed to have an effective date of Jan. 1, 2020. He stated that interested parties supported the proposed changes, but comments from Kaiser Permanente were received requesting an expansion for lease determination beyond what is permitted under U.S. GAAP. Mr. Stultz stated that these revisions are not supported as they would create a GAAP to SAP difference in lease determination. Mr. Stultz stated that the issue paper was revised to detail the requested change and the rationale for not incorporating the requested revisions. Mike Reis (Northwestern Mutual), representing interested parties, stated they were appreciative of the effort to incorporate substantive changes for leases.

Mr. Hudson made a motion, seconded by Ms. Weaver to adopt *Issue Paper No. 161—Leases*, with the revisions noted by Mr. Stultz (Attachment One-I), and the exposed SSAP No. 22R—*Leases* (Attachment One-J) with an effective date of Jan. 1, 2020. The motion passed unanimously.

b. **Agenda Item 2018-04**

Mr. Bruggeman directed the Working Group to agenda item 2018-04: Valuation of Securities Task Force Bank Loan Referral. Ms. Gann stated that this agenda item was in response to a referral from the Task Force on the classification of bank loans. She stated that although discussion on that referral is still ongoing, during the 2019 Spring National Meeting, revisions were exposed to clarify that investments in scope of another SSAP do not become a collateral loan in scope of SSAP No. 21R—*Other Admitted Assets*, because the investment is also secured with collateral. Ms. Gann stated editorial comments were received from interested parties requesting to change the reference from “securities” to “investments” and NAIC staff supports these edits. Mr. Reis stated they were supportive of the changes and would be willing to assist in the continued discussion of bank loans.

Ms. Walker made a motion, seconded by Ms. Gosselin, to adopt the revisions to SSAP No. 21R modified to reflect the interested parties’ proposed edits (Attachment One-K). The motion passed unanimously.

c. **Agenda Item 2018-22**

Mr. Bruggeman directed the Working Group to agenda item 2018-22: Participating Agreement in a Mortgage Loan. Ms. Gann stated that this agenda item intends to further clarify the items in scope of SSAP No. 37—*Mortgage Loans*. She stated that while direct mortgage loans are included in the scope, the revisions further clarify that securities and funds are excluded with reference to “bundled” mortgage loans. Ms. Gann stated that the revisions also clarify the requirements for mortgage participation agreements. She stated that interested party comments noted support for the proposed revisions, with recommendations to
replaced references from ‘original lender’ to ‘lender of record.’ Ms. Gann indicated that an informal regulator comment to require public recording of mortgage interest was not included as that is not believed to be standard practice for participation agreements. Mr. Reis stated support for the edits proposed by NAIC staff, noting that participation agreements would be filed with the county similar to a regular mortgage. In response to an inquiry from Mr. Bruggeman, no comments were received indicating a need for additional exposure.

Mr. Armstrong made a motion, seconded by Ms. Malm, to adopt revisions to SSAP No. 37 with the modifications discussed during the meeting (Attachment One-L). The motion passed unanimously.

a. Agenda Item 2019-03

Mr. Bruggeman directed the Working Group to agenda item 2019-03: Affiliated Transactions. Ms. Gann stated that during the 2019 Spring National Meeting, the Working Group exposed revisions to SSAP No. 25—Affiliates and Other Related Parties, SSAP No. 26R—Bonds, SSAP No. 32—Preferred Stock, SSAP No. 43R—Loan-backed and Structured Securities and SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies to clarify principal concepts in identifying related party transactions in the financial statements and investment schedules. She stated that the exposed revisions clarify a related party classification based on the substance of the transaction. Ms. Gann stated that comments were received from interested parties noting that the terms ‘affiliates’ and ‘related parties’ were used interchangeably and these terms have different definitions. Ms. Gann agreed with these comments and stated that proposed edits were incorporated to use the term “related party” when referring to the overall guidance, and the term “affiliate” when referring to classification on the investment schedules. Mr. Reis stated support for the modifications in response to the interested parties’ comment letter. In response to an inquiry from Mr. Bruggeman, no comments were received indicating a need for additional exposure.

Mr. Hudson made a motion, seconded by Ms. Weaver, to adopt revisions to SSAP No. 25, SSAP No. 26R, SSAP No. 32, SSAP No. 43R and SSAP No. 48 with the modifications discussed during the meeting (Attachment One-M). The motion passed unanimously.

b. Agenda Item 2019-06

Mr. Bruggeman directed the Working Group to agenda item 2019-06: ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts. Ms. Gann stated that during the 2019 Spring National Meeting, the Working Group exposed revisions to reject this ASU for statutory accounting in SSAP No. 50—Classifications of Insurance or Managed Care Contracts, SSAP No. 51R—Life Contracts, SSAP No. 52—Deposit-Type Contracts, SSAP No. 56—Separate Accounts, SSAP No. 71—Policy Acquisition Costs and Commissions and SSAP No. 86—Derivatives. Although the proposal was to reject the ASU, she stated that revisions were proposed to the Preamble to update information on U.S. GAAP guidance. With exposure, comments were requested on whether revisions to statutory accounting disclosures should be considered. Ms. Gann stated that comments received agreed with rejecting the ASU without incorporating disclosure revisions, but that SSAP No. 54—Individual and Group Accident and Health Contracts and SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses, should also note the ASU as being rejected. Mr. Bruggeman stated the review for additional disclosures originally came at his request to ensure that necessary information was being obtained. Mr. Reis stated that interested parties confirmed with an auditing firm that rejection of the ASU will not create any Other Comprehensive Basis of Accounting (OCBOA) issues.

Mr. Matheson made a motion, seconded by Mr. Hudson, to adopt the edits to the Preamble and reject ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts for statutory accounting in SSAP No. 50, SSAP No. 51R, SSAP No. 52, SSAP No. 54 SSAP No. 55, SSAP No. 56, SSAP No. 71 and SSAP No. 86 (Attachment One-N). The motion passed unanimously.

c. Agenda Item 2019-08

Mr. Bruggeman directed the Working Group to agenda item 2019-08: Reporting Deposit-Type Contracts. Ms. Gann stated that during the 2019 Spring National Meeting, this agenda item was exposed to gather information on deposit-type contracts that were being reported in the annual statement exhibits as life or accident and health contracts. She stated that industry responses to the exposure have led to further inquiries, and additional questions have been proposed to solicit whether statutory accounting changes are necessary to ensure consistent reporting.
Mr. Hudson made a motion, seconded by Ms. Weaver, to expose agenda item 2019-08, with the inclusion of the comments received and inquiries to obtain additional information, and directed referrals to the Financial Stability (EX) Task Force and the Life Actuarial (A) Task Force to notify of the exposure and request comments. The motion passed unanimously.

5. Reviewed Comments and Considered Action on Exposed Items

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

a. Agenda Item 2018-26

Mr. Bruggeman directed the Working Group to agenda item 2018-26: SCA Loss-Tracking Accounting Guidance. Ms. Gann stated that this agenda item addresses accounting guidance when an SCA is at a negative equity value. She stated that SSAP No. 97—Subsidiary, Controlled and Affiliated Entities currently indicates that the reported value of an SCA does not cease at zero in situations where there is a negative equity position and the insurance reporting entity has provided a financial guarantee or commitment. Ms. Gann stated that a potential disconnect exists between SSAP No. 97 and SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets regarding reporting of financial guarantees. Ms. Gann stated that interested parties’ stated support for guidance in SSAP No. 5R, but Ms. Gann noted that additional revisions are necessary to ensure subsequent updating of noncontingent liabilities as the existing guidance only refers to initial recognition of the guarantee.

Ms. Walker made a motion, seconded by Ms. Brown, to expose revisions to SSAP No. 5R and SSAP No. 97 to clarify that an SCA in a negative equity position shall be reported at zero, with recognition of the financial guarantee or commitment in accordance with revised guidance in SSAP No. 5R. The revisions to SSAP No. 5R clarify that the noncontingent liability of a guarantee shall be the greater of the fair value of the guarantee or the extent the SCA is in a negative equity position but should not exceed the maximum amount of the guarantee. The motion passed unanimously.

b. Agenda Item 2018-38

Mr. Bruggeman directed the Working Group to agenda item 2018-38: Prepayment to Service and Claims Adjusting Providers. Ms. Marcotte stated that this agenda item was exposed during the 2019 Spring National Meeting with revisions to emphasize existing guidance. She stated that interested parties, particularly the health members, provided comments and recommended revisions.

Ms. Marcotte noted that NAIC staff worked with interested parties to propose additional revisions for exposure. She noted that some of the industry comments were generated by the long sentences in the previously exposed text. She stated that the proposed revisions mirror existing guidance that liabilities are established regardless of payments to third parties. She stated that existing guidance requiring claims and loss adjustment expense (LAE) to be expensed as incurred is unchanged and that additional wording has been added to make this clearer. Ms. Marcotte stated that additional annual statement line references in paragraphs 4 and 5 have been recommended. She also noted that a reference to SSAP No. 84—Health Care and Government Insured Plan Receivables regarding prepayments to providers was also added to the proposed revisions to address industry concerns.

Ms. Marcotte noted that some of the other revisions recommended by industry were not included in the final revisions to the guidance already addressed the stated concern. Carl Labus (Blue Cross and Blue Shield Association—BCBSA) expressed appreciation on behalf of BCBSA and AHIP for staff consideration of initial concerns and edits and will work with staff on the new exposure to fine tune the language.

Bruggeman stated this topic is simply the recognition of certain prepayments into the income statement and this exposure should not substantially change current practice. He noted that the original issue was a nonstandard example.

Mr. Hudson made a motion, seconded by Mr. Bartlett, to expose agenda item 2018-38. The motion passed unanimously.

c. Agenda Items 2019-09 and 2019-10

Mr. Bruggeman directed the Working Group to agenda items 2019-09: SSAP No. 101–Q/A Updates–TCJA and 2019-10: SSAP No. 101–Q/A Updates–DTA/DTL Offset for simultaneous discussion. Ms. Marotte stated agenda item 2019-09 was in response to the federal Tax Cut and Jobs Act (TCJA) to incorporate necessary revisions to the Q/A section of SSAP No.
101—Income Taxes. She stated that the interested parties’ comments indicated support for the revisions. She stated interested parties technical representatives informally provided very minor editorial changes. She noted that the NAIC /AICPA Task Force of the AICPA (not an NAIC Task Force) provided comments on the need for transition guidance for both agenda items. Ms. Marcotte stated that NAIC staff has provided transition guidance for both items with an effective for financial accounting years ending Dec. 31, 2019. Marcotte stated that agenda item 2019-10 clarified the admittance of deferred tax assets that can be offset by deferred tax liabilities noting that scheduling is only required to the extent that it was necessary to use the reversal patterns of deferred tax items in determining the valuation allowance. She stated that interested parties’ comments regarding agenda item 2019-10 proposed additional footnote language, but this change was not recommended by NAIC staff as the previously exposed guidance was sufficient regarding paragraph 7.e.

Keith Bell (Travelers), representing interested parties, thanked NAIC staff for their work on these very technical issues. Mr. Bruggeman also noted appreciation for the initial drafting work by interested parties technical representative, Art Schneider.

Mr. Ford made a motion, seconded by Mr. Hudson, to adopt the exposed revisions to SSAP No. 101, with the editorial edits discussed during the meeting, effective for financial accounting years ending Dec. 31, 2019. (Attachment One-O ). The motion passed unanimously.

d. Agenda Item 2019-12

Mr. Bruggeman directed the Working Group to agenda item 2019-12: ASU 2014-17, Business Combinations – Pushdown Accounting. Gann stated this agenda item was exposed at the 2019 Spring National Meeting with a proposal to reject the application of pushdown accounting when acquiring SCAs for statutory accounting. Ms. Gann stated that after receiving information from representatives of the American Institute of Certified Public Accountants (AICPA) and interested parties, as well as historical information on the application of pushdown, the agenda item was revised to request comments on three proposals: 1) full rejection of pushdown accounting, 2), allowing pushdown for non-insurance SCAs, or 3) allowing pushdown for SEC registrants. Ms. Gann stated that the agenda item also proposes revisions to SSAP No. 68—Business Combinations and Goodwill to clarify that if pushdown has been applied, a look-through should be utilized to ensure the 10% goodwill limitation is not exceeded.

Mr. Bell, on the behalf of interested parties, indicated they agreed with exposure of this agenda item. He stated that U.S. GAAP guidance allows the election of pushdown at the determination of the acquiree instead of the acquirer. Mr. Bruggeman requested that the information presented by NAIC Staff on the application of pushdown and the historical statutory accounting guidance be incorporated into the agenda item. He also stated that application of pushdown prior to the conclusion of this agenda item shall be monitored by regulators to ensure a company does not attempt to improperly utilize pushdown before a final determination can be made.

Mr. Matheson made a motion, seconded by Mr. Hudson, to expose agenda item 2019-12 with a request for comments on the three proposals for application of pushdown for statutory accounting and the proposed edits to SSAP No. 68. The motion passed unanimously.

e. Agenda Item 2019-13

Mr. Bruggeman directed the Working Group to agenda item 2019-13: Clarification of a Look-Through Approach. Ms. Gann stated that this agenda item was proposed to clarify guidance on the application of the SSAP No. 97 downstream holding company look-through approach. She stated that the original exposure suggested a one-level look-through, but comments were received regarding entities utilizing multiple-shell holding companies. Ms. Gann stated that the comments indicated that multiple levels may be required due to standard business practices where organizations have multiple shell companies. She noted that these situations are not concerning when each holding company complies with SSAP No. 97 provisions for look-through, including the provision that the holding company does not hold any other material assets or material liabilities. Mr. Bruggeman agreed with these comments and stated that the recommendation is to dispose the agenda item without statutory accounting revisions. Mr. Bell, representing interested parties, stated that explicit guidance detailing the permission of a multiple look-through approach would be beneficial.

Mr. Matheson made a motion, seconded by Mr. Moser, to dispose agenda items 2019-13 without statutory accounting revisions. The motion passed unanimously. With disposal, the Working Group directed a new agenda item to consider clarifying that a more-than-one holding company structure is permitted if each of the holding companies comply with SSAP No. 97.
Draft Pending Adoption

f. Agenda Item 2019-14

Mr. Bruggeman directed the Working Group to agenda items 2019-14: Attribution of Goodwill. Ms. Gann stated that the exposed revisions to SSAP No. 97 would require goodwill from the acquisition of a downstream holding company to be assigned to the companies held by the holding company. Further, downstream holding company goodwill should be assigned at the time of acquisition. She stated this is important for SCA filings as the attributed goodwill should not be admitted if the look-through approach is utilized and the underlying companies are not admitted. Ms. Gann stated the assignment of goodwill is a disclosure element and does not reflect pushdown accounting. She stated that the intent is similar to U.S. GAAP requirements for the assignment of goodwill to reporting units. She stated that in response to interested parties’ comments, additional revisions have been proposed to clarify the intent of the agenda item and propose disclosures. Mr. Bruggeman reiterated that this agenda item does not result in new accounting entries and is strictly a disclosure item.

Mr. Ford made a motion, seconded by Mr. Hudson, to expose the revisions to SSAP No. 97. The motion passed unanimously.

g. Agenda Item 2019-18

Mr. Bruggeman directed the Working Group to agenda items 2019-18: Other Derivatives. Ms. Gann stated this agenda was exposed after the 2019 Spring National meeting in response to interested parties’ comments to clarify the accounting guidance in SSAP No. 86 when a derivative is not part of a hedging, income generation or replication transaction. She stated that these comments were received as a result of adopted revisions that classify structured notes as derivatives as they contain a risk of principal loss other than credit risk. Ms. Gann stated that the definition of an “other derivative” is included in the annual statement instructions and includes any derivative that is not a derivative used in a hedging, income generation, or replication transaction. The exposed revisions indicated that other derivatives shall be reported at fair value and nonadmitted in the statutory financial statements. Ms. Gann stated that the nonadmitted classification is consistent with the current guidance that would be applicable pursuant to SSAP No. 4—Assets and Nonadmitted Assets, as other derivatives are not currently identified as admitted assets. She stated that these types of derivatives are also likely outside of state investment laws. Ms. Gann stated that interested parties’ comments had suggested incorporating guidance for structured notes explicitly in SSAP No. 86, but that approach would incorporate guidance for specific derivative instruments, which is not consistent with existing guidance in which the accounting and reporting is determined based on the derivative program. She stated that NAIC staff originally recommended that the Working Group consider adoption of the exposed revisions, but she had been contacted by interested parties with a request for re-exposure to allow additional time prior to adoption. Ms. Gann stated that NAIC staff did not oppose an additional exposure period.

Mr. Bruggeman stated that state investment laws may allow for these types of transactions as prescribed accounting practices. Ms. Gann also stated that comments received from interested parties on minor differences on the definition of a structured note between SSAP No. 26R and SSAP No. 86 is being addressed in agenda item 2019-27EP, Editorial Update.

Mr. Reis, representing interested parties, stated that additional time is requested to allow industry to analyze existing investments to determine whether they are structured notes and captured in scope of SSAP No. 86. Mr. Bruggeman stated that specific transaction examples shall be submitted if comments are provided on what is captured in the structured note classification. Mr. Reis stated that while he believes these should be rare investments, more items may be in scope that have previously been identified.

Mr. Bartlett made a motion, seconded by Ms. Malm, to re-expose revisions to SSAP No. 86 on the accounting and reporting for other derivatives. No modifications were reflected from the prior exposure. The motion passed unanimously.

6. Considered Maintenance Agenda—Pending Listing—Exposures

Mr. Hudson made a motion, seconded by Ms. Weaver, to move agenda items 2019-19 through 2019-24 and agenda item 2019-26 through 2109-31 to the active listing, and expose all items for comment, with distinction of each item as either substantive or nonsubstantive, and with corresponding referrals as recommended by NAIC staff. The motion passed unanimously.

a. Agenda Item 2019-19

Mr. Bruggeman directed the Working Group to agenda item 2019-19: SIRI – Equity Interests. Ms. Gann stated that this
nonsubstantive agenda item is being considered subsequent to revisions incorporated to the Supplement Investment Risk Interrogatory (SIRI) Line 2: 10 Largest Exposures to a Single Issuer / Borrower / Investment and the inclusion of a new reporting category for “fund managers.” She stated that this agenda item proposes similar concepts to Line 13: 10 Largest Equity Interests, with a proposal to exclude diversified funds from the look-through and aggregation requirements in determining the largest equity interests, but that a look-through is required for non-diversified equity funds. The proposal also clarifies that any equity interest (regardless of diversification) that individually qualifies as one of the largest equity interests shall be captured in SIRI Line 13. Ms. Gann stated that the exposure proposes to exclude SVO-Identified Bond Exchange Traded Funds (ETFs) and SVO-Identified investments with characteristics of fixed-income investments from the scope of this equity listing. Ms. Gann stated that NAIC staff recommends a referral to the Capital Adequacy (E) Task Force with notice of the exposure and a request for the impact, if any, the changes would have to risk-based capital. Ms. Gann clarified that this agenda item will not result with statutory accounting revisions, but if supported, would result with a proposal to the Blanks (E) Working Group.

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

b. **Agenda Item 2019-20**

Mr. Bruggeman directed the Working Group to agenda item 2019-20: Rolling Short-Term Investments. Ms. Gann stated that this nonsubstantive agenda item was drafted due to certain securities being structured to mature at or around 364 days in order to be classified as short-term investments with those investments being rolled or renewed. Ms. Gann stated these investments are in substance long-term investments, however they are structured to qualify for short-term reporting. She stated that the agenda item has been drafted with an attempt in order to avoid unattended consequences for certain investments, such as Treasury bills, commercial paper, and certificates of deposit, as these types of investments should not be captured in the proposed restrictions. Ms. Gann stated that the scope of the agenda item was to include only affiliated SSAP No. 26R investments, all SSAP No. 43R investments and all investments that would be captured on Schedule BA – Other Long-Term Invested Assets if they did not qualify for cash equivalent or short-term reporting.

Ms. Gann provided the three principles for short-term and cash equivalent reporting proposed in the agenda item:

- An overall principle that investments are permitted for short-term and cash equivalent reporting only if the reporting entity reasonably expects the investment duration to be realized on the designated maturity date. If the reporting entity does not expect that the investment will terminate or mature on the designated date but will be renewed or rolled beyond the cash equivalent or short-term maturity deadlines, then the investment shall not be classified as a short-term investment.

- Provisions that a cash equivalent or short-term investment is only permitted to be reported within those classifications for one applicable reporting period. As such, if an investment is reported as a short-term investment in one year and the investment does not mature on the original scheduled maturity date, the reporting entity would not be permitted to report the investment as a short-term investment in the next annual reporting period. For these situations, if a security is held after the initial maturity timeframes have passed, the reporting entity shall report the investment as a long-term investment on the appropriate schedule.

- Provision that the sale or maturity of an investment, with a reacquisition of the same or substantially similar security within a one-year timeframe, will preclude the reporting entity from reporting the currently held security as a cash equivalent or short-term investment regardless of the maturity date.

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

c. **Agenda Item 2019-21**

Mr. Bruggeman directed the Working Group to agenda item 2019-21: SSAP No. 43R – Equity. Ms. Gann stated that this nonsubstantive agenda item was drafted due to information received on a type of SSAP No. 43R investment involving a private equity fund or hedge fund assets known as a collateralized fund obligation (CFO). In these types of structures, the “security” issued from the trust represents the expected gain in an equity investment, but as they are structured for inclusion within scope of SSAP No. 43R, they are reported on Schedule D-1, Long-Term Bonds. Ms. Gann stated that CFO’s have been formed through repackaging of existing owned assets, which would result with equity investments being moved from Schedule BA,
Other Long-Term Invested Asset, to the bond schedule. She stated that these structures, and other similar investments that reflect underlying equity interests, do not fit the original scope or intent of SSAP No. 43R and the agenda item proposes revisions to exclude these items from that statement. She also noted that the revisions propose a footnote to refer to existing provisions covering lease-backed securities and equipment trust certificates, however, as that pertains to a separate topic, based on comments received, that element could be removed from this agenda item and captured in a separate agenda item. Mr. Bruggeman confirmed that this was proposed as a nonsubstantive change, however, based on comments received an issue paper could be considered.

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

d. Agenda Item 2019-22

Mr. Bruggeman directed the Working Group to agenda item 2019-22: Wash Sale Disclosure. Mr. Stultz stated that this nonsubstantive agenda item proposes revisions to the wash sale disclosure captured in SSAP No. 103—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities as a result of feedback from industry regarding the significant amount of resources consumed in the tracking of wash sales. Mr. Stultz stated that this agenda item proposes revisions to only require the wash sale disclosure when the wash sale crosses reporting period end dates.

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

e. Agenda Item 2019-23

Mr. Bruggeman directed the Working Group to agenda item 2019-23: Going Concern. Ms. Gann stated that this agenda item is in response to issues noted from the review of SCA filings in which there have been situations noted where a reporting entity may have a going concern identified in the notes to the financial statements, but not in the audit opinion. She stated that this agenda item exposes language to clarify that if an unalleviated going concern is mentioned in any part of the audit report or accompanying financial statements, the value of the SCA shall be nonadmitted. Only when the going concern is identified as alleviated is the SCA permitted to be an admitted asset.

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

f. Agenda Item 2019-24

Mr. Bruggeman directed the Working Group to agenda item 2019-24: Commissions. Ms. Marcotte stated that this nonsubstantive agenda item was in response to regulator inquiries and recommends clarifications to the existing levelized commissions guidance and provides additional guidance regarding commissions based on policy persistency. She noted that SSAP No. 71—Policy Acquisition Costs and Commission describes that levelized commissions occur in situations in which a third party pays agents non-levelized commissions, generally upfront, and the reporting entity pays a third party by levelized payments. She noted that SSAP No. 71 notes that often it is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid to the third party from the reporting entity. She stated that SSAP No. 71 identifies such arrangements as funding agreements between the reporting entity and the third party. She stated that SSAP No. 71 identifies that the use of a commission arrangement where commission payments are not linked to traditional elements (such as premium payments and policy persistency) requires the establishment of a liability for the full amount of the unpaid principal and accrued interest payable to a third party related to levelized commissions.

Ms. Marcotte stated that the questions received by NAIC staff related to the use of a levelized commission arrangement. She stated that the third party was paying the agents upfront, and the insurance company was paying the third party over time, but not recognizing the full amount that was owed to the third party until the amount was earned fully by the third party. She noted that this seemed to be shifting expenses to a subsequent period.

Ms. Marcotte stated that proposed revisions clarify that a levelized commission arrangement (whether linked to traditional or nontraditional elements) requires the establishment of a liability for the full amount of the unpaid principal and accrued interest payable to a third party. She noted that the revisions also provide that a persistency commission is accrued proportionately over the policy period in which the commission relates to and is not deferred until fully earned. She stated that for example, a persistency commission is accrued during the policy year that it relates to and recognition is not deferred until the end of the policy year.
Marty Carus (Marty Carus Consulting) noted his prior work as a financial regulator for 35 years. He stated that he was on the Codification of Statutory Accounting Principles (E) Working Group which was a predecessor to the current Working Group. He stated that the proposed revisions may be a substantive change. He noted that persistency clauses that attach to these agreements do not necessarily meet the definition of liability until the persistency standard has been met. He said that in other cases, such as policy reserves or incurred but not reported (IBNR) reserves, you cannot point to an actual legal obligation to pay a particular person an amount as of a date, but this issue is different because it does not arise from a statutory provision that requires setting up a liability such as IBNR or a statutory reserve. He noted that he thinks that the issue arises from certain companies that sell annuity type products that distribute their products in this manner. Mr. Carus stated that the issue may be nonsubstantive to the industry as a whole, but substantive to particular companies. Mr. Bruggeman noted that it would be exposed as nonsubstantive, however industry could submit comments on whether it is substantive during the exposure period.

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

g. Agenda Item 2019-25

Mr. Bruggeman directed the Working Group to agenda item 2019-25: Working Capital Finance Investments. Ms. Marcotte stated that the Valuation of Securities (E) Task Force has referred to the Working Group industry-prepared tracked revisions to SSAP No. 105—Working Capital Finance Investments and materials produced by the Task Force NAIC staff on the issues raised. She stated that the Task Force recommended that the Working Group consider the amendments, which the Task Force has previously exposed. She stated that the nonsubstantive agenda item has been drafted to address the referral.

Ms. Marcotte stated that the industry-proposed revisions to SSAP No. 105 can be grouped into the following broad categories:

- Changes to program and or obligor credit quality requirements
- Changes to program administration and/or documentation
- Changes to regulatory compliance requirements
- Changes to statutory reporting requirements

Ms. Marcotte stated that the materials grouped the industry proposed revisions into 10 different changes. She stated that the NAIC staff recommendation is for the Working Group to receive the referral and direct NAIC to proceed with drafting revisions for six of the 10 industry proposed revisions to SSAP No. 105 for future Working Group discussion. She noted that four elements requested by industry are not supported by NAIC staff. Mr. Bruggeman stated that as the recommendation is to direct NAIC staff to develop materials for a future exposure, this item would have a separate vote.

Adam Dener (Fermat Capital Management), representing the ACLI, stated that the quality of SSAP No. 105 has led to low adoption of the Working Capital Finance Investments (WCFI) asset class. He stated that in the more than 10 years since industry and regulators began working on this investment, and its passage in 2013, only five investments have been filed with the SVO. He stated that of those five applications, one was approved, two were approved with restrictions (for unrated entities) and two were rejected (one for unrated entities and one for finance agent). He stated that there was an immaterial amount of $224 million outstanding in WCFI at year end 2018. He stated that WCFI are high-quality investments that pay significantly more than other comparable fixed income investments of the same quality. He noted that availability of the asset class and its accessibility from dealers given the minimum size requirements means it is not available to small insurers.

Mr. Dener stated that industry believes that the other four proposed changes to SSAP No. 105, which were not recommended by NAIC Staff, are necessary. He stated that beginning with the industry request to allow unrated subsidiaries, that the NAIC Staff comments note that such capability is “overly complex, broad and difficult to apply.” He noted that such a change would require analysis and judgment. He questioned that if there is no analytical judgement applied in the review of the transaction, then a regulated entity should not incur a $10,000 filing fee. He noted that NAIC Staff has interpreted the absence of guidance on unrated entities as requiring a guarantee from the rated entity and industry views this as intractable. He stated that the industry proposal criteria has two requirements: 1) ratings criteria for WCFI should rely on a Credit Rating Provider (CRP) rating of a specific entity and 2) the operational linkage of the CRP rated entity to the obligations under the filing. He stated that the issue of evaluating unrated subsidiaries is actually a judgment about the scope of operational control entanglement and something that happens every day.
Mr. Dener stated that whether or not an authorized party in a corporation is agreeing to making a commitment to payment for its legal entities is a controlled activity in that corporation, which happens every day in corporations and banks, and is a non-trivial decision by both the corporation and finance agent and something that can be observed through reviewing the contracts that are presented under the WCFI filing. He stated that regulators make similar judgments regarding insurers. He noted that while legally distinct, the operational functions are entangled through shared services beyond entity legal boundaries and do not involve guarantees of other parties which are impractical and inappropriate given tax, disclosure and commercial reasons. He recommended instructing the NAIC SVO to make such judgments and incorporating provisions in SSAP No. 105 to allow unrated subsidiaries to use the rating of the rated parent into the statement and the SVO requirements.

Mr. Dener addressed the request to allow lower credit quality (NAIC 3 and NAIC 4) WCFI, stating that other investments are not restricted based on credit quality. He stated that any domestic regulator can choose not to adopt a regulation. He stated that short-term fixed income investments typically are reported on Schedule DA, but the guidance for WCFI requires reporting on Schedule BA. He proposed that reporting issues could be resolved through the creation of a separate code to allow WCFI to be reported on Schedule DA, noting that insurers are reluctant to report on Schedule BA. He noted that reporting entities that are capable of investing in WCFI are large and sophisticated; and state approval is not a practical risk mitigant. He questioned the criteria that a state would be able to use to determine if a company should invest in the asset class. He noted that industry requests that all 10 changes be made to SSAP No. 105.

Mr. Fry stated that when the Valuation of Securities (E) Task Force started looking at this asset class five years ago, at the request of the company that was investing in them, the Task Force thought it would be beneficial for the industry particularly during the low interest rate environment. He stated that the program requirements may be so restrictive that investment in the asset class remains low. He stated that he supports the industry revisions that NAIC staff recommends. He said that for the four revisions which were not recommended by NAIC staff, that as a regulator he makes frequent analytical judgments and he thinks that the program should be expanded to allow the SVO to use analytical judgment regarding unrated subsidiaries. He said that without the unrated subsidiary consideration, industry investments in WCFI programs would still be very limited. He stated support for removing the language on possible need for commissioner approval and allowing lower credit quality obligors of NAIC 3 and NAIC 4., but noted that allowing lower credit quality obligors may not be necessary. He noted that since the NAIC has already created a framework for Schedule BA reporting that perhaps the industry request to change the annual statement reporting was likely less important of a request.

Mr. Bruggeman stated that the Working Group needed to receive the Task Force referral. He noted that the Working Group could direct the NAIC staff to go forward with proposing revisions pursuant to the NAIC staff recommendation or direct additional revisions. Mr. Bruggeman noted that the SVO designation of the programs were at a point in time and if a subsidiary was sold or had some other change, the SVO does not monitor those changes. Mr. Bruggeman noted that in his view there would need to be some type of process to address that aspect. He identified that some of the issues would have additional discussion after exposure. Mr. Fry noted he would also be comfortable having additional discussion on the unrated subsidiary topic in the future. Mr. Bruggeman stated that going forward with the items in which there is some agreement would allow for more productive discussion on the other items that may require additional discussion.

Mr. Hudson made a motion, seconded by Mr. Fry, to receive the referral from the Valuation of Securities (E) Task Force (Attachment One-P) and direct NAIC staff to draft revisions to SSAP No. 105 for the six items in the agenda that NAIC staff recommended. The motion passed unanimously.

h. Agenda Item 2019-26

Mr. Bruggeman directed the Working Group to agenda item 2019-26: A-785 Updates for Covered Agreement. Mr. Stultz stated that on June 25, 2019, the NAIC Executive Committee and Plenary adopted revisions to the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) to incorporate relevant provisions from the “Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance” and the “Bilateral Agreement Between the United States of America and the United Kingdom Regarding Insurance and Reinsurance” (collectively referred to as the Covered Agreement). Mr. Stultz stated this agreement allows for reduced collateral requirements for insurers in reciprocal jurisdictions and that upcoming changes in Annual Statement Blanks, SSAP No. 61R and SSAP No. 62R are likely forthcoming as a result of this adoption. Mr. Stultz stated that the current agenda item proposes nonsubstantive revisions to Appendix A-785 to reflect the changes made to Model Law and Model Regulation.
In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

i. **Agenda Item 2019-27EP**

Mr. Bruggeman directed the Working Group to agenda item 2019-27EP: Editorial Update. Mr. Stultz stated that this agenda item proposes nonsubstantive editorial revisions to clarify wording, delete duplicate definitions, and add SVO suffixes. In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

j. **Agenda Item 2019-28**

Mr. Bruggeman directed the Working Group to agenda item 2019-28: ASU 2019-15, Targeted Transition Relief. Jim Pinegar (NAIC) stated that this nonsubstantive agenda item is an update to expected credit loss guidance captured in ASU 2016-13 – Credit Losses. Mr. Pinegar stated that the ASU provides optionality to elect an alternative accounting treatment for the fair value option for certain financial assets previously measured at an amortized cost basis. He stated that the agenda item proposes to reject ASU 2019-15 in SSAP No. 100R—Fair Value as statutory accounting principles require assets to be measured in accordance with the applicable SSAP and do not permit fair value measurement elections. In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

k. **Agenda Item 2019-29**

Mr. Bruggeman directed the Working Group to agenda item 2019-29: ASU 2019-06, Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities. Mr. Pinegar stated that this ASU extends certain goodwill alternatives available for private companies to not-for-profit entities. Under this ASU, the alternative accounting treatment allows a not-for-profit entity to amortize goodwill on a straight-line basis over the lesser of 10 years or its demonstrated useful life. He stated that the nonsubstantive agenda item proposes to reject ASU 2019-15 as goodwill is already required to be amortized over its useful life, not to exceed 10 years, under SSAP No. 68. In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

l. **Agenda Item 2019-30**

Mr. Bruggeman directed the Working Group to agenda item 2019-14: ASU 2019-03, Updating the Definition of Collectibles. Mr. Pinegar stated that the term “collections” in the Master Glossary of the FASB Accounting Standards Codification was not fully aligned with the definition used in the American Alliance of Museums’ (AAM) Code of Ethics for Museums. He stated that the ASU clarifies that “collections” are to be defined as works of art, historical treasures, or similar assets that meet certain criteria to realign the definitions between both organizations. He stated that this nonsubstantive agenda item proposes to reject ASU 2019-03 as not applicable to statutory accounting.

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

m. **Agenda Item 2019-31**

Mr. Bruggeman directed the Working Group to agenda item 2019-31: ASU 2018-08, Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made. Mr. Pinegar stated that this agenda item is to clarify and improve the scope and accounting guidance for contributions received and contributions made. He stated ASU 2018-08 should assist entities in evaluating whether transactions should be accounted for as contributions (nonreciprocal transactions) or exchange (reciprocal) transactions and in determining whether the contribution is conditional. Mr. Pinegar stated that this is a matter most prevalent for government grants and contracts. He stated that the nonsubstantive agenda item proposes to reject ASU 2019-31 as not applicable to statutory accounting.

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

7. **Considered Maintenance Agenda—Active Listing**
Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

a. Agenda Item 2019-04

Mr. Bruggeman directed the Working Group to agenda item 2019-04: SSAP No. 32 – Investment Classification Project. Ms. Gann stated this item agenda item proposes exposure of an issue paper detailing substantive revisions to SSAP No. 32—Preferred Stock pursuant to the Working Group’s Investment Classification Project. Ms. Gann stated that the key revisions detailed in the issue paper pertain to definitions, measurement and impairment of preferred stock.

Ms. Walker made a motion, seconded by Mr. Ford, to expose the issue paper. The motion passed unanimously.

b. Agenda Item 2018-07

Mr. Bruggeman directed the Working Group to agenda item 2018-07: Surplus Note Accounting – Referral from the Reinsurance Task Force. Ms. Gann stated that this agenda item addresses “linked surplus notes.” She stated that a regulator-only call occurred on July 2, 2019, which discussed the information received from industry and regulators regarding specific insurance company situations involving linked surplus notes. Ms. Gann stated that regulators requested additional information on how these instruments are used and the prevalence of these instruments. She stated that with the timing for blanks revisions, only two options exist for timely obtaining additional information. The first option would require linked surplus notes to be captured as permitted or prescribed practices in Note 1 of the year-end 2019 statutory financial statements. The second option available would solicit information through a data call. Ms. Gann stated that she anticipates industry concern with the first option, but the second option would require state regulators to oversee compliance in completing the request. She stated that she has received a proposed data call template from industry and would suggest the inclusion of additional data elements. Ms. Gann stated that if the data call is the preferred approach, she would work with industry on finalizing the data call components. Additionally, she stated that an additional disclosure will be subsequently proposed to SSAP No. 41R—Surplus Notes to allow data-capturing of this information for year-end 2020.

Mr. Bruggeman restated both options available, noting that industry considers reporting in Note 1 with a negative connotation and more information could be obtained with a data call. He stated his preference was the data call and requested comments from the Working Group. Mr. Arfanis stated he was supportive of the data call option.

Tom Finnell (America Health Insurance Plans—AHIP) inquired if guidance would be included to specify which surplus notes would be included in scope. Mr. Bruggeman responded that a definition would be included in the data call request to ensure the appropriate data was obtained. Ms. Gann stated that the criteria for the definition of a linked surplus note was in the provided materials and discussion continues if a surplus note is linked because of the terms of the agreement or offsetting cashflows. She stated for the purposes of this data call, both linkage types would be subject to data call reporting.

Mr. Arfanis made a motion, seconded by Ms. Mears, to proceed with the data call. The motion passed unanimously. Mr. Bruggeman confirmed that a separate agenda item would be considered to capture additional disclosures in SSAP No. 41R.

c. Agenda Item 2017-28 and Informal Drafting Life and Health Reinsurance Drafting Group Update

Mr. Bruggeman directed the Working Group to agenda item 2017-28: Reinsurance Credit – Informal Life and Health Reinsurance Drafting Group Recommendations. Ms. Marcotte stated that this nonsubstantive agenda item is part of the ongoing project to develop clearer reinsurance credit rules. She noted that the Working Group previously adopted revisions to SSAP No. 62R—Property and Casualty Reinsurance in November 2018. The SSAP No. 61R—Life and Health Reinsurance work is ongoing through the Informal Life and Health Reinsurance Drafting Group.

Ms. Marcotte provided an update noting that the Informal Life and Health Reinsurance Drafting Group met four times during the interim primarily focused on complex yearly renewable term (YRT) issues. She noted that additional meetings will continue in the interim as the Drafting Group works to address YRT issues and other topics such as non proportional reinsurance. She noted that the Drafting Group reviewed prior comments and recommends exposure of the following:

1. SSAP No. 61R Disclosures, (previously exposed) with notification to the Financial Analysis (E) Working Group of the exposure as the disclosures were originally developed at their request.

2. Two A-791 QA items, one regarding the topic of certain nonproportional reinsurance contracts covered under the A-791 and one regarding business that has a statutorily required medical loss ratio or similar refund / rebate.
Ms. Marcotte noted that regulator members of the Drafting Group also recommend exposure of revisions to add A-791 QA under paragraph 2c regarding group term life YRT reinsurance contracts. She said the Drafting Group members agreed to expand paragraph 2c. QA regarding group term life YRT. She noted that the industry members drafted a Q&A in relation to paragraph 2c. of A-791 for consideration. She stated that the regulator members agreed to the suggested approach to add the QA but eliminated the second part of the industry proposed answer that would continue to allow the reinsurer to charge premiums in excess of the underlying direct proportionate premium if the ceding entity established a liability for the excess amount. She said that after further discussion, the regulator and industry members of the subgroup could not come to agreement. She stated that the regulator members continued to question whether such group term life YRT contracts appropriately transferred risk if a reinsurer could charge premiums in excess of the underlying direct proportionate premium. She said that it was noted that these contracts generally include other risk limiting features, such as loss carry forward provisions, and would typically not pass risk transfer requirements under U.S. GAAP. She stated that the industry members prefer to seek ways to explicitly allow the group term life YRT reinsurance contracts to exceed the amount of the underlying direct proportionate premium.

She stated that the NAIC staff recommendation was to expose the regulator modified version of the revisions to the A-791 QA under paragraph 2.c. to allow for specific concerns to be raised and addressed.

Mr. Hudson made a motion, seconded by Mr. Bartlett, to receive the informal drafting group update and expose the nonsubstantive revisions as described by NAIC Staff. The motion passed unanimously.

8. Discussed Other Matters

a. Agenda Item 2016-20: Credit Losses

Ms. Gann stated that the Working Group has had prior discussions and exposures regarding ASU 2016-13: Credit Losses. She stated that with the discussions that are ongoing, discussion on the ASU has been put on perpetual deferral, with NAIC staff monitoring the FASB discussions. Ms. Gann stated that the FASB is considering an implementation delay for certain entities, however SEC registrants will still have to comply with the standard by January 1, 2020.

Mr. Bell, representing interested parties, stated that the proposed FASB implementation delay is complicated because the deferrals are determined by size of the organization, but no deferral is allowed for SEC registrants. He also stated that two bills have been introduced in Congress which will require a ‘defer and study’ approach for SEC registrants. Mike Monahan (American Council of Life Insurers—ACLI) stated they were successful in persuading the FASB’s deferral of the expected credit loss standard and other key standards that will impact insurance reporting entities.

Mr. Bruggeman stated that the NAIC staff will continue to monitor the FASB discussions on this topic.

b. Receive Committee on Property and Liability Financial Reporting (COPLFR) of the American Academy of Actuaries Comments

Ms. Marcotte stated the Committee on Property and Liability Financial Reporting (COPLFR) of the American Academy of Actuaries (Academy) has provided a letter to the Working Group and the Casualty Actuarial and Statistical (C) Task Force and the Surplus Lines (E) Task Force. She said that the letter states that COPLFR has noticed that the existing guidance for portfolio retroactive reinsurance that meets the exception to be accounted for as affiliated prospective reinsurance is ambiguous regarding reporting requirements, particularly regarding the reporting in Schedule P. She stated that letter notes that because there is ambiguity regarding the exact way to do the accounting, it has led to materially different presentations in Schedule P. She noted that the letter requests that this ambiguity in Schedule P presentation be addressed, given that Schedule P is utilized for risk-based capital (RBC) purposes and given the increased propensity for companies to entertain partial loss portfolio transfers that do not fully meet the requirements of “Run-Off Agreements.” Ms. Marcotte agreed that there is diversity in practice and that examples and additional annual statement instructions would be beneficial.

Kathy Odomirok (E&Y) speaking as the chair of COPLFR, stated that they look forward to assisting with this project. Ms. Marcotte stated that her understanding was that COPLFR was not taking a position on the preferred methods. Ms. Odomirok affirmed that was correct, and that COPLFR just identified the issue of diversity in practice and provided examples. Ms. Marcotte noted that she would be contacting Working Group members and various members of industry to work on the project.
Ms. Marcotte noted that her recommendation was to provide examples that were similar in detail as the examples on P&C Run off contracts in SSAP No. 62R.

Ms. Walker made a motion, seconded by Mr. Hudson to receive the referral and direct NAIC staff to work with regulators and other parties to develop examples for future Working Group discussion. The motion passed unanimously.

c. AP&P Update – Manual & Electronic Version

Ms. Gann stated that the process to obtain a printed Accounting Practices and Procedures Manual will continue, and that reservations must be made by December 13, 2019 in order to secure a printed version. Ms. Gann stated that those that do not reserve printed copies will only receive a printed version if there are copies remaining. She stated that if no copies are available, the requester will be limited to the electronic version. Ms. Gann also stated that purchasers that acquire the electronic product do not have to pre-purchase the subsequent year’s manual to access the updates adopted throughout the year. Rather, these updates are included as subsequent chapters to the Manual available directly in the electronic product. Purchasers of the printed Manual will still be required to pre-purchase the Manual to receive updates adopted throughout the year. If a purchaser wants to move towards the electronic product, there is a process in place to acquire the updates without having to pre-purchase the subsequent Manual.

d. U.S. GAAP Exposures

Mr. Pinegar stated that NAIC staff has reviewed U.S. GAAP exposures and noted that comments during the exposure periods are not recommended, with a review once issued as final ASUs under the statutory maintenance process. Mr. Pinegar briefly discussed two such items, one being a FASB request to comment regarding the treatment of goodwill for public entities and an exposure document detailing transitional accounting guidance for entities initiating or discontinuing the equity method of accounting.

e. Receive LATF Request for Coordination on YRT

Ms. Marcotte stated the Life Actuarial (A) Task Force submitted a request to the Working Group to coordinate in accordance with the joint policy statements in the Accounting Practices and Procedures Manual and the Valuation Manual. The issue is regarding yearly-renewable term (YRT) reinsurance credits in modeling YRT reinsurance cash flows under principle-based reserving (PBR) and differences in the related guidance in the Accounting Practices and Procedures Manual and in the Valuation Manual. Ms. Marcotte noted that there is some guidance in SSAP No. 61R and in A-791 regarding YRT reinsurance credit which generally indicates that reinsurance credit should not be greater than ½ Cx. She noted that under the Valuation Manual the modelling of reinsurance cash flows can result in larger credits. Ms. Marcotte noted that the Task Force adopted a limitation of ½ Cx for 2020 and is working on a longer-term solution. Ms. Walker made a motion, seconded by Ms. Brown, to receive the request and direct staff to assist the Task Force with the YRT issue in accordance with the NAIC Policy Statement on Coordination with the Valuation Manual. (Attachment One-Q). The motion passed unanimously.

f. Review of 2020 Charges

Ms. Marcotte stated the Working Group has an outstanding charge to develop a model guideline allowing exception to state-imposed limitations on derivative transitions. She stated that this was part of three charges that were recommended by the Variable Annuities Issues (E) Working Group to the Financial Condition (E) Committee as charges for the Working Group. She noted that two of the charges have been completed, and the remaining charge seemed to be a request to draft recommendations for exceeding the Investments of Insurers Model Act (Defined Limits Version) (Model #280) for hedging transactions. She stated that Model 280 has a limit of admitted derivative activity to 7.5% of assets and is only adopted by nine jurisdictions. She noted that 2018 data analysis indicated that no domestic companies in any of the nine jurisdictions had derivative transactions which exceeded the 7.5% model guideline threshold, and of all reporting entities, only five companies from three different groups exceeded the threshold. Ms. Marcotte stated that with the data provided, a model guideline for exceeding derivative limits for hedging transactions did not seem warranted. Mr. Bruggeman inquired of Ms. Walker if the changes to the charges would be discussed at the Accounting Practices and Procedures (E) Task Force. Ms. Walker confirmed that exposure of the 2020 charges was planned at this Summer National Meeting.

Mr. Matheson made a motion, seconded by Mr. Hudson to recommend deletion of this charge to the Accounting Practices and Procedures (E) Task Force. The motion passed unanimously.
Mr. Bruggeman that October 11, 2019 is the public comment deadline for all other exposures and the submission of new items.

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

G:\FRS\DATA\StatAcctg\3. National Meetings\A. National Meeting Materials\2019\FallHearing\1 - 08 2019 StatAcctWGmin.docx
This page intentionally left blank.
Statutory Accounting Principles (E) Working Group  
Conference Call  
September 9, 2019

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met via conference call Sept. 9, 2019. The following Working Group members participated: Dale Bruggeman, Chair (OH); Carrie Mears, Vice Chair (IA); Kim Hudson (CA); William Arfanis (CT); Ryllynn Brown (DE); Eric Moser (IL); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Joe DiMemmo (PA); Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI). Also participating was: Jack Broccoli (RI).

1. **Considered Maintenance Agenda Item 2019-32**

Mr. Bruggeman directed the Working Group to agenda item 2019-32: Segregated Accounts. Ms. Gann stated this agenda item was drafted to clarify statutory accounting provisions for insurance and reinsurance operations reported within segregated accounts that are not captured in scope of *Statement of Statutory Accounting Principles (SSAP) No. 56—Separate Accounts* or *SSAP No. 74—Insurance-Linked Securities Issued Through a Protected Cell*. Ms. Gann stated that the term “segregated account” within this agenda item was intended to capture all scenarios in which a reporting entity has legally separated specific assets and liabilities for certain insurance risks. The legal classification and use of segregated accounts is determined based on domiciliary state law and state insurance regulator approval. Ms. Gann stated that while segregated accounts are considered separate and distinct from items captured in SSAP No. 56 or SSAP No. 74, the draft agenda item clarifies that all assets and liabilities within segregated accounts shall be captured within the principles detailed in the NAIC *Accounting Practices and Procedures Manual* (AP&P Manual). Further, any departure from the AP&P Manual shall be captured as a permitted or prescribed practice as detailed in *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures*. Ms. Gann stated that this agenda item was proposed for initial exposure to solicit comments and feedback from state insurance regulators and interested parties.

Ms. Gann stated that the primary focus of the proposed SSAP was to clarify that statutory accounting principles apply to segregated accounts. She stated that two reporting options were proposed within the SSAP. The first option was to report the segregated account aggregated into the general account. The second was to report the segregated account disaggregated from the general account. Ms. Gann stated the two reporting methods were proposed in order to comply with differing domiciliary laws that dictate a certain reporting method.

Mr. Smith stated the legal status of segregated accounts remains uncertain and questioned why an SSAP would be created before the legal questions were resolved. He stated that questions continue on whether segregated accounts should be used for insurance purposes and that the issuance of an SSAP addressing segregated accounts may be premature. Mr. Bruggeman stated that there are known situations where segregated accounts are being used. However, he said there is a current lack of direction on accounting and reporting, regardless of outstanding legal status questions. Mr. Bruggeman stated that the Restructuring Mechanisms (E) Subgroup should lead the legal discussion. However, he said the proposed SSAP exposure was intended to begin the process for obtaining feedback on how segregated accounts should be reported, irrespective of legal status.

Mr. Stolte stated he believes the issuance of an SSAP was getting ahead of the Restructuring Mechanisms (E) Subgroup as the legal status of this type of structure remains an outstanding question. Mr. Stolte stated that this type of structure may not be in the best interest of policyholders and that if an SSAP were issued, it may legitimize the practice. He stated that Virginia is concerned with moving forward until the legal questions regarding segregated accounts are addressed.

Ms. Gann stated that NAIC staff agreed with the comments mentioned. However, she said the SSAP was designed so that in the event a state has approved a segregated account structure, the reporting of assets and liabilities would be captured in existing statutory accounting principles. She stated that the proposed guidance was to clarify how segregated accounts should be reported until the Restructuring Mechanisms (E) Subgroup comes to a final conclusion regarding the use of segregated account structures. She stated that NAIC staff support referring the proposal to the Restructuring Mechanisms (E) Subgroup.

Mr. Stolte stated that statutory accounting, through Note 1, already provides guidance on reporting if practices deviate from current codified statutory accounting principles. He stated that if companies were using an existing SSAP for reporting such a
structure, the domiciliary states should require a Note 1 disclosure for oversight and risk-based capital (RBC) purposes. In response to an inquiry from Mr. Bruggeman, Mr. Stolte confirmed he was referring to the prescribed practice disclosure that should be completed when state laws permit segregated accounts.

Mr. Hudson stated that California was supportive of Mr. Stolte and Mr. Smith’s comments. He stated that while a segregated account’s assets and liabilities should be reported, the process of reviewing a segregated account should begin with a different group and agreed with a referral to the Restructuring Mechanisms (E) Subgroup. Ms. Malm stated that she agreed with Mr. Hudson’s comments and suggested that an annual statement blank instruction should be developed detailing how segregated accounts should be reported. Mr. Hudson agreed with Ms. Malm.

Mr. Bruggeman stated that he understands the comments and clarified that if a state law permits a segregated account to be formed, the reporting entity should be detailing the provision in Note 1 as a prescribed practice.

Ms. Gann stated that the annual statement blanks currently indicate a reporting line for “segregated accounts, protected cells, and separate accounts.” However, she said only protected cells and separate accounts are addressed by statutory accounting. She stated that NAIC staff agree with the comments made, but an SSAP update is warranted to clarify reporting for items that are not captured in SSAP No. 56 or SSAP No. 74. She stated that reporting “segregated accounts” on the noted reporting line results with distinct RBC effects that do not reflect the same RBC impact that would have occurred if the items were reported in the general account.

Mr. Smith inquired if an SSAP interpretation would be an appropriate method in lieu of the issuance of a new SSAP. Mr. Bruggeman stated that an interpretation may be an appropriate method, but it may not be substantial enough due to the nature of these structures and as interpretations are generally used to clarify an existing SSAP. Mr. Bruggeman said that due to the circumstances, specific guidance on how to report segregated accounts is warranted.

Ms. Gann stated that due to the comments noting concerns on the aggregated or disaggregated reporting options, the proposed SSAP could be modified to remove these options and clarify that segregated accounts are not captured within SSAP No. 56 or SSAP No. 74 and require disclosure of segregated accounts. Mr. Hudson stated support for this suggested edit.

Mr. Broccoli stated that while the legal status of segregated accounts remains in question, the proposed draft SSAP provides an appropriate reporting mechanism. He stated that the general account does not have legal access to the assets in the segregated account. As such, it is important for state insurance regulators to review the financial condition of the segregated account independent of the general account because if combined, a strong general account could mask an insolvent segregated account. Mr. Broccoli stated that the draft SSAP provides a transparent method of assessing the segregated account as its policyholders do not have access to general account assets in the event a segregated account becomes insolvent.

Mr. Bruggeman stated that a Note 1 option could be employed to capture all items not specifically identified in statutory accounting, detailing the segregated account effect on the reporting entity’s surplus and income. However, as assets from the general account and segregated account are not transferable between the two entities, increased reporting and disclosure could be beneficial for assessing the segregated account. Mr. Stolte stated Virginia has seen the surplus of segregated accounts being combined into the general account, even though the segregated account surplus is not free and unencumbered for use by the general account. He said that Note 1, if properly used, could properly report a segregated account.

In response to an inquiry from Mr. Bruggeman on next steps, Mr. Hudson and Ms. Malm stated they support the discussed editorial updates to the proposed SSAP for subsequent review by the Working Group. Mr. Bruggeman inquired if there were any objections to this approach. No objections were noted.

2. Discussed Other Matters

Ms. Gann stated that a data call template regarding surplus notes has been provided to members of the Working Group and that feedback should be provided by Sept. 13.

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.
Issue: SIRI – Equity Interests

Check (applicable entity):

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

Description of Issue:
This agenda item has been drafted pursuant to direction received during the 2019 Spring National Meeting to clarify what shall be captured in Line 13: 10 Largest Equity Interests of the Supplemental Investment Risks Interrogatories (SIRI). The intent of the SIRI is to assist regulators in reviewing compliance with state investment limitations and analyzing the risks inherent in an entity’s investment portfolio. However, from questions received on certain categories, it has been identified that clarity is needed to ensure consistent reporting and that the desired aggregation of risks is reported.

This agenda item is being considered subsequent to revisions incorporated to SIRI Line 2: 10 Largest Exposures to a Single Issuer / Borrower / Investment and the proposal of a new reporting category for “fund managers.” These clarification items were exposed by the Blanks (E) Working Group during the 2019 Spring National Meeting and adopted for 2019 year-end reporting during the Blanks (E) Working Group June 24 conference call.

Pursuant to the revisions previously recommended, it is suggested that the following concepts be followed in aggregating investments for SIRI:

- Investments held in diversified funds do not need to be separately aggregated with other investments due to the fund diversification. For this exclusion, only funds in which the issuer can assert that the fund is diversified in accordance with the 1940 Investment Act are excluded from aggregation.

- Investments held in non-diversified funds shall be aggregated with other exposures for reporting in SIRI. This aggregation shall be based on the underlying investments in funds (or other commingled investment structures). For example, if a non-diversified was issued by BlackRock, the investment exposure is not to BlackRock, but the investments captured within the non-diversified fund. To further expand, if the non-diversified fund held investments from Exxon Mobile, then those investments shall be aggregated with other investments held from Exxon Mobile (held directly or in a non-diversified fund) to determine the overall aggregate exposure to Exxon Mobile. (This requires a look-through into non-diversified funds.)

During the 2019 Spring National Meeting, two options were presented to clarify the aggregation of equity interests in Line 13. Pursuant to informal comments received, as well as the concepts noted above, this agenda item proposes revisions in accordance with the proposed “Option 2”. This approach excludes diversified funds from the look-through / aggregation requirement and clarifies that a look-through is required to non-diversified equity funds for aggregation and reporting. It also clarifies that any equity interest (regardless of diversification) that individually qualifies as one of the largest equity interests shall be captured in SIRI Line 13.

Existing Authoritative Literature:

*Supplemental Investment Risk Interrogatories (SIRI)*
This set of Supplemental Interrogatories is to assist regulators in identifying and analyzing the risks inherent in the entity’s investment portfolio. The Supplemental Investment Risks Interrogatories apply only to general account assets. These lines were determined based upon the investment categories contained in the NAIC Statutory Statement and considered as invested assets. The reported amounts are to be consistent with net admitted amounts reported by the entity in the statement and supporting schedules, not on a consolidated basis. Compute the percentage calculations by dividing the reported amount by the total admitted assets reported in Line 1 of the Interrogatories unless otherwise indicated. It is recommended that the first step in responding to this set of Interrogatories is for the person preparing this document to read through the Interrogatories to gain an understanding of the reporting requirements.

Line 13.02 through 13.11  Report the amounts and percentages of admitted assets held in the ten largest equity interests (including investments in the shares of mutual funds, preferred stocks, publicly traded equity securities, and other equity securities (including Schedule BA equity interests), and excluding money market and bond mutual funds listed in Part Six, Sections 2(f) and (g) of the Purposes and Procedures Manual of the NAIC Investment Analysis Office as exempt or NAIC 1).

Determine the ten largest equity interests by first aggregating investments included in this line by issuer. For example, the reporting entity owns preferred stock of the XYZ Company of $600,000 and common stock of the XYZ Company of $300,000. The total is $900,000 ($600,000+$300,000). The reporting entity also owns bonds issued by the XYZ Company of $500,000 that are excluded from this calculation because bonds are debt instruments. Other equity securities include partnerships and Limited Liability Companies (LLC) and any other investments reported in Schedule BA classified as equity.

SIRI – As Modified Following the Blanks (E) Working Group June 2019 Conference Call – 2019-13BWG:

Line 2  Report the single 10 largest exposures to a single issuer/borrower/investment.

Determine the ten largest exposures by first, aggregating investments from all investment categories (except the excluded categories) by issuer. The first six digits of the CUSIP number can be used as a starting point; however, please note that the same issuer may have more than one unique series of the first six digits of the CUSIP. For example, the reporting entity owns bonds issued by the XYZ Company of $500,000 and common stock of the XYZ Company of $600,000. In addition, the reporting entity has a mortgage loan to the XYZ Company of $300,000. The total exposure to Issuer XYZ Company is $1.4 million ($500,000+$600,000+$300,000).

For funds that are not diversified within the meaning of the Investment Company Act of 1940, insurance reporting entities are required to identify actual exposures and aggregate those exposures with directly held investments to determine the 10 largest exposures. For example, if a reporting entity directly holds a significant number of investments in Exxon Mobil and holds a non-diversified closed-end fund with a high concentration of Exxon Mobil, the reporting entity shall aggregate the direct investments with the investments in the closed-end funds to determine the aggregate investment risk to Exxon Mobile.

Excluding: U.S. government securities (Part Six, Section 2(e)), U. S. government agency securities (Part Six, Section 2(e)),

those U. S. Government money market funds (Part Six, Section 2(f)) listed in the Purposes and Procedures Manual of the NAIC Investment Analysis Office as exempt;
property-occupied by the company; and

policy-loans.

Also exclude asset types that are investment companies (mutual funds) and common trust funds that are diversified within the meaning of the Investment Company Act of 1940 [Section 5(b) (1)].

All SEC and foreign registered funds (open-end, closed-end, UIT and ETFs) and common trust funds that are diversified within the meaning of the Investment Company Act of 1940 [Section 5(b) (1)].

**Line 14.06 through 14.15** Report the investments held in the ten largest fund managers, with allocation between funds that are diversified or non-diversified in accordance with the meaning of the Investment Company Act of 1940. This should include all “funds” regardless of the type of fund (private placement, mutual fund, exchange-traded fund, closed-end fund, money market mutual fund, etc.), reporting schedule or underlying investments captured in a fund.

Determine the ten largest fund managers by aggregating all “fund” investments by fund manager. For example, if a reporting entity holds a BlackRock SVO-Identified Bond ETF (diversified within the meaning of the Investment Company Act of 1940) reported on Schedule D-1 at $500,000, four BlackRock diversified mutual funds reported on Schedule D-2-2 at $2,200,000 and two BlackRock non-diversified closed-end funds totaling $1,500,000, the reporting entity shall report their aggregated investment in BlackRock funds of $4,200,000, with $2,700,000 in diversified funds and $1,500,000 in non-diversified funds.

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

During the 2019 Spring National Meeting, the Statutory Accounting Principles (E) Working Group sponsored a blanks proposal (2019-13BWG) to clarify the instructions for Line 2: 10 Largest Exposures and to incorporate a new category for fund managers (Line 14). These revisions were adopted during the Blanks (E) Working Group June 24, 2019 conference call. (The revisions are detailed above.) Also, during the 2019 Spring National Meeting, the Working Group received two options to consider revisions to Line 13: 10 Largest Equity Interests. These proposed revisions would clarify that reporting entities should always look-through funds for aggregation (option one) or add provisions that would remove diversified funds from the look-through requirement (option two):

- **Option One**: Further expansion of the instruction to identify that reporting entities shall look-through all funds (except for the money market mutual funds and SVO-Identified bond funds) to aggregate equity interests, with explicit identification of any equity fund that qualifies as one of the 10 largest interests. (This option would not be a change in guidance but would explicitly clarify the existing requirement.)

Report the amounts and percentages of admitted assets held in the ten largest equity interests (including equity funds that qualify individually as one of the largest equity interests, and a look-through of investments in the shares of mutual funds, preferred stocks, publicly traded equity securities, and other security securities (including Schedule BA equity interests), and excluding money market and bond mutual funds listed in Part Six, Section 2(f) and (g) of the Purposes and Procedures Manual of the NAIC Investment Analysis Office as exempt or NAIC 1.

Determine the ten largest equity interested by first aggregating investments included in this line by issuer. For example, the reporting entity owns preferred stock of the XYZ Company of
$600,000 and common stock of XYZ Company of $300,000 and $100,000 of XYZ identified through a look-through of a diversified stock mutual fund reported on Schedule D-2-2. The total is $91,000,000 (600,000+300,000+100,000). The reporting entity also owns bonds issued by XYZ Company of $500,000 that are excluded from this calculation because bonds are debt instruments. Other equity securities include partnerships and Limited Liability Companies (LLC) and any other investments reported in Schedule BA as equity.

- **Option Two:** Incorporate revisions to exclude aggregation of equity interests in diversified funds. With this approach, an entity would only need to look-through funds that are not diversified in accordance with the Investment Company Act of 1940 to aggregate their ten largest equity interests. (This change would still require explicit identification of any equity funds that qualifies as one of the 10 largest interests.)

Report the amounts and percentages of admitted assets held in the ten largest equity interests (including equity funds that qualify individually as one of the largest equity interests, and a look-through of investments in the shares of non-diversified mutual funds and ETFs, preferred stocks, publicly traded equity securities, and other security securities (including Schedule BA equity interests), and excluding money market and bond mutual funds listed in Part Six, Section 2(f) and (g) of the Purposes and Procedures Manual of the NAIC Investment Analysis Office as exempt or NAIC 1. Equity interests in all funds that are diversified in accordance with the Investment Company Act of 1940 do not need to be individually assessed and aggregated to determine the ten largest equity interests. For funds that are not diversified within the meaning of the Investment Company Act of 1940, insurance reporting entities are required to identify actual equity interests within the fund and aggregate those equity interests to determine their ten largest equity interests.

Determine the ten largest equity interests by first aggregating investments included in this line by issuer. For example, the reporting entity owns preferred stock of the XYZ Company of $600,000 and common stock of XYZ Company of $300,000 and $50,000 of XYZ identified through a look-through of a non-diversified stock closed-end fund reported on Schedule D-2-2. The total is $965,000 (600,000+300,000+50,000). The reporting entity also owns bonds issued by XYZ Company of $500,000 that are excluded from this calculation because bonds are debt instruments. The reporting entity may also have exposure to equity interests in XYZ through mutual funds that are excluded from this calculation as the funds are diversified within the meaning of the Investment Company Act of 1940. Other equity securities include partnerships and Limited Liability Companies (LLC) and any other investments reported in Schedule BA as equity.

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

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

**Staff Recommendation:** NAIC staff recommends that the Working Group expose this agenda item with the intent to sponsor a blanks proposal to clarify what should be captured in SIRI Line 13: 10 Largest Equity Interests. These proposed blanks revisions clarify that a look-through should only occur for non-diversified funds, and that investments within a diversified fund investment shall be excluded from an aggregation requirement to other equity investments. It also clarifies that any equity interest (regardless of diversification) that individually qualifies as one of the largest equity interests shall be captured in SIRI Line 13. This is consistent with the Option 2 approach presented at the 2019 Spring National Meeting. Additionally, the revisions expand the guidance to include SVO-Identified Bond ETFs, and SVO-Identified investments with characteristics of fixed-income investments as specific exclusions from the listing. (The exclusions for money market mutual funds and SVO bond mutual funds are currently in the guidance.) Comments from regulators are specifically requested on these exclusions.
Proposed Revisions to the annual statement instructions for SIRI Line 13: Ten Largest Equity Interests:

Report the amounts and percentages of admitted assets held in the ten largest equity interests (including equity funds that quality individually as one of the largest equity interests, and a look-through of investments in the shares of non-diversified mutual funds and ETFs, preferred stocks, publicly traded equity securities, and other security securities (including Schedule BA equity interests), and excluding money market and bond mutual funds listed in Part Six, Section 2(f) and (g) of the Purposes and Procedures Manual of the NAIC Investment Analysis Office as exempt or NAIC-1. Equity interests in all funds that are diversified in accordance with the Investment Company Act of 1940 do not need to be individually assessed and aggregated to determine the ten largest equity interests. For funds that are not diversified within the meaning of the Investment Company Act of 1940, insurance reporting entities are required to identify actual equity interests within the fund and aggregate those equity interests to determine their ten largest equity interests.

Determine the ten largest equity interested by first aggregating investments included in this line by issuer. For example, the reporting entity owns preferred stock of the XYZ Company of $600,000, and common stock of XYZ Company of $300,000 and $50,000 of XYZ identified through a look-through of a non-diversified stock closed-end fund reported on Schedule D-2-2. The total is $950,000 (600,000+300,000+50,000). The reporting entity also owns bonds issued by XYZ Company of $500,000 that are excluded from this calculation because bonds are debt instruments. The reporting entity may also have exposure to equity interests in XYZ through mutual funds that are excluded from this calculation as the funds are diversified within the meaning of the Investment Company Act of 1940. Other equity securities include partnerships and Limited Liability Companies (LLC) and any other investments reported in Schedule BA as equity.

The following funds shall also be excluded from aggregation as equity interests: SVO-Identified U.S. Direct Obligations / Full Faith And Credit Exempt List of Money Market Mutual Funds, SVO-Identified Bond ETFs, SVO-Identified Bond Mutual Funds and SVO Identified fund investments with underlying characteristics of fixed-income investments, which do not contain underlying equities and that are outlined within the Purposes and Procedures Manual of the NAIC Investment Analysis Office.

Staff Review Completed by: Julie Gann – May 2019

Status:
On August 3, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions that clarify what should be captured in SIRI Line 13: 10 Largest Equity Interests, noting that a look-through should only occur for non-diversified funds. The revisions also exclude Securities Valuation Office (SVO)-Identified Bond Exchange-Traded Funds (ETFs) and SVO-Identified investments with underlying characteristics of fixed-income investments from this equity interrogatory. With exposure, a referral was directed to the Capital Adequacy (E) Task Force with a request for clarification on the impact, if any, these changes may have to risk-based capital.
This page intentionally left blank.
Issue: Wash Sale Disclosure

Check (applicable entity):

- Modification of existing SSAP: P/C [x] Life [x] Health [x]
- New Issue or SSAP: P/C [ ] Life [ ] Health [ ]
- Interpretation: P/C [ ] Life [ ] Health [ ]

Description of Issue: This agenda item has been drafted to consider revisions to the wash sale disclosure captured in SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. The wash sale guidance was revised in 2017 to 1) clarify what types of investment are subject to the wash sale disclosure, 2) respond to several comments from interested parties, and 3) clarify what investments are subject to and what investments were exempt from this disclosure.

NAIC staff have been informed by industry that the tracking of wash sales can be very time-consuming and uses a large amount of resources while not necessarily responding to the main risks associated with these transactions. Investments sold and repurchased during the same reporting period, such as sold on May 1 and repurchased on May 20 and then held at the reporting date do not pose any greater risk than if the investments had been held throughout that period and at the period end date. The real risk with these transactions is investments that are sold prior to the end of a reporting period and then repurchased shortly after that date.

Existing Authoritative Literature:

- SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities provides the definition of a wash sale and the disclosure requirements.

- U.S. GAAP provides limited guidance on wash sales, mostly to identify that wash sales are captured as “sales” unless there is a concurrent contract to repurchase or redeem the transferred financial asset. (There is no definition or required disclosure for wash sales under U.S. GAAP.)

- The SEC defines a wash sale as follows:
  A wash sale occurs when you sell or trade securities at a loss and within 30 days before or after the sale you:
  
  - Buy substantially identical securities,
  - Acquire substantially identical securities in a fully taxable trade, or
  - Acquire a contract or option to buy substantially identical securities.
  
  Internal Revenue Service rules prohibit you from deducting losses related to wash sales. For more information about wash sales, read IRS Publication 550, Investment Income and Expenses (Including Capital Gains and Losses).

- The IRS has a similar definition to the SEC and disallows the recognition of losses for wash sales:
  A wash sale occurs when you sell or trade stock or securities at a loss and within 30 days before or after the sale you:
  
  - Buy substantially identical stock or securities,
  - Acquire substantially identical stock or securities in a fully taxable trade,
Acquire a contract or option to buy substantially identical stock or securities, or
Acquire substantially identical stock for your individual retirement account (IRA) or Roth IRA.
If you sell stock and your spouse or a corporation you control buys substantially identical stock, you also have a wash sale.

If your loss was disallowed because of the wash sale rules, add the disallowed loss to the cost of the new stock or securities (except in (4) above). The result is your basis in the new stock or securities. This adjustment postpones the loss deduction until the disposition of the new stock or securities. Your holding period for the new stock or securities includes the holding period of the stock or securities sold.

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 2017-23 included clarification that money market mutual funds are excluded from the wash sale disclosure. Further, agenda item 2017-31 clarified that all cash equivalents, derivative instruments and short-term investments with credit assessments equivalent to an NAIC 1-2 designation are excluded from the disclosure.

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:
It is recommended that the Working Group move this agenda item to the active listing, categorized as nonsubstantive, and expose draft revisions to clarify that only investments that meet the definition of a wash sale in accordance with SSAP No. 103R, which are purchased or sold prior to a reporting period end and sold or repurchased after that reporting date would be subject to the wash sale disclosure. This will eliminate the need to report transactions that meet the wash sale criteria in SSAP No. 103R that are sold and purchased within the same reporting period. Wash sales that cross either a quarterly or annual reporting period must be disclosed.

Proposed Revisions to SSAP No. 103R:

28.I. A reporting entity shall disclose the following information for wash sales, as defined in paragraph 12, involving transactions for securities with an NAIC designation of 3 or below, or that do not have an NAIC designation (excluding all cash equivalents, derivative instruments as well as short-term investments with credit assessments equivalent to an NAIC 1-2 designation). This disclosure shall be included in the financial statements for when the investment was initially sold and is only applicable for sales and purchases that cross quarter-end or year-end reporting periods. For example, if the investment was sold December 20, 2017, and reacquired on January 10, 2018, the transaction shall be captured in the wash sale disclosure included in the year-end 2017 financial statements, while an investment sold on May 1, 2019 and reacquired on May 20, 2019 would not be required to be disclosed:

i. A description of the reporting entity’s objectives regarding these transactions;
ii. An aggregation of transactions by NAIC designation 3 or below, or that do not have an NAIC designation;
iii. The number of transactions involved during the reporting period;
iv. The book value of securities sold;
v. The cost of securities repurchased; and  
vi. The realized gains/losses associated with the securities involved.

**Staff Review Completed by:** 
Jake Stultz—June 2019

**Status:**
On August 3, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, as illustrated above, to clarify that only investments that meet the definition of a wash sale in accordance with SSAP No. 103R that cross reporting period-end dates would be subject to the wash sale disclosure.
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Going Concern

Check (applicable entity):

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

Description of Issue:
This agenda item has been drafted due to the prevalence of SCAs being identified as a “going concern” in 2018 audit reports for SCA Sub 2 filings. The going concern principle is the assumption that a company will continue into the foreseeable future, unless there is evidence to the contrary. During a financial statement audit, the auditor has an obligation to review the company’s ability to continue as a going concern. If there is substantial doubt about the company’s ability to continue in the future, a going concern qualification is supposed to be included in the auditor’s opinion of the company’s financial statements. Indicators of going concern can include the following:

- Negative trends such as declining sales, increasing costs, recurring losses, adverse financial ratios, etc.
- Legal proceedings against the company, which may include pending liabilities and penalties related to the violation of environmental or other laws
- Loss or expiration of a key license or patent
- Default on a loan or inability to secure new financing
- Loss of a major customer or key supplier

Under statutory accounting, the investment in a company with a going concern audit opinion must be nonadmitted in the reporting insurance entity’s financial statements. However, statutory accounting procedures do not specify any action to be taken in the event that a going concern is noted in any other part of the audit report aside from the audit opinion. Over the last year there have been a few instances in which the audit opinions did not explicitly detail the going concern, but the notes in the audited financial statements identified that there was a going concern. (In one situation, the audit opinion originally reflected a going concern, but the audit opinion was refiled with the NAIC to eliminate the reference from the audit opinion. In this resubmission, the going concern for the company was still detailed in the audited financial statements.)

One of the key foundation concepts of statutory accounting is conservatism. Conservative valuation procedures provide protection to policyholders against adverse fluctuations in financial condition or operating results. Statutory accounting should be reasonably conservative over the span of economic cycles and in recognition of the primary responsibility to regulate for financial solvency. As such, if an unalleviated going concern is mentioned in any part of the audit report or accompanying financial statements / notes, the value of the SCA should be nonadmitted.

Existing Authoritative Literature:

SSAP No. 97:

Paragraph 8  
  c. The following provides guidance regarding the audits for entities covered under paragraph 8.b.:
  
  i. The investment in the SCA shall be nonadmitted if the audited financial statements include substantial doubt about the entity’s ability to continue as a going concern. Additionally, the
Paragraph 21

e. The investment shall be nonadmitted if the audit opinion contains explanatory language indicating that there is substantial doubt about the investee’s ability to continue as a going concern.

Exhibit C – Implementation Questions and Answers

5. Q - Does the audit opinion provided on the subsidiaries financial statements have to be clean or unqualified in order for the SCA investment to be admitted?

5.1 A – Paragraph 21 addresses various opinions that can be issued in which an entity can record certain investments under the GAAP Equity method of accounting. In certain cases, such as when the audit opinion is a disclaimer of opinion or there is indication that there is substantial doubt about the entity’s ability to continue as a going concern, the guidance states the investment shall be nonadmitted. In addition, if there is a qualified opinion due to a departure from GAAP (or an adverse opinion) or due to a scope limitation, the investment shall be nonadmitted unless the impact of the departure is quantified within the audit opinion (see quantification exception related to the valuation of a U.S. insurance entity on the basis of U.S. statutory accounting principles discussed below). In cases where the departure is quantified, the reporting entity would admit the amount after adjusting for the quantified departure from GAAP. An audit report that contains a qualified or adverse opinion for any other reason than for what is stated within paragraph 21 would result in the nonadmissibility of the investment within that subsidiary. There is no need to quantify the impact of a departure from GAAP in either the auditor’s report or the footnotes to the financial statements if a qualified audit opinion is issued due to a departure from GAAP and the departure is related to the valuation of an U.S. insurance entity on the basis of U.S. statutory accounting principles. In such cases, the investment shall be admitted without quantifying the departure.

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

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

Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation:
Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, as detailed below, to expand the parameters for nonadmittance of entities with going concern.

Proposed Revisions:

SSAP No. 97:

Paragraph 8

c. The following provides guidance regarding the audits for entities covered under paragraph 8.b.:

i. The investment in the SCA shall be nonadmitted if the audited financial statements include substantial doubt about the entity’s ability to continue as a going concern. Additionally, the investment shall be nonadmitted on the basis/contents of the audit opinion as detailed in paragraph 21.
Paragraph 21

e. The investment shall be nonadmitted if the audit opinion report or accompanying financial statements / notes contains explanatory language indicating that there is an unalleviated substantial doubt about the investee’s ability to continue as a going concern.

5. Q - Does the audit opinion provided on the subsidiaries financial statements have to be clean or unqualified in order for the SCA investment to be admitted?

5.1 A – Paragraph 21 addresses various opinions that can be issued in which an entity can record certain investments under the GAAP Equity method of accounting. In certain cases, such as when the audit opinion is a disclaimer of opinion or there is indication that there is substantial doubt about the entity’s ability to continue as a going concern, the guidance states the investment shall be nonadmitted. In instances where there is a substantial doubt about the entity’s ability to continue as a going concern listed in any part of the audit report or accompanying financial statements / notes, the investment shall be nonadmitted. In addition, if there is a qualified opinion due to a departure from GAAP (or an adverse opinion) or due to a scope limitation, the investment shall be nonadmitted unless the impact of the departure is quantified within the audit opinion (see quantification exception related to the valuation of a U.S. insurance entity on the basis of U.S. statutory accounting principles discussed below). In cases where the departure is quantified, the reporting entity would admit the amount after adjusting for the quantified departure from GAAP. An audit report that contains a qualified or adverse opinion for any other reason than for what is stated within paragraph 21 would result in the nonadmissibility of the investment within that subsidiary. There is no need to quantify the impact of a departure from GAAP in either the auditor’s report or the footnotes to the financial statements if a qualified audit opinion is issued due to a departure from GAAP and the departure is related to the valuation of an U.S. insurance entity on the basis of U.S. statutory accounting principles. In such cases, the investment shall be admitted without quantifying the departure.

Staff Review Completed by:
Fatima Sediqzad - NAIC Staff
July 2019

Status:
On August 3, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, as illustrated above, to clarify that if an unalleviated going concern is noted in audited financial statements or audit opinion, the SCA shall be nonadmitted.
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Appendix A-785 Revisions from U.S./EU and U.S./UK Covered Agreements

Check (applicable entity):

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

Description of Issue:
On June 25, 2019, NAIC Executive Committee and Plenary adopted revisions to the *Credit for Reinsurance Model Law* (#785) and the *Credit for Reinsurance Model Regulation* (#786) to incorporate relevant provisions from the “Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance” and the “Bilateral Agreement Between the United States of America and the United Kingdom Regarding Insurance and Reinsurance” (collectively referred to as the Covered Agreement). The purpose of this agenda item is to incorporate those revisions into Appendix A-785, *Credit for Reinsurance*.

Existing Authoritative Literature:
The *Credit for Reinsurance Model Law* (#785) and the *Credit for Reinsurance Model Regulation* (#786), as they are adopted by the states are the primary legal guidance for credit for reinsurance, and relevant excerpts from Model #785 and Model #786 are included in Appendix A-785.

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

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

Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to Appendix A-785 to incorporate the updates from the adopted *Credit for Reinsurance Model Law* (#785) and the *Credit for Reinsurance Model Regulation* (#786) that incorporate the relevant provisions from the Covered Agreement. The proposed revisions to the full Appendix A-785 are included in the subsequent pages. With this exposure, NAIC staff request input from regulators and interested parties on how best to establish effective dates for these revisions in Appendix A-785.

Staff Review Completed by: Jake Stultz—July 2019

Status:
On August 3, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to Appendix A-785, *Credit for Reinsurance*, as illustrated below, related to the “Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance And Reinsurance” (Covered Agreement) adopted to the *Credit for Reinsurance Model Law* (#785) and the *Credit for Reinsurance Model Regulation* (#786).
Appendix A-785

Credit For Reinsurance

Relevant SSAPs:
- SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance
- SSAP No. 62R—Property and Casualty Reinsurance
- SSAP No. 66—Retrospectively Rated Contracts

Definitions

Note: There are references to where the changes came from in the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) in the paragraphs below. These are only to assist in reviewing and will be removed from the final version of Appendix A-785 when it is adopted.

1. “Commissioner” refers to the commissioner of insurance in the state where credit or a reduction from liability is taken.

2. “Jurisdiction” refers to any state, district or territory of the United States and also to territories, provinces or jurisdictions other than the United States.

3. “Liabilities” shall mean the assuming insurer’s gross liabilities attributable to reinsurance ceded by U. S. domiciled insurers that are not otherwise secured by acceptable means.

4. “Beneficiary” means the entity for whose sole benefit the trust has been established and any successor of the beneficiary by operation of law. If a court of law appoints a successor in interest to the named beneficiary, then the named beneficiary includes and is limited to the court appointed domiciliary receiver (including conservator, rehabilitator or liquidator).

5. “Grantor” means the entity that has established a trust for the sole benefit of the beneficiary. When established in conjunction with a reinsurance agreement, the grantor is the unlicensed, unaccredited assuming insurer.

6. “Obligations,” as used in paragraph 3029 of this appendix means:
   a. Reinsured losses and allocated loss expenses paid by the ceding company, but not recovered from the assuming insurer;
   b. Reserves for reinsured losses reported and outstanding;
   c. Reserves for reinsured losses incurred but not reported; and
   d. Reserves for allocated reinsured loss expenses and unearned premiums.

Credit Allowed a Domestic Ceding Insurer

7. Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of paragraphs 8, 9, 10, 11, 12, or 13 or 14 of this appendix. Credit shall be allowed under paragraphs 8, 9, or 10 of this appendix only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise allowed to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under paragraphs 10 or 11 of this appendix only if the applicable requirements of paragraph 1544 have been satisfied.
8. Credit shall be allowed when the reinsurance is ceded to an assuming insurer that is licensed to transact insurance or reinsurance in the domiciliary state of the ceding insurer.

9. Credit shall be allowed when the reinsurance is ceded to an assuming insurer that is accredited as a reinsurer by the domiciliary state of the ceding insurer. In order to be eligible for accreditation, a reinsurer must:
   a. File with the commissioner evidence of its submission to the domiciliary state’s jurisdiction;
   b. Submit to the domiciliary state’s authority to examine its books and records;
   c. Be licensed to transact insurance or reinsurance in at least one state, or in the case of a U.S. branch of an alien assuming insurer, is entered through and licensed to transact insurance or reinsurance in at least one state;
   d. File annually with the commissioner a copy of its annual statement filed with the insurance department of its state of domicile and a copy of its most recent audited financial statement; and
   e. Demonstrate to the satisfaction of the commissioner that it has adequate financial capacity to meet its reinsurance obligations and is otherwise qualified to assume reinsurance from domestic insurers. An assuming insurer is deemed to meet this requirement as of the time of its application if it maintains a surplus as regards policyholders in an amount not less than $20,000,000 and its accreditation has not been denied by the commissioner within ninety (90) days after submission of its application.

10. a. Credit shall be allowed when the reinsurance is ceded to an assuming insurer that is domiciled in, or in the case of a U.S. branch of an alien assuming insurer is entered through, a state that employs standards regarding credit for reinsurance substantially similar to those of the domiciliary state of the ceding insurer and the assuming insurer or U.S. branch of an alien assuming insurer:
   i. Maintains a surplus as regards policyholders in an amount not less than $20,000,000; and
   ii. Submits to the authority of the domiciliary state to examine its books and records.
   b. The requirement of paragraph 10.a.i. does not apply to reinsurance ceded and assumed pursuant to pooling arrangements among insurers in the same holding company system.

11. a. Credit shall be allowed when the reinsurance is ceded to an assuming insurer that maintains a trust fund in a qualified U.S. financial institution, as defined in paragraph 5453, for the payment of the valid claims of its U.S. ceding insurers, their assigns and successors in interest. The assuming insurer shall report annually information substantially the same as that required to be reported on the NAIC Annual Statement form by licensed insurers. The assuming insurer shall submit to examination of its books and records by the commissioner and bear the expense of examination.
   b. i. Credit for reinsurance shall not be granted under this paragraph 11 unless the form of the trust and any amendments to the trust have been approved by:
      (a) The commissioner of the state where the trust is domiciled; or
      (b) The commissioner of another state who, pursuant to the terms of the trust instrument, has accepted principal regulatory oversight of the trust.
   ii. The trust instrument shall provide that:
(a) Contested claims shall be valid and enforceable out of funds in trust to the extent remaining unsatisfied thirty (30) days after entry of the final order of any court of competent jurisdiction in the United States;

(b) Legal title to the assets of the trust shall be vested in the trustee for the benefit of the grantor’s U.S. ceding insurers, their assigns and successors in interest;

(c) The trust shall be subject to examination as determined by the commissioner;

(d) The trust shall remain in effect for as long as the assuming insurer, or any member or former member of a group of insurers, shall have outstanding obligations under reinsurance agreements subject to the trust; and

(e) No later than February 28 of each year the trustee of the trust shall report to the commissioner in writing setting forth the balance in the trust and listing the trust’s investments at the preceding year-end, and shall certify the date of termination of the trust, if so planned, or certify that the trust shall not expire prior to the following December 31.

c. The following requirements apply to the following categories of assuming insurer:

i. The trust fund for a single assuming insurer shall consist of funds in trust in an amount not less than the assuming insurer’s liabilities attributable to reinsurance ceded by U.S. ceding insurers, and, in addition, the assuming insurer shall maintain a trusteed surplus of not less than $20,000,000, except as provided in paragraph 11.c.ii. of this appendix.

ii. At any time after the assuming insurer has permanently discontinued underwriting new business secured by the trust for at least three full years, the commissioner with principal regulatory oversight of the trust may authorize a reduction in the required trusteed surplus, but only after a finding, based on an assessment of the risk, that the new required surplus level is adequate for the protection of U.S. ceding insurers, policyholders and claimants in light of reasonably foreseeable adverse loss development. The risk assessment may involve an actuarial review, including an independent analysis of reserves and cash flows, and shall consider all material risk factors, including when applicable the lines of business involved, the stability of the incurred loss estimates and the effect of the surplus requirements on the assuming insurer’s liquidity or solvency. The minimum required trusteed surplus may not be reduced to an amount less than thirty percent (30%) of the assuming insurer’s liabilities attributable to reinsurance ceded by U.S. ceding insurers covered by the trust.

iii. (a) In the case of a group including incorporated and individual unincorporated underwriters:

(1) For reinsurance ceded under reinsurance agreements with an inception, amendment or renewal date on or after January 1, 1993, the trust shall consist of a trusteed account in an amount not less than the respective underwriters’ several liabilities attributable to business ceded by U.S. domiciled ceding insurers to any underwriter of the group;

(2) For reinsurance ceded under reinsurance agreements with an inception date on or before December 31, 1992, and not amended or renewed after that date, notwithstanding the other provisions contained herein, the trust shall consist of a trusteed account in an amount not less than the
respective underwriters’ several insurance and reinsurance liabilities attributable to business written in the United States; and

(3) In addition to these trusts, the group shall maintain in trust a trusteeed surplus of which $100,000,000 shall be held jointly for the benefit of the U.S. domiciled ceding insurers of any member of the group for all years of account; and

(b) The incorporated members of the group shall not be engaged in any business other than underwriting as a member of the group and shall be subject to the same level of regulation and solvency control by the group’s domiciliary regulator as are the unincorporated members.

(c) Within ninety (90) days after its financial statements are due to be filed with the group’s domiciliary regulator, the group shall provide to the commissioner an annual certification by the group’s domiciliary regulator of the solvency of each underwriter member; or if a certification is unavailable, financial statements, prepared by independent public accountants, of each underwriter member of the group.

iv. In the case of a group of incorporated underwriters under common administration, the group shall:

(a) Have continuously transacted an insurance business outside the United States for at least three (3) years immediately prior to making application for accreditation;

(b) Maintain aggregate policyholders’ surplus of at least $10,000,000,000;

(c) Maintain a trust fund in an amount not less than the group’s several liabilities attributable to business ceded by U.S. domiciled ceding insurers to any member of the group pursuant to reinsurance contracts issued in the name of the group;

(d) In addition, maintain a joint trusteeed surplus of which $100,000,000 shall be held jointly for the benefit of U.S. domiciled ceding insurers of any member of the group as additional security for these liabilities; and

(e) Within ninety (90) days after its financial statements are due to be filed with the group’s domiciliary regulator, make available to the commissioner an annual certification of each underwriter member’s solvency by the member’s domiciliary regulator and financial statements of each underwriter member of the group prepared by its independent public accountant.

d. For the purposes of this paragraph 11., the term “liabilities” shall mean the assuming insurer’s gross liabilities attributable to reinsurance ceded by U.S. domiciled insurers excluding liabilities that are otherwise secured by acceptable means, and shall include:

i. For business ceded by domestic insurers authorized to write accident and health, and property and casualty insurance:

(a) Losses and allocated loss expenses paid by the ceding insurer, recoverable from the assuming insurer;

(b) Reserves for losses reported and outstanding;
(c) Reserves for losses incurred but not reported;
(d) Reserves for allocated loss expenses; and
(e) Unearned premiums.

ii. For business ceded by domestic insurers authorized to write life, health and annuity insurance:

(a) Aggregate reserves for life policies and contracts net of policy loans and net due and deferred premiums;
(b) Aggregate reserves for accident and health policies;
(c) Deposit funds and other liabilities without life or disability contingencies; and
(d) Liabilities for policy and contract claims.

12. Credit shall be allowed when the reinsurance is ceded to an assuming insurer that has been certified as a reinsurer in the domestic state of the ceding insurer and secures its obligations in accordance with the requirements of this paragraph 12.

a. In order to be eligible for certification, the assuming insurer shall meet the following requirements:

i. The assuming insurer must be domiciled and licensed to transact insurance or reinsurance in a qualified jurisdiction, as determined by the domestic state of the ceding insurer pursuant to paragraphs 12.c. and 12.k. of this subsection;

ii. The assuming insurer must maintain minimum capital and surplus, or its equivalent, in an amount as provided in paragraph 12.i.iii.(b) of this appendix;

iii. The assuming insurer must maintain financial strength ratings from two or more rating agencies deemed acceptable by the domestic state of the ceding insurer, as provided in paragraph 12.i.iii.(c) of this appendix;

iv. The assuming insurer must agree to submit to the jurisdiction of the domestic state of the ceding insurer, appoint the commissioner of the domestic state of the ceding insurer as its agent for service of process in that state, and agree to provide security for 100 percent of the assuming insurer’s liabilities attributable to reinsurance ceded by U.S. ceding insurers if it resists enforcement of a final U.S. judgment;

v. The assuming insurer must agree to meet applicable information filing requirements as determined by the domestic state of the ceding insurer, both with respect to an initial application for certification and on an ongoing basis; and

vi. The assuming insurer must satisfy any other requirements for certification deemed relevant by the domestic state of the ceding insurer.

b. An association including incorporated and individual unincorporated underwriters may be a certified reinsurer. In order to be eligible for certification, in addition to satisfying requirements of paragraph 12.a. of this appendix:
i. The association shall satisfy its minimum capital and surplus requirements through the
capital and surplus equivalents (net of liabilities) of the association and its members,
which shall include a joint central fund that may be applied to any unsatisfied obligation
of the association or any of its members, in an amount determined by the domestic state
of the ceding insurer to provide adequate protection;

ii. The incorporated members of the association shall not be engaged in any business other
than underwriting as a member of the association and shall be subject to the same level of
regulation and solvency control by the association’s domiciliary regulator as are the
unincorporated members; and

iii. Within ninety (90) days after its financial statements are due to be filed with the
association’s domiciliary regulator, the association shall provide to the domestic state
of the ceding insurer an annual certification by the association’s domiciliary regulator of the
solvency of each underwriter member; or if a certification is unavailable, financial
statements, prepared by independent public accountants, of each underwriter member of
the association.

c. The domestic state of the ceding insurer shall create and publish a list of qualified jurisdictions,
under which an assuming insurer licensed and domiciled in such jurisdiction is eligible to be
considered for certification by the domestic state of the ceding insurer as a certified reinsurer.

i. In order to determine whether the domiciliary jurisdiction of a non-U.S. assuming insurer
is eligible to be recognized as a qualified jurisdiction, the domestic state of the ceding
insurer shall evaluate the appropriateness and effectiveness of the reinsurance supervisory
system of the jurisdiction, both initially and on an ongoing basis, and consider the rights,
benefits and the extent of reciprocal recognition afforded by the non-U.S. jurisdiction to
reinsurers licensed and domiciled in the U.S. A qualified jurisdiction must agree to share
information and cooperate with the domestic state of the ceding insurer with respect to all
certified reinsurers domiciled within that jurisdiction. A jurisdiction may not be
recognized as a qualified jurisdiction if the domestic state of the ceding insurer has
determined that the jurisdiction does not adequately and promptly enforce final U.S.
judgments and arbitration awards. Additional factors may be considered in the discretion
of the domestic state of the ceding insurer.

ii. A list of qualified jurisdictions shall be published through the NAIC Committee Process.
The domestic state of the ceding insurer shall consider this list in determining qualified
jurisdictions. If the domestic state of the ceding insurer approves a jurisdiction as
qualified that does not appear on the list of qualified jurisdictions, the state shall provide
thoroughly documented justification in accordance with criteria to be developed under
regulations.

iii. U.S. jurisdictions that meet the requirement for accreditation under the NAIC financial
standards and accreditation program shall be recognized as qualified jurisdictions.

iv. If a certified reinsurer’s domiciliary jurisdiction ceases to be a qualified jurisdiction, the
domestic state of the ceding insurer has the discretion to suspend the reinsurer’s
certification indefinitely, in lieu of revocation.

d. The domestic state of the ceding insurer shall assign a rating to each certified reinsurer, giving
due consideration to the financial strength ratings that have been assigned by rating agencies
deemed acceptable to the commissioner pursuant to regulation. The domestic state of the ceding
insurer shall publish a list of all certified reinsurers and their ratings.
e. A certified reinsurer shall secure obligations assumed from U.S. ceding insurers under this subsection at a level consistent with its rating, as specified in paragraph 12.h.i. of this appendix.

i. In order for a domestic ceding insurer to qualify for full financial statement credit for reinsurance ceded to a certified reinsurer, the certified reinsurer shall maintain security in a form acceptable to the domestic state of the ceding insurer and consistent with the provisions of paragraph 19 of this appendix, or in a multibeneficiary trust in accordance with paragraph 11 of this appendix, except as otherwise provided in paragraph 12.e.ii. through 12.e.v. of this appendix.

ii. If a certified reinsurer maintains a trust to fully secure its obligations subject to paragraph 11 of this appendix, and chooses to secure its obligations incurred as a certified reinsurer in the form of a multibeneficiary trust, the certified reinsurer shall maintain separate trust accounts for its obligations incurred under reinsurance agreements issued or renewed as a certified reinsurer with reduced security as permitted by paragraph 12, or comparable laws of other U.S. jurisdictions, and for its obligations subject to paragraph 11 of this appendix. It shall be a condition to the grant of certification under paragraph 12 of this appendix that the certified reinsurer shall have bound itself, by the language of the trust and agreement with the commissioner with principal regulatory oversight of each such trust account, to fund, upon termination of any such trust account, out of the remaining surplus of such trust any deficiency of any other such trust account.

iii. The minimum trusteed surplus requirements provided in paragraph 11 of this appendix are not applicable with respect to a multibeneficiary trust maintained by a certified reinsurer for the purpose of securing obligations incurred under this subsection, except that such trust shall maintain a minimum trusteed surplus of $10,000,000.

iv. With respect to obligations incurred by a certified reinsurer under paragraph 12 of this appendix, if the security is insufficient, the allowable reinsurance credit shall be reduced by an amount proportionate to the deficiency, and the domestic state of the ceding insurer has the discretion to impose further reductions in allowable credit upon finding that there is a material risk that the certified reinsurer’s obligations will not be paid in full when due.

v. For purposes of paragraph 12, a certified reinsurer whose certification has been terminated for any reason shall be treated as a certified reinsurer required to secure 100 percent of its obligations.

(a) As used in paragraph 12.e.v., the term “terminated” refers to revocation, suspension, voluntary surrender and inactive status.

(b) If the domestic state of the ceding insurer continues to assign a higher rating as permitted by other provisions of paragraph 12, this requirement does not apply to a certified reinsurer in inactive status or to a reinsurer whose certification has been suspended.

f. If an applicant for certification has been certified as a reinsurer in an NAIC accredited jurisdiction, the domestic state of the ceding insurer has the discretion to defer to that jurisdiction’s certification, and has the discretion to defer to the rating assigned by that jurisdiction, and such assuming insurer shall be considered to be a certified reinsurer in the domestic state of the ceding insurer.
g. A certified reinsurer that ceases to assume new business in this state may request to maintain its certification in inactive status in order to continue to qualify for a reduction in security for its in-force business. An inactive certified reinsurer shall continue to comply with all applicable requirements of paragraph 12, and the domestic state of the ceding insurer shall assign a rating that takes into account, if relevant, the reasons why the reinsurer is not assuming new business.

h. The credit allowed under paragraph 12 shall be based upon the security held by or on behalf of the ceding insurer in accordance with a rating assigned to the certified reinsurer by the commissioner. The security shall be in a form consistent with the provisions of paragraph 12 and paragraph 19 of this appendix, and paragraphs 20-51 of this appendix, as applicable. The amount of security required in order for full credit to be allowed shall correspond with the following requirements:

<table>
<thead>
<tr>
<th>Ratings</th>
<th>Security Required</th>
</tr>
</thead>
<tbody>
<tr>
<td>Secure – 1</td>
<td>0%</td>
</tr>
<tr>
<td>Secure – 2</td>
<td>10%</td>
</tr>
<tr>
<td>Secure – 3</td>
<td>20%</td>
</tr>
<tr>
<td>Secure – 4</td>
<td>50%</td>
</tr>
<tr>
<td>Secure – 5</td>
<td>75%</td>
</tr>
<tr>
<td>Vulnerable – 6</td>
<td>100%</td>
</tr>
</tbody>
</table>

i. Affiliated reinsurance transactions shall receive the same opportunity for reduced security requirements as all other reinsurance transactions.

iii. The commissioner shall require the certified reinsurer to post one hundred percent (100%), for the benefit of the ceding insurer or its estate, security upon the entry of an order of rehabilitation, liquidation or conservation against the ceding insurer.

iv. In order to facilitate the prompt payment of claims, a certified reinsurer shall not be required to post security for catastrophe recoverables for a period of one year from the date of the first instance of a liability reserve entry by the ceding company as a result of a loss from a catastrophic occurrence as recognized by the commissioner. The one year deferral period is contingent upon the certified reinsurer continuing to pay claims in a timely manner. Reinsurance recoverables for only the following lines of business as reported on the NAIC annual financial statement related specifically to the catastrophic occurrence will be included in the deferral:

(a) Line 1: Fire
(b) Line 2: Allied Lines
(c) Line 3: Farmowners multiple peril
(d) Line 4: Homeowners multiple peril
(e) Line 5: Commercial multiple peril
(f) Line 9: Inland Marine
(g) Line 12: Earthquake
(h) Line 21: Auto physical damage
v. Credit for reinsurance under paragraph 12 of this appendix shall apply only to reinsurance contracts entered into or renewed on or after the effective date of the certification of the assuming insurer. Any reinsurance contract entered into prior to the effective date of the certification of the assuming insurer that is subsequently amended after the effective date of the certification of the assuming insurer, or a new reinsurance contract, covering any risk for which collateral was provided previously, shall only be subject to this section with respect to losses incurred and reserves reported from and after the effective date of the amendment or new contract.

vi. Nothing in paragraph 12 of this appendix shall prohibit the parties to a reinsurance agreement from agreeing to provisions establishing security requirements that exceed the minimum security requirements established for certified reinsurers under this section.

i. Certification Procedure

i. The commissioner of the domestic state of the ceding insurer shall post notice on the insurance department’s website promptly upon receipt of any application for certification, including instructions on how members of the public may respond to the application. The commissioner may not take final action on the application until at least thirty (30) days after posting the notice required by this paragraph.

ii. The commissioner of the domestic state of the ceding insurer shall issue written notice to an assuming insurer that has made application and been approved as a certified reinsurer. Included in such notice shall be the rating assigned the certified reinsurer in accordance with paragraph 12.h. of this appendix. The commissioner shall publish a list of all certified reinsurers and their ratings.

iii. In order to be eligible for certification, the assuming insurer shall meet the following requirements:

(a) The assuming insurer must be domiciled and licensed to transact insurance or reinsurance in a Qualified Jurisdiction, as determined by the commissioner pursuant to paragraph 12.c. and 12.k. of this appendix.

(b) The assuming insurer must maintain capital and surplus, or its equivalent, of no less than $250,000,000 calculated in accordance with paragraph 12.i.iv.(h) of this appendix. This requirement may also be satisfied by an association including incorporated and individual unincorporated underwriters having minimum capital and surplus equivalents (net of liabilities) of at least $250,000,000 and a central fund containing a balance of at least $250,000,000.

(c) The assuming insurer must maintain financial strength ratings from two or more rating agencies deemed acceptable by the commissioner. These ratings shall be based on interactive communication between the rating agency and the assuming insurer and shall not be based solely on publicly available information. These financial strength ratings will be one factor used by the commissioner in determining the rating that is assigned to the assuming insurer. Acceptable rating agencies include the following:

(1) Standard & Poor’s;
(2) Moody’s Investors Service;
(3) Fitch Ratings;
(4) A.M. Best Company; or
(5) Any other Nationally Recognized Statistical Rating Organization.

(d) The certified reinsurer must comply with any other requirements reasonably imposed by the commissioner of the domestic state of the ceding insurer.

iv. Each certified reinsurer shall be rated on a legal entity basis, with due consideration being given to the group rating where appropriate, except that an association including incorporated and individual unincorporated underwriters that has been approved to do business as a single certified reinsurer may be evaluated on the basis of its group rating. Factors that may be considered as part of the evaluation process include, but are not limited to, the following:

(a) The certified reinsurer’s financial strength rating from an acceptable rating agency. The maximum rating that a certified reinsurer may be assigned will correspond to its financial strength rating as outlined in the table below. The commissioner shall use the lowest financial strength rating received from an approved rating agency in establishing the maximum rating of a certified reinsurer. A failure to obtain or maintain at least two financial strength ratings from acceptable rating agencies will result in loss of eligibility for certification:

<table>
<thead>
<tr>
<th>Ratings</th>
<th>Best</th>
<th>S&amp;P</th>
<th>Moody’s</th>
<th>Fitch</th>
</tr>
</thead>
<tbody>
<tr>
<td>Secure – 1</td>
<td>A++</td>
<td>AAA</td>
<td>Aaa</td>
<td>AAA</td>
</tr>
<tr>
<td>Secure – 2</td>
<td>A+</td>
<td>AA+, AA, AA-</td>
<td>Aa1, Aa2, Aa3</td>
<td>AA+, AA, AA-</td>
</tr>
<tr>
<td>Secure – 3</td>
<td>A</td>
<td>A+, A</td>
<td>A1, A2</td>
<td>A+, A</td>
</tr>
<tr>
<td>Secure – 4</td>
<td>A-</td>
<td>A-</td>
<td>A3</td>
<td>A-</td>
</tr>
<tr>
<td>Secure – 5</td>
<td>B++, B+</td>
<td>BBB+, BBB, BBB-</td>
<td>Baa1, Baa2, Baa3</td>
<td>BBB+, BBB, BBB-</td>
</tr>
</tbody>
</table>

(b) The business practices of the certified reinsurer in dealing with its ceding insurers, including its record of compliance with reinsurance contractual terms and obligations;
(c) For certified reinsurers domiciled in the U.S., a review of the most recent applicable NAIC Annual Statement Blank, either Schedule F (for property/casualty reinsurers) or Schedule S (for life and health reinsurers);

(d) For certified reinsurers not domiciled in the U.S., a review annually of Form CR-F (for property/casualty reinsurers) or Form CR-S (for life and health reinsurers);

(e) The reputation of the certified reinsurer for prompt payment of claims under reinsurance agreements, based on an analysis of ceding insurers’ Schedule F reporting of overdue reinsurance recoverables, including the proportion of obligations that are more than ninety (90) days past due or are in dispute, with specific attention given to obligations payable to companies that are in administrative supervision or receivership;

(f) Regulatory actions against the certified reinsurer;

(g) The report of the independent auditor on the financial statements of the insurance enterprise, on the basis described in paragraph (h) below;

(h) For certified reinsurers not domiciled in the U.S., audited financial statements (audited U.S. GAAP basis if available, audited IFRS basis statements are allowed but must include an audited footnote reconciling equity and net income to a U.S. GAAP basis, or, with the permission of the state insurance commissioner, audited IFRS statements with reconciliation to U.S. GAAP certified by an officer of the company), regulatory filings, and actuarial opinion (as filed with the non-U.S. jurisdiction supervisor, with a translation into English). Upon the initial application for certification, the commissioner will consider audited financial statements for the last two (2) years filed with its non-U.S. jurisdiction supervisor; [Model #786, Section 8B(4)(h)]

(i) The liquidation priority of obligations to a ceding insurer in the certified reinsurer’s domiciliary jurisdiction in the context of an insolvency proceeding;

(j) A certified reinsurer’s participation in any solvent scheme of arrangement, or similar procedure, which involves U.S. ceding insurers. The commissioner shall receive prior notice from a certified reinsurer that proposes participation by the certified reinsurer in a solvent scheme of arrangement; and

(k) Any other information deemed relevant by the commissioner.

v. Based on the analysis conducted under paragraph 12.i.iv.(e) of a certified reinsurer’s reputation for prompt payment of claims, the commissioner may make appropriate adjustments in the security the certified reinsurer is required to post to protect its liabilities to U.S. ceding insurers, provided that the commissioner shall, at a minimum, increase the security the certified reinsurer is required to post by one rating level under paragraph 12.h if the commissioner finds that:

(a) more than fifteen percent (15%) of the certified reinsurer’s ceding insurance clients have overdue reinsurance recoverables on paid losses of ninety (90) days or more which are not in dispute and which exceed $100,000 for each cedent; or

(b) the aggregate amount of reinsurance recoverables on paid losses which are not in dispute that are overdue by ninety (90) days or more exceeds $50,000,000.

© 2019 National Association of Insurance Commissioners 12
vi. The assuming insurer must submit a properly executed Form CR-1 as evidence of its submission to the jurisdiction of this state, appointment of the commissioner as an agent for service of process in this state, and agreement to provide security for one hundred percent (100%) of the assuming insurer’s liabilities attributable to reinsurance ceded by U.S. ceding insurers if it resists enforcement of a final U.S. judgment. The commissioner shall not certify any assuming insurer that is domiciled in a jurisdiction that the commissioner has determined does not adequately and promptly enforce final U.S. judgments or arbitration awards.

vii. The certified reinsurer must agree to meet applicable information filing requirements as determined by the commissioner, both with respect to an initial application for certification and on an ongoing basis. All information submitted by certified reinsurers which are not otherwise public information subject to disclosure shall be exempted from disclosure under [cite state law equivalent of Freedom of Information Act] and shall be withheld from public disclosure. The applicable information filing requirements are, as follows:

(a) Notification within ten (10) days of any regulatory actions taken against the certified reinsurer, any change in the provisions of its domiciliary license or any change in rating by an approved rating agency, including a statement describing such changes and the reasons therefore;

(b) Annually, Form CR-F or CR-S, as applicable;

(c) Annually, the report of the independent auditor on the financial statements of the insurance enterprise, on the basis described in paragraph 12.i.vii.(d) below;

(d) Annually, the most recent audited financial statements (audited U.S. GAAP basis if available, audited IFRS basis statements are allowed but must include an audited footnote reconciling equity and net income to a U.S. GAAP basis, or, with the permission of the state insurance commissioner, audited IFRS statements with reconciliation to U.S. GAAP certified by an officer of the company), regulatory filings, and actuarial opinion (as filed with the certified reinsurer’s supervisor, with a translation into English). Upon the initial certification, audited financial statements for the last two-three (23) years filed with the certified reinsurer’s supervisor; (Model #786, Section 8B(7)(d))

(e) At least annually, an updated list of all disputed and overdue reinsurance claims regarding reinsurance assumed from U.S. domestic ceding insurers;

(f) A certification from the certified reinsurer’s domestic regulator that the certified reinsurer is in good standing and maintains capital in excess of the jurisdiction’s highest regulatory action level; and

(g) Any other information that the commissioner may reasonably require.

j. Change in Rating or Revocation of Certification

i. In the case of a downgrade by a rating agency or other disqualifying circumstance, the commissioner shall upon written notice assign a new rating to the certified reinsurer in accordance with the requirements of paragraph 12.i.
ii. The commissioner shall have the authority to suspend, revoke, or otherwise modify a certified reinsurer’s certification at any time if the certified reinsurer fails to meet its obligations or security requirements under this section, or if other financial or operating results of the certified reinsurer, or documented significant delays in payment by the certified reinsurer, lead the commissioner to reconsider the certified reinsurer’s ability or willingness to meet its contractual obligations.

iii. If the rating of a certified reinsurer is upgraded by the commissioner, the certified reinsurer may meet the security requirements applicable to its new rating on a prospective basis, but the commissioner shall require the certified reinsurer to post security under the previously applicable security requirements as to all contracts in force on or before the effective date of the upgraded rating. If the rating of a certified reinsurer is downgraded by the commissioner, the commissioner shall require the certified reinsurer to meet the security requirements applicable to its new rating for all business it has assumed as a certified reinsurer.

iv. Upon revocation of the certification of a certified reinsurer by the commissioner, the assuming insurer shall be required to post security in accordance with paragraph 1918 in order for the ceding insurer to continue to take credit for reinsurance ceded to the assuming insurer. If funds continue to be held in trust in accordance with paragraph 11, the commissioner may allow additional credit equal to the ceding insurer’s pro rata share of such funds, discounted to reflect the risk of uncollectibility and anticipated expenses of trust administration. Notwithstanding the change of a certified reinsurer’s rating or revocation of its certification, a domestic insurer that has ceded reinsurance to that certified reinsurer may not be denied credit for reinsurance for a period of three (3) months for all reinsurance ceded to that certified reinsurer, unless the reinsurance is found by the commissioner to be at high risk of uncollectibility.

k. Qualified Jurisdictions

i. If, upon conducting an evaluation with respect to the reinsurance supervisory system of any non-U.S. assuming insurer, the commissioner of the domestic state of the ceding insurer determines that the jurisdiction qualifies to be recognized as a qualified jurisdiction, the commissioner shall publish notice and evidence of such recognition in an appropriate manner. The commissioner may establish a procedure to withdraw recognition of those jurisdictions that are no longer qualified.

ii. In order to determine whether the domiciliary jurisdiction of a non-U.S. assuming insurer is eligible to be recognized as a qualified jurisdiction, the commissioner shall evaluate the reinsurance supervisory system of the non-U.S. jurisdiction, both initially and on an ongoing basis, and consider the rights, benefits and the extent of reciprocal recognition afforded by the non-U.S. jurisdiction to reinsurers licensed and domiciled in the U.S. The commissioner shall determine the appropriate approach for evaluating the qualifications of such jurisdictions, and create and publish a list of jurisdictions whose reinsurers may be approved by the commissioner as eligible for certification. A qualified jurisdiction must agree to share information and cooperate with the commissioner with respect to all certified reinsurers domiciled within that jurisdiction. Additional factors to be considered in determining whether to recognize a qualified jurisdiction, in the discretion of the commissioner, include but are not limited to the following:

(a) The framework under which the assuming insurer is regulated.
(b) The structure and authority of the domiciliary regulator with regard to solvency regulation requirements and financial surveillance.

(c) The substance of financial and operating standards for assuming insurers in the domiciliary jurisdiction.

(d) The form and substance of financial reports required to be filed or made publicly available by reinsurers in the domiciliary jurisdiction and the accounting principles used.

(e) The domiciliary regulator’s willingness to cooperate with U.S. regulators in general and the commissioner in particular.

(f) The history of performance by assuming insurers in the domiciliary jurisdiction.

(g) Any documented evidence of substantial problems with the enforcement of final U.S. judgments in the domiciliary jurisdiction. A jurisdiction will not be considered to be a qualified jurisdiction if the commissioner has determined that it does not adequately and promptly enforce final U.S. judgments or arbitration awards.

(h) Any relevant international standards or guidance with respect to mutual recognition of reinsurance supervision adopted by the International Association of Insurance Supervisors or successor organization.

(i) Any other matters deemed relevant by the commissioner.

iii. A list of qualified jurisdictions shall be published through the NAIC Committee Process. The commissioner shall consider this list in determining qualified jurisdictions. If the commissioner approves a jurisdiction as qualified that does not appear on the list of qualified jurisdictions, the commissioner shall provide thoroughly documented justification with respect to the criteria provided under paragraphs 12.k.ii.(a) to (i).

iv. U.S. jurisdictions that meet the requirements for accreditation under the NAIC financial standards and accreditation program shall be recognized as qualified jurisdictions.

1. Recognition of Certification Issued by an NAIC Accredited Jurisdiction

i. If an applicant for certification has been certified as a reinsurer in an NAIC accredited jurisdiction, the commissioner has the discretion to defer to that jurisdiction’s certification, and to defer to the rating assigned by that jurisdiction, if the assuming insurer submits a properly executed Form CR-1 and such additional information as the commissioner requires. The assuming insurer shall be considered to be a certified reinsurer in this State.

ii. Any change in the certified reinsurer’s status or rating in the other jurisdiction shall apply automatically in this State as of the date it takes effect in the other jurisdiction. The certified reinsurer shall notify the commissioner of any change in its status or rating within 10 days after receiving notice of the change.

iii. The commissioner may withdraw recognition of the other jurisdiction’s rating at any time and assign a new rating in accordance with paragraph 12.j. of this appendix.
iv. The commissioner may withdraw recognition of the other jurisdiction’s certification at any time, with written notice to the certified reinsurer. Unless the commissioner suspends or revokes the certified reinsurer’s certification in accordance with paragraph 12.j. of this appendix, the certified reinsurer’s certification shall remain in good standing in the domestic state of the ceding insurer for a period of three (3) months, which shall be extended if additional time is necessary to consider the assuming insurer’s application for certification in this State.

m. Mandatory Funding Clause. In addition to the clauses required under SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance and SSAP No. 62R—Property and Casualty Reinsurance, reinsurance contracts entered into or renewed under paragraph 12 of this appendix shall include a proper funding clause, which requires the certified reinsurer to provide and maintain security in an amount sufficient to avoid the imposition of any financial statement penalty on the ceding insurer under this section for reinsurance ceded to the certified reinsurer.

c. The commissioner shall comply with all reporting and notification requirements that may be established by the NAIC with respect to certified reinsurers and qualified jurisdictions.

13. Credit shall be allowed when the reinsurance is ceded to an assuming insurer meeting each of the conditions set forth in paragraphs 13.a through 13.h. Credit shall be allowed for reinsurance ceded by a domestic insurer to an assuming insurer that is licensed to write reinsurance by, and has its head office or is domiciled in, a Reciprocal Jurisdiction, and which meets the other requirements of paragraph 13. (Model #786, Section 9A)

a. The assuming insurer must have its head office or be domiciled in, as applicable, and be licensed in a Reciprocal Jurisdiction. A “Reciprocal Jurisdiction” is a jurisdiction that meets one of the following: (Model #785, Section 2F(1)(a) Model #786, Section 9B)

i. A non-U.S. jurisdiction that is subject to an in-force covered agreement with the United States, each within its legal authority, or, in the case of a covered agreement between the United States and European Union, is a member state of the European Union. For purposes of this subsection, a “covered agreement” is an agreement entered into pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act, 31 U.S.C. §§ 313 and 314, that is currently in effect or in a period of provisional application and addresses the elimination, under specified conditions, of collateral requirements as a condition for entering into any reinsurance agreement with a ceding insurer domiciled in this state or for allowing the ceding insurer to recognize credit for reinsurance;

ii. A U.S. jurisdiction that meets the requirements for accreditation under the NAIC financial standards and accreditation program; or

iii. A qualified jurisdiction, as determined by the commissioner, which is not otherwise described in paragraphs 13.a.i or 13.a.ii, above and which the commissioner determines meets all of the following additional requirements:

(a) Provides that an insurer which has its head office or is domiciled in such qualified jurisdiction shall receive credit for reinsurance ceded to a U.S.-domiciled assuming insurer in the same manner as credit for reinsurance is received for reinsurance assumed by insurers domiciled in such qualified jurisdiction;
(b) Does not require a U.S.-domiciled assuming insurer to establish or maintain a local presence as a condition for entering into a reinsurance agreement with any ceding insurer subject to regulation by the non-U.S. jurisdiction or as a condition to allow the ceding insurer to recognize credit for such reinsurance:

(c) Recognizes the U.S. state regulatory approach to group supervision and group capital, by providing written confirmation by a competent regulatory authority, in such qualified jurisdiction, that insurers and insurance groups that are domiciled or maintain their headquarters in this state or another jurisdiction accredited by the NAIC shall be subject only to worldwide prudential insurance group supervision including worldwide group governance, solvency and capital, and reporting, as applicable, by the commissioner or the commissioner of the domiciliary state and will not be subject to group supervision at the level of the worldwide parent undertaking of the insurance or reinsurance group by the qualified jurisdiction; and

(d) Provides written confirmation by a competent regulatory authority in such qualified jurisdiction that information regarding insurers and their parent, subsidiary, or affiliated entities, if applicable, shall be provided to the commissioner in accordance with a memorandum of understanding or similar document between the commissioner and such qualified jurisdiction, including but not limited to the International Association of Insurance Supervisors Multilateral Memorandum of Understanding or other multilateral memoranda of understanding coordinated by the NAIC.

b. The assuming insurer must have and maintain on an ongoing basis minimum capital and surplus, or its equivalent, calculated on at least an annual basis as of the preceding December 31 or at the annual date otherwise statutorily reported to the Reciprocal Jurisdiction, and confirmed as set forth in paragraph 12.g. according to the methodology of its domiciliary jurisdiction, in the following amounts: (Model #786, Section 9C(2))

i. No less than $250,000,000; or

ii. If the assuming insurer is an association, including incorporated and individual unincorporated underwriters:

   (a) Minimum capital and surplus equivalents (net of liabilities) or own funds of the equivalent of at least $250,000,000; and

   (b) A central fund containing a balance of the equivalent of at least $250,000,000.

c. The assuming insurer must have and maintain on an ongoing basis a minimum solvency or capital ratio, as applicable, as follows: (Model #786, Section 9C(3))

i. If the assuming insurer has its head office or is domiciled in a Reciprocal Jurisdiction as defined in paragraph 13.a.i., the ratio specified in the applicable covered agreement;

ii. If the assuming insurer is domiciled in a Reciprocal Jurisdiction as defined in paragraph 13.a.ii, a risk-based capital (RBC) ratio of three hundred percent (300%) of the authorized control level, calculated in accordance with the formula developed by the NAIC; or
iii. If the assuming insurer is domiciled in a Reciprocal Jurisdiction as defined in paragraph 13.a.iii., after consultation with the Reciprocal Jurisdiction and considering any recommendations published through the NAIC Committee Process, such solvency or capital ratio as the commissioner determines to be an effective measure of solvency.

d. The assuming insurer must agree and provide adequate assurance to the commissioner, in a form of a properly executed Form RJ-1, as follows: *(Model #786, Section 9C(4))*

i. The assuming insurer must provide prompt written notice and explanation to the commissioner if it falls below the minimum requirements set forth in paragraphs 13.b. or 13.c., or if any regulatory action is taken against it for serious noncompliance with applicable law;

ii. The assuming insurer must consent in writing to the jurisdiction of the courts of this state and to the appointment of the commissioner as agent for service of process. The commissioner may require that consent for service of process be provided to the commissioner and included in each reinsurance agreement. Nothing in this provision shall limit, or in any way alter, the capacity of parties to a reinsurance agreement to agree to alternative dispute resolution mechanisms, except to the extent such agreements are unenforceable under applicable insolvency or delinquency laws;

iii. The assuming insurer must consent in writing to pay all final judgments, wherever enforcement is sought, obtained by a ceding insurer or its legal successor, that have been declared enforceable in the jurisdiction where the judgment was obtained;

iv. Each reinsurance agreement must include a provision requiring the assuming insurer to provide security in an amount equal to one hundred percent (100%) of the assuming insurer’s liabilities attributable to reinsurance ceded pursuant to that agreement if the assuming insurer resists enforcement of a final judgment that is enforceable under the law of the jurisdiction in which it was obtained or a properly enforceable arbitration award, whether obtained by the ceding insurer or by its legal successor on behalf of its resolution estate; and

v. The assuming insurer must confirm that it is not presently participating in any solvent scheme of arrangement which involves this state’s ceding insurers, and agree to notify the ceding insurer and the commissioner and to provide security in an amount equal to one hundred percent (100%) of the assuming insurer’s liabilities to the ceding insurer, should the assuming insurer enter into such a solvent scheme of arrangement. Such security shall be in a form consistent with the provisions of paragraph 12 and paragraph 19. The term “solvent scheme of arrangement” means a foreign or alien statutory or regulatory compromise procedure subject to requisite majority creditor approval and judicial sanction in the assuming insurer’s home jurisdiction either to finally commute liabilities of duly noticed classed members or creditors of a solvent debtor, or to reorganize or restructure the debts and obligations of a solvent debtor on a final basis, and which may be subject to judicial recognition and enforcement of the arrangement by a governing authority outside the ceding insurer’s home jurisdiction.

vi. The assuming insurer must agree in writing to meet the applicable information filing requirements as set forth in paragraph 13.e.
e. The assuming insurer or its legal successor must provide, if requested by the commissioner, on behalf of itself and any legal predecessors, the following documentation to the commissioner: (Model #786, Section 9C(5))

i. For the two years preceding entry into the reinsurance agreement and on an annual basis thereafter, the assuming insurer's annual audited financial statements, in accordance with the applicable law of the jurisdiction of its head office or domiciliary jurisdiction, as applicable, including the external audit report;

ii. For the two years preceding entry into the reinsurance agreement, the solvency and financial condition report or actuarial opinion, if filed with the assuming insurer’s supervisor;

iii. Prior to entry into the reinsurance agreement and not more than semi-annually thereafter, an updated list of all disputed and overdue reinsurance claims outstanding for 90 days or more, regarding reinsurance assumed from ceding insurers domiciled in the United States; and

iv. Prior to entry into the reinsurance agreement and not more than semi-annually thereafter, information regarding the assuming insurer’s assumed reinsurance by ceding insurer, ceded reinsurance by the assuming insurer, and reinsurance recoverable on paid and unpaid losses by the assuming insurer to allow for the evaluation of the criteria set forth in paragraph 13.f.

f. The assuming insurer must maintain a practice of prompt payment of claims under reinsurance agreements. The lack of prompt payment will be evidenced if any of the following criteria is met: (Model #786, Section 9C(6))

i. More than fifteen percent (15%) of the reinsurance recoverables from the assuming insurer are overdue and in dispute as reported to the commissioner;

ii. More than fifteen percent (15%) of the assuming insurer’s ceding insurers or reinsurers have overdue reinsurance recoverable on paid losses of 90 days or more which are not in dispute and which exceed for each ceding insurer $100,000, or as otherwise specified in a covered agreement; or

iii. The aggregate amount of reinsurance recoverable on paid losses which are not in dispute, but are overdue by 90 days or more, exceeds $50,000,000, or as otherwise specified in a covered agreement.

g. The assuming insurer’s supervisory authority must confirm to the commissioner on an annual basis, as of the preceding December 31 or at the annual date otherwise statutorily reported to the Reciprocal Jurisdiction, that the assuming insurer complies with the requirements set forth in paragraphs 13.b. and 13.c. (Model #786, Section 9C(7))

h. Nothing in this provision precludes an assuming insurer from providing the commissioner with information on a voluntary basis. (Model #786, Section 9C(8))

i. The commissioner shall timely create and publish a list of Reciprocal Jurisdictions. (Model #785, Section 2F(2) and Model #786, Section 9D)
i. A list of Reciprocal Jurisdictions is published through the NAIC Committee Process. The commissioner’s list shall include any Reciprocal Jurisdiction as defined under paragraphs 13.a.i. and 13.a.ii., and shall consider any other Reciprocal Jurisdiction included on the NAIC list. The commissioner may approve a jurisdiction that does not appear on the NAIC list of Reciprocal Jurisdictions.

ii. The commissioner may remove a jurisdiction from the list of Reciprocal Jurisdictions upon a determination that the jurisdiction no longer meets one or more of the requirements of a Reciprocal Jurisdiction, except that the commissioner shall not remove from the list a Reciprocal Jurisdiction as defined under paragraphs 13.a.i. and 13.a.ii. Upon removal of a Reciprocal Jurisdiction from this list credit for reinsurance ceded to an assuming insurer domiciled in that jurisdiction shall be allowed, if otherwise allowed pursuant to this appendix.

j. The commissioner shall timely create and publish a list of assuming insurers that have satisfied the conditions set forth in paragraph 13 and to which cessions shall be granted credit in accordance with paragraph 13. (Model #786, Section 9E)

i. If an NAIC accredited jurisdiction has determined that the conditions set forth in paragraph 13 have been met, the commissioner has the discretion to defer to that jurisdiction’s determination, and add such assuming insurer to the list of assuming insurers to which cessions shall be granted credit in accordance with this subsection. The commissioner may accept financial documentation filed with another NAIC accredited jurisdiction or with the NAIC in satisfaction of the requirements of paragraph 13.b., 13.c. and 13.d.

ii. When requesting that the commissioner defer to another NAIC accredited jurisdiction’s determination, an assuming insurer must submit a properly executed Form RJ-1 and additional information as the commissioner may require. A state that has received such a request will notify other states through the NAIC Committee Process and provide relevant information with respect to the determination of eligibility.

k. If the commissioner determines that an assuming insurer no longer meets one or more of the requirements under this section, the commissioner may revoke or suspend the eligibility of the assuming insurer for recognition under this section. (Model #786, Section 9F)

i. While an assuming insurer’s eligibility is suspended, no reinsurance agreement issued, amended or renewed after the effective date of the suspension qualifies for credit except to the extent that the assuming insurer’s obligations under the contract are secured in accordance with paragraph 19.

ii. If an assuming insurer’s eligibility is revoked, no credit for reinsurance may be granted after the effective date of the revocation with respect to any reinsurance agreements entered into by the assuming insurer, including reinsurance agreements entered into prior to the date of revocation, except to the extent that the assuming insurer’s obligations under the contract are secured in a form acceptable to the commissioner and consistent with the provisions of paragraph 19.

l. Before denying statement credit or imposing a requirement to post security with respect to paragraph 13.k. or adopting any similar requirement that will have substantially the same regulatory impact as security, the commissioner shall. (Model #786, Section 9G)
Communicate with the ceding insurer, the assuming insurer, and the assuming insurer’s supervisory authority that the assuming insurer no longer satisfies one of the conditions listed in paragraphs 13.a., 13.b. and 13.c.;

Provide the assuming insurer with 30 days from the initial communication to submit a plan to remedy the defect, and 90 days from the initial communication to remedy the defect, except in exceptional circumstances in which a shorter period is necessary for policyholder and other consumer protection;

After the expiration of 90 days or less, as set out in paragraph 13.l.ii., if the commissioner determines that no or insufficient action was taken by the assuming insurer, the commissioner may impose any of the requirements as set out in this subsection; and

Provide a written explanation to the assuming insurer of any of the requirements set out in paragraph 13.l.

If subject to a legal process of rehabilitation, liquidation or conservation, as applicable, the ceding insurer, or its representative, may seek and, if determined appropriate by the court in which the proceedings are pending, may obtain an order requiring that the assuming insurer post security for all outstanding liabilities. (Model #786, Section 9H)

Nothing in this subsection shall limit or in any way alter the capacity of parties to a reinsurance agreement to agree on requirements for security or other terms in that reinsurance agreement, except as expressly prohibited by this appendix. (Model #785, Section 2F(6))

Credit may be taken under this subsection only for reinsurance agreements entered into, amended, or renewed on or after the effective date of the statute adding this subsection, and only with respect to losses incurred and reserves reported on or after the later of (i) the date on which the assuming insurer has met all eligibility requirements pursuant to paragraphs 13.a through 13.h., and (ii) the effective date of the new reinsurance agreement, amendment, or renewal. (Model #785, Section 2F(7))

This paragraph does not alter or impair a ceding insurer’s right to take credit for reinsurance, to the extent that credit is not available under this subsection, as long as the reinsurance qualifies for credit under any other applicable provision of this appendix.

Nothing in this subsection shall authorize an assuming insurer to withdraw or reduce the security provided under any reinsurance agreement except as permitted by the terms of the agreement.

Nothing in this subsection shall limit, or in any way alter, the capacity of parties to any reinsurance agreement to renegotiate the agreement.

Credit shall be allowed when the reinsurance is ceded to an assuming insurer not meeting the requirements of paragraphs 8, 9, 10, 11, or 12 or 13 of this appendix, but only as to the insurance of risks located in jurisdictions where the reinsurance is required by applicable law or regulation of that jurisdiction.

If the assuming insurer is not licensed, accredited or certified to transact insurance or reinsurance in the domiciliary state of the ceding insurer, the credit allowed by paragraphs 10 and 11 of this appendix shall not be allowed unless the assuming insurer agrees in the reinsurance agreements:
a. 
   i. That in the event of the failure of the assuming insurer to perform its obligations under the terms of the reinsurance agreement, the assuming insurer, at the request of the ceding insurer, shall submit to the jurisdiction of any court of competent jurisdiction in any state of the United States, will comply with all requirements necessary to give the court jurisdiction, and will abide by the final decision of the court or of any appellate court in the event of an appeal.

   ii. To designate the commissioner or a designated attorney as its true and lawful attorney upon whom may be served any lawful process in any action, suit or proceeding instituted by or on behalf of the ceding insurer.

b. This paragraph 1544 is not intended to conflict with or override the obligation of the parties to a reinsurance agreement to arbitrate their disputes, if this obligation is created in the agreement.

1645. If the assuming insurer does not meet the requirements of paragraphs 8, 9 or 10, the credit allowed by paragraph 11 or 12 of this appendix shall not be allowed unless the assuming insurer agrees in the trust agreements to the following conditions:

a. Notwithstanding any other provisions in the trust instrument, if the trust fund is inadequate because it contains an amount less than the amount required by paragraph 11 c. of this appendix, or if the grantor of the trust has been declared insolvent or placed into receivership, rehabilitation, liquidation or similar proceedings under the laws of its state or country of domicile, the trustee shall comply with an order of the commissioner with regulatory oversight over the trust or with an order of a court of competent jurisdiction directing the trustee to transfer to the commissioner with regulatory oversight all of the assets of the trust fund.

b. The assets shall be distributed by and claims shall be filed with and valued by the commissioner with regulatory oversight in accordance with the laws of the state in which the trust is domiciled that are applicable to the liquidation of domestic insurance companies.

c. If the commissioner with regulatory oversight determines that the assets of the trust fund or any part thereof are not necessary to satisfy the claims of the U.S. ceding insurers of the grantor of the trust, the assets or part thereof shall be returned by the commissioner with regulatory oversight to the trustee for distribution in accordance with the trust agreement.

d. The grantor shall waive any right otherwise available to it under U.S. law that is inconsistent with this provision.

1746. If an accredited or certified reinsurer ceases to meet the requirements for accreditation or certification, the domestic state of the ceding insurer may suspend or revoke the reinsurer’s accreditation or certification.

a. The domestic state of the ceding insurer must give the reinsurer notice an opportunity for hearing. The suspension or revocation may not take effect until after the state’s order on hearing, unless:

   i. The reinsurer waives its right to hearing;
ii. The state’s order is based on regulatory action by the reinsurer’s domiciliary jurisdiction or the voluntary surrender or termination of the reinsurer’s eligibility to transact insurance or reinsurance business in its domiciliary jurisdiction or in the primary certifying state of the reinsurer under paragraph 12.f. of this appendix; or

iii. The domestic state of the ceding insurer finds that an emergency requires immediate action and a court of competent jurisdiction has not stayed the state’s action.

b. While a reinsurer’s accreditation or certification is suspended, no reinsurance contract issued or renewed after the effective date of the suspension qualifies for credit except to the extent that the reinsurer’s obligations under the contract are secured in accordance with paragraph 1948. If a reinsurer’s accreditation or certification is revoked, no credit for reinsurance may be granted after the effective date of the revocation except to the extent that the reinsurer’s obligations under the contract are secured in accordance with paragraph 12.e. or paragraph 1948.

Valuation of and Requirements for Trust Assets

1847. Assets deposited in the trust shall be valued according to their current fair market value and shall consist only of cash in U.S. dollars, certificates of deposit issued by a U.S. financial institution as defined in paragraph 5352, clean, irrevocable, unconditional and “evergreen” letters of credit issued or confirmed by a qualified U.S. financial institution, as defined in paragraph 5352, and investments of the type specified in this paragraph, but investments in or issued by an entity controlling, controlled by or under common control with either the grantor or beneficiary of the trust shall not exceed five percent (5%) of total investments. No more than twenty percent (20%) of the total of the investments in the trust may be foreign investments authorized under paragraphs 1847.a.v., c., f.ii. or g. of this paragraph, and no more than ten percent (10%) of the total of the investments in the trust may be securities denominated in foreign currencies. For purposes of applying the preceding sentence, a depository receipt denominated in U.S. dollars and representing rights conferred by a foreign security shall be classified as a foreign investment denominated in a foreign currency. The assets of a trust shall be invested only as follows:

a. Government obligations that are not in default as to principal or interest, that are valid and legally authorized and that are issued, assumed or guaranteed by:

i. The United States or by any agency or instrumentality of the United States;

ii. A state of the United States;

iii. A territory, possession or other governmental unit of the United States;

iv. An agency or instrumentality of a governmental unit referred to in paragraphs 1847.a.i. and 1847.a.ii. if the obligations shall be by law (statutory of otherwise) payable, as to both principal and interest, from taxes levied or by law required to be levied or from adequate special revenues pledged or otherwise appropriated or by law required to be provided for making these payments, but shall not be obligations eligible for investment under this paragraph if payable solely out of special assessments on properties benefited by local improvements; or

v. The government of any other country that is a member of the Organization for Economic Cooperation and Development and whose government obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC;
b. Obligations that are issued in the United States, or that are dollar denominated and issued in a non-U.S. market, by a solvent U.S. institution (other than an insurance company) or that are assumed or guaranteed by a solvent U.S. institution (other than an insurance company) and that are not in default as to principal or interest if the obligations:

i. Are rated A or higher (or the equivalent) by a securities rating agency recognized by the Securities Valuation Office of the NAIC, or if not so rated, are similar in structure and other material respects to other obligations of the same institution that are so rated;

ii. Are insured by at least one authorized insurer (other than the investing insurer or a parent, subsidiary or affiliate of the investing insurer) licensed to insure obligations in this state and, after considering the insurance, are rated AAA (or the equivalent) by a securities rating agency recognized by the Securities Valuation Office of the NAIC; or

iii. Have been designated as Class One or Class Two by the Securities Valuation Office of the NAIC;

c. Obligations issued, assumed or guaranteed by a solvent non-U.S. institution chartered in a country that is a member of the Organization for Economic Cooperation and Development or obligations of U.S. corporations issued in a non-U.S. currency, provided that in either case the obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC;

d. An investment made pursuant to the provisions of paragraph 1847.a., b. or c. shall be subject to the following additional limitations:

i. An investment in or loan upon the obligations of an institution other than an institution that issues mortgage-related securities shall not exceed five percent (5%) of the assets of the trust;

ii. An investment in any one mortgage-related security shall not exceed five percent (5%) of the assets of the trust;

iii. The aggregate total investment in mortgage-related securities shall not exceed twenty-five percent (25%) of the assets of the trust; and

iv. Preferred or guaranteed shares issued or guaranteed by a solvent U.S. institution are permissible investments if all of the institution’s obligations are eligible as investments under paragraphs 1847.b.i. and b.iii. of this paragraph, but shall not exceed two percent (2%) of the assets of the trust.

e. As used in this appendix:

i. “Mortgage-related security” means an obligation that is rated AA or higher (or the equivalent) by a securities rating agency recognized by the Securities Valuation Office of the NAIC and that either:

(a) Represents ownership of one or more promissory notes or certificates of interest or participation in the notes (including any rights designed to assure servicing of, or the receipt or timeliness of receipt by the holders of the notes, certificates, or participation of amounts payable under, the notes, certificates or participation), that:
(1) Are directly secured by a first lien on a single parcel of real estate, including stock allocated to a dwelling unit in a residential cooperative housing corporation, upon which is located a dwelling or mixed residential and commercial structure, or on a residential manufactured home as defined in 42 U.S.C.A. Section 5402(6), whether the manufactured home is considered real or personal property under the laws of the state in which it is located; and

(2) Were originated by a savings and loan association, savings bank, commercial bank, credit union, insurance company, or similar institution that is supervised and examined by a federal or state housing authority, or by a mortgagee approved by the Secretary of Housing and Urban Development pursuant to 12 U.S.C.A. Sections 1709 and 1715-b, or, where the notes involve a lien on the manufactured home, by an institution approved for insurance by the Secretary of Housing and Urban Development pursuant to 12 U.S.C.A. Section 1703; or

(b) Is secured by one or more promissory notes or certificates of deposit or participations in the notes (with or without recourse to the insurer of the notes) and, by its terms, provides for payments of principal in relation to payments, or reasonable projections of payments, or notes meeting the requirements of paragraphs 18(e.i.(a)(1) and 18(e.i.(a)(2);

ii. “Promissory note,” when used in connection with a manufactured home, shall also include a loan, advance or credit sale as evidenced by a retail installment sales contract or other instrument.

f. Equity interests

i. Investments in common shares or partnership interests of a solvent U.S. institution are permissible if:

(a) Its obligations and preferred shares, if any, are eligible as investments under this paragraph; and

(b) The equity interests of the institution (except an insurance company) are registered on a national securities exchange as provided in the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a to 78kk or otherwise registered pursuant to that Act, and if otherwise registered, price quotations for them are furnished through a nationwide automated quotations system approved by the Financial Industry Regulatory Authority, or successor organization. A trust shall not invest in equity interests under this paragraph an amount exceeding one percent (1%) of the assets of the trust even though the equity interests are not so registered and are not issued by an insurance company.

ii. Investments in common shares of a solvent institution organized under the laws of a country that is a member of the Organization for Economic Cooperation and Development, if:

(a) All its obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC; and
(b) The equity interests of the institution are registered on a securities exchange regulated by the government of a country that is a member of the Organization for Economic Cooperation and Development.

iii. An investment in or loan upon any one institution’s outstanding equity interests shall not exceed one percent (1%) of the assets of the trust. The cost of an investment in equity interests made pursuant to this paragraph, when added to the aggregate cost of other investments in equity interests then held pursuant to this paragraph, shall not exceed ten percent (10%) of the assets in the trust;

g. Obligations issued, assumed or guaranteed by a multinational development bank, provided the obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC.

h. Investment companies:

i. Securities of an investment company registered pursuant to the Investment Company Act of 1940, 15 U.S.C. § 802, are allowable investments if the investment company:

   (a) Invests at least ninety percent (90%) of its assets in the types of securities that qualify as an investment under paragraphs 18.17.a., 18.17.b., or 18.17.c., or invests in securities that are determined to be substantively similar to the types of securities set forth in paragraphs 18.17.a., 18.17.b., or 18.17.c.; or

   (b) Invests at least ninety percent (90%) of its assets in the types of equity interests that qualify as an investment under paragraph 18.17.f.i.;

ii. Investments made by a trust in investment companies under this paragraph shall not exceed the following limitations:

   (a) An investment in an investment company qualifying under paragraph 18.17.h.i. (a) shall not exceed ten percent (10%) of the assets in the trust and the aggregate amount of investment in qualifying investment companies shall not exceed twenty-five percent (25%) of the assets in the trust; and

   (b) Investments in an investment company qualifying under paragraph 18.17.h.i. (b) of this paragraph shall not exceed five percent (5%) of the assets in the trust and the aggregate amount of investment in qualifying investment companies shall be included when calculating the permissible aggregate value of equity interests pursuant to paragraph 18.17.f.i.

i. Letters of Credit

   i. In order for a letter of credit to qualify as an asset of the trust, the trustee shall have the right and the obligation pursuant to the deed of trust or some other binding agreement (as duly approved by the commissioner), to immediately draw down the full amount of the letter of credit and hold the proceeds in trust for the beneficiaries of the trust if the letter of credit will otherwise expire without being renewed or replaced.

   ii. The trust agreement shall provide that the trustee shall be liable for its negligence, willful misconduct or lack of good faith. The failure of the trustee to draw against the letter of credit in circumstances where such draw would be required shall be deemed to be negligence and/or willful misconduct.
Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements detailed above under “Credit Allowed a Domestic Ceding Insurer” (paragraphs 7-18)

1918. An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements under “Credit Allowed a Domestic Ceding Insurer” (paragraphs 7-18) shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer. The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined under “Qualified U.S. Financial Institutions” at paragraph 5453. This security may be in the form of:

a. Cash;

b. Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners, including those deemed exempt from filing as defined by the Purposes and Procedures Manual of the NAIC Securities Valuation Office, and qualifying as admitted assets;

Drafting Note: The Purposes and Procedures Manual of the NAIC Securities Valuation Office has been renamed the Purposes and Procedures Manual of the NAIC Investment Analysis Office, however, the Model law refers to the previous name.

c. i. Clean, irrevocable, unconditional and evergreen letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in paragraph 5352, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding insurer on or before the filing date of its annual statement;

ii. Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution’s subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs.

d. An admitted asset or a reduction from liability for reinsurance ceded to an unauthorized assuming insurer pursuant to this appendix shall be allowed only when the requirements of paragraph 1514 and the applicable portions under the sections below titled “Trust Agreements Qualified under Paragraph 1918”, “Letters of Credit Qualified under Paragraph 1918”, and “Other Security” at paragraph 5150.

Trust Agreements Qualified under Paragraph 1918

2049. The trust agreement shall be entered into between the beneficiary, the grantor and a trustee, which shall be a qualified U.S. financial institution as defined in paragraph 5453.

2120. The trust agreement shall create a trust account into which assets shall be deposited.

2224. All assets in the trust account shall be held by the trustee at the trustee’s office in the United States.

2322. The trust agreement shall provide that:

a. The beneficiary shall have the right to withdraw assets from the trust account at any time, without notice to the grantor, subject only to written notice from the beneficiary to the trustee;
b. No other statement or document is required to be presented to withdraw assets, except that the beneficiary may be required to acknowledge receipt of withdrawn assets;

c. It is not subject to any conditions or qualifications outside of the trust agreement; and

d. It shall not contain references to any other agreements or documents except as provided for in paragraph 3029.

2423. The trust agreement shall be established for the sole benefit of the beneficiary.

2524. The trust agreement shall require the trustee to:

a. Receive assets and hold all assets in a safe place;

b. Determine that all assets are in such form that the beneficiary, or the trustee upon direction by the beneficiary, may whenever necessary negotiate any such assets, without consent or signature from the grantor or any other person or entity;

c. Furnish to the grantor and the beneficiary a statement of all assets in the trust account upon its inception and at intervals no less frequent than the end of each calendar quarter;

d. Notify the grantor and the beneficiary within ten (10) days, of any deposits to or withdrawals from the trust account;

e. Upon written demand of the beneficiary, immediately take any and all steps necessary to transfer absolutely and unequivocally all right, title and interest in the assets held in the trust account to the beneficiary and deliver physical custody of the assets to the beneficiary; and

f. Allow no substitutions or withdrawals of assets from the trust account, except on written instructions from the beneficiary, except that the trustee may, without the consent of but with notice to the beneficiary, upon call or maturity of any trust asset, withdraw such asset upon condition that the proceeds are paid into the trust account.

2625. The trust agreement shall provide that at least thirty (30) days, but not more than forty-five (45) days, prior to termination of the trust account, written notification of termination shall be delivered by the trustee to the beneficiary.

2726. The trust agreement shall be made subject to and governed by the laws of the state in which the trust is domiciled.

2827. The trust agreement shall prohibit invasion of the trust corpus for the purpose of paying compensation to, or reimbursing the expenses of, the trustee. In order for a letter of credit to qualify as an asset of the trust, the trustee shall have the right and the obligation pursuant to the deed of trust or some other binding agreement, as duly approved by the commissioner, to immediately draw down the full amount of the letter of credit and hold the proceeds in trust for the beneficiaries of the trust if the letter of credit will otherwise expire without being renewed or replaced.

2928. The trust agreement shall provide that the trustee shall be liable for its negligence, willful misconduct or lack of good faith. The failure of the trustee to draw against the letter of credit in circumstances where such draw would be required shall be deemed to be negligence and/or willful misconduct.

3029. Notwithstanding other provisions of this appendix, when a trust agreement is established in conjunction with a reinsurance agreement covering risks other than life, annuities and accident and health, where it is customary practice to provide a trust agreement for a specific purpose, the trust agreement may provide that the
ceding insurer shall undertake to use and apply amounts drawn upon the trust account, without diminution because of the insolvency of the ceding insurer or the assuming insurer, only for the following purposes:

a. To pay or reimburse the ceding insurer for the assuming insurer’s share under the specific reinsurance agreement regarding any losses and allocated loss expenses paid by the ceding insurer, but not recovered from the assuming insurer, or for unearned premiums due to the ceding insurer if not otherwise paid by the assuming insurer;

b. To make payment to the assuming insurer of any amounts held in the trust account that exceed 102 percent of the actual amount required to fund the assuming insurer’s obligations under the specific reinsurance agreement; or

c. Where the ceding insurer has received notification of termination of the trust account and where the assuming insurer’s entire obligations under the specific reinsurance agreement remain unliquidated and undischarged ten (10) days prior to the termination date, to withdraw amounts equal to the obligations and deposit those amounts in a separate account, in the name of the ceding insurer in any qualified U.S. financial institution as defined in paragraph 5453 apart from its general assets, in trust for such uses and purposes specified in paragraphs 3029.a. and b. above as may remain executory after such withdrawal and for any period after the termination date.

3130. Notwithstanding other provisions of this appendix, when a trust agreement is established to meet the requirements of paragraph 1948 in conjunction with a reinsurance agreement covering life, annuities or accident and health risks, where it is customary to provide a trust agreement for a specific purpose, the trust agreement may provide that the ceding insurer shall undertake to use and apply amounts drawn upon the trust account, without diminution because of the insolvency of the ceding insurer or the assuming insurer, only for the following purposes:

a. To pay or reimburse the ceding insurer for:

i. The assuming insurer’s share under the specific reinsurance agreement of premiums returned, but not yet recovered from the assuming insurer, to the owners of policies reinsured under the reinsurance agreement on account of cancellations of the policies; and

ii. The assuming insurer’s share under the specific reinsurance agreement of surrenders and benefits or losses paid by the ceding insurer, but not yet recovered from the assuming insurer, under the terms and provisions of the policies reinsured under the reinsurance agreement;

b. To pay to the assuming insurer amounts held in the trust account in excess of the amount necessary to secure the credit or reduction from liability for reinsurance taken by the ceding insurer; or

c. Where the ceding insurer has received notification of termination of the trust and where the assuming insurer’s entire obligations under the specific reinsurance agreement remain unliquidated and undischarged ten (10) days prior to the termination date, to withdraw amounts equal to the assuming insurer’s share of liabilities, to the extent that the liabilities have not yet been funded by the assuming insurer, and deposit those amounts in a separate account, in the name of the ceding insurer in any qualified U.S. financial institution apart from its general assets, in trust for the uses and purposes specified in paragraphs 3130.a. and b. as may remain executory after withdrawal and for any period after the termination date.
Either the reinsurance agreement or the trust agreement must stipulate that assets deposited in the trust account shall be valued according to their current fair market value and shall consist only of cash in United States dollars, certificates of deposit issued by a United States bank and payable in United States dollars, and investments permitted by the Insurance Code or any combination of the above, provided investments in or issued by an entity controlling, controlled by or under common control with either the grantor or the beneficiary of the trust shall not exceed five percent (5%) of total investments. The agreement may further specify the types of investments to be deposited. If the reinsurance agreement covers life, annuities or accident and health risks, then the provisions required by this paragraph must be included in the reinsurance agreement.

Notwithstanding any other provisions in the trust instrument, if the grantor of the trust has been declared insolvent or placed into receivership, rehabilitation, liquidation or similar proceedings under the laws of its state or country of domicile, the trustee shall comply with an order of the commissioner with regulatory oversight over the trust or court of competent jurisdiction directing the trustee to transfer to the commissioner with regulatory oversight or other designated receiver all of the assets of the trust fund. The assets shall be applied in accordance with the priority statutes and laws of the state in which the trust is domiciled applicable to the assets of insurance companies in liquidation. If the commissioner with regulatory oversight determines that the assets of the trust fund or any part thereof are not necessary to satisfy claims of the U.S. beneficiaries of the trust, the assets or any part of them shall be returned to the trustee for distribution in accordance with the trust agreement.

The trust agreement may provide that the trustee may resign upon delivery of a written notice of resignation, effective not less than ninety (90) days after the beneficiary and grantor receive the notice and that the trustee may be removed by the grantor by delivery to the trustee and the beneficiary of a written notice of removal, effective not less than ninety (90) days after the trustee and the beneficiary receive the notice, provided that no such resignation or removal shall be effective until a successor trustee has been duly appointed and approved by the beneficiary and the grantor and all assets in the trust have been duly transferred to the new trustee.

The grantor may have the full and unqualified right to vote any shares of stock in the trust account and to receive from time to time payments of any dividends or interest upon any shares of stock or obligations included in the trust account. Any interest or dividends shall be either forwarded promptly upon receipt to the grantor or deposited in a separate account established in the grantor’s name.

The trustee may be given authority to invest, and accept substitutions of, any funds in the account, provided that no investment or substitution shall be made without prior approval of the beneficiary, unless the trust agreement specifies categories of investments acceptable to the beneficiary and authorizes the trustee to invest funds and to accept substitutions that the trustee determines are at least equal in market value to the assets withdrawn and that are consistent with the restrictions in paragraph 39.b.

The trust agreement may provide that the beneficiary may at any time designate a party to which all or part of the trust assets are to be transferred. Transfer may be conditioned upon the trustee receiving, prior to or simultaneously, other specified assets.

The trust agreement may provide that, upon termination of the trust account, all assets not previously withdrawn by the beneficiary shall, with written approval by the beneficiary, be delivered over to the grantor.

A reinsurance agreement may contain provisions that:

a. Require the assuming insurer to enter into a trust agreement and to establish a trust account for the benefit of the ceding insurer, and specifying what the agreement is to cover;

b. Require the assuming insurer, prior to depositing assets with the trustee, to execute assignments or endorsements in blank, or to transfer legal title to the trustee of all shares, obligations or any other assets requiring assignments, in order that the ceding insurer, or the trustee upon the
direction of the ceding insurer, may whenever necessary negotiate these assets without consent or signature from the assuming insurer or any other entity;

c. Require that all settlements of account between the ceding insurer and the assuming insurer be made in cash or its equivalent; and

d. Stipulate that the assuming insurer and the ceding insurer agree that the assets in the trust account, established pursuant to the provisions of the reinsurance agreement, may be withdrawn by the ceding insurer at any time, notwithstanding any other provisions in the reinsurance agreement, and shall be utilized and applied by the ceding insurer or its successors in interest by operation of law, including without limitation any liquidator, rehabilitator, receiver or conservator of such company, without diminution because of insolvency on the part of the ceding insurer or the assuming insurer, only for the following purposes:

i. To pay or reimburse the ceding insurer for:

   (a) The assuming insurer’s share under the specific reinsurance agreement of premiums returned, but not yet recovered from the assuming insurer, to the owners of policies reinsured under the reinsurance agreement because of cancellations of such policies;

   (b) The assuming insurer’s share of surrenders and benefits or losses paid by the ceding insurer pursuant to the provisions of the policies reinsured under the reinsurance agreement; and

   (c) Any other amounts necessary to secure the credit or reduction from liability for reinsurance taken by the ceding insurer;

ii. To make payment to the assuming insurer of amounts held in the trust account in excess of the amount necessary to secure the credit or reduction from liability for reinsurance taken by the ceding insurer.

4039. The reinsurance agreement also may contain provisions that:

a. Give the assuming insurer the right to seek approval from the ceding insurer, which shall not be unreasonably or arbitrarily withheld, to withdraw from the trust account all or any part of the trust assets and transfer those assets to the assuming insurer, provided:

   i. The assuming insurer shall, at the time of withdrawal, replace the withdrawn assets with other qualified assets having a current fair market value equal to the market value of the assets withdrawn so as to maintain at all times the deposit in the required amount; or

   ii. After withdrawal and transfer, the current fair market value of the trust account is no less than 102 percent of the required amount.

b. Provide for the return of any amount withdrawn in excess of the actual amounts required for paragraph 3938.d., and for interest payments at a rate not in excess of the prime rate of interest on such amounts;

c. Allow the award by any arbitration panel or court of competent jurisdiction of:

   i. Interest at a rate different from that provided in paragraph 4039.b.;

   ii. Court or arbitration costs;
iii. Attorney’s fees; and

iv. Any other reasonable expenses.

Financial Reporting - A trust agreement may be used to reduce any liability for reinsurance ceded to an unauthorized assuming insurer in statutory financial statements when established on or before the date of filing of the statutory financial statement of the ceding insurer. Further, the reduction for the existence of an acceptable trust account may be up to the current fair market value of acceptable assets available to be withdrawn from the trust account at that time, but such reduction shall be no greater than the specific obligations under the reinsurance agreement that the trust account was established to secure.

The failure of any trust agreement to specifically identify the beneficiary as defined in paragraph 4 shall not be construed to affect any actions or rights that the commissioner may take or possess pursuant to the provisions of the laws of the domiciliary state.

Letters of Credit Qualified under Paragraph 1948

The letter of credit must be clean, irrevocable, unconditional and issued or confirmed by a qualified U.S. financial institution as defined in paragraph 5352. The letter of credit shall contain an issue date and expiration date and shall stipulate that the beneficiary need only draw a sight draft under the letter of credit and present it to obtain funds and that no other document need be presented. The letter of credit also shall indicate that it is not subject to any condition or qualifications outside of the letter of credit. In addition, the letter of credit itself shall not contain reference to any other agreements, documents or entities, except as provided in paragraph 5049.a. If a court of law appoints a successor in interest to the named beneficiary, then the named beneficiary includes and is limited to the court appointed domiciliary receiver (including conservator, rehabilitator or liquidator).

The heading of the letter of credit may include a boxed section containing the name of the applicant and other appropriate notations to provide a reference for the letter of credit. The boxed section shall be clearly marked to indicate that such information is for internal identification purposes only.

The letter of credit shall contain a statement to the effect that the obligation of the qualified U.S. financial institution under the letter of credit is in no way contingent upon reimbursement with respect thereto.

The term of the letter of credit shall be for at least one year and shall contain an “evergreen clause” that prevents the expiration of the letter of credit without due notice from the issuer. The “evergreen clause” shall provide for a period of no less than thirty (30) days notice prior to expiration date or nonrenewal.

The letter of credit shall state whether it is subject to and governed by the laws of the ceding insurers state or the Uniform Customs and Practice for Documentary Credits of the International Chamber of Commerce (Publication 600) or International Standby Practices of the International Chamber of Commerce Publication 590 (ISP98), or any successor publication, and all drafts drawn thereunder shall be presentable at an office in the United States of a qualified U.S. financial institution.

If the letter of credit is made subject to the Uniform Customs and Practice for Documentary Credits of the International Chamber of Commerce Publication 600 (UCP 600) or International Standby Practices of the International Chamber of Commerce Publication 590 (ISP98), or any successor publication, then the letter of credit shall specifically address and provide for an extension of time to draw against the letter of credit in the event that one or more of the occurrences specified in Article 36 of Publication 600 or any other successor publication, occur.

If the letter of credit is issued by a financial institution authorized to issue letters of credit, other than a qualified U.S. financial institution as described in paragraph 4342, then the following additional requirements shall be met:
a. The issuing financial institution shall formally designate the confirming qualified U.S. financial institution as its agent for the receipt and payment of the drafts; and

b. The “evergreen clause” shall provide for thirty (30) days notice prior to expiration date for nonrenewal.

5049. Reinsurance agreement provisions:

a. The reinsurance agreement in conjunction with which the letter of credit is obtained may contain provisions that:

i. Require the assuming insurer to provide letters of credit to the ceding insurer and specify what they are to cover;

ii. Stipulate that the assuming insurer and ceding insurer agree that the letter of credit provided by the assuming insurer pursuant to the provisions of the reinsurance agreement may be drawn upon at any time, notwithstanding any other provisions in the agreement, and shall be utilized by the ceding insurer or its successors in interest only for one or more of the following reasons:

(a) To pay or reimburse the ceding insurer for:

(1) The assuming insurer’s share under the specific reinsurance agreement of premiums returned, but not yet recovered from the assuming insurers, to the owners of policies reinsured under the reinsurance agreement on account of cancellations of such policies;

(2) The assuming insurer’s share, under the specific reinsurance agreement, of surrenders and benefits or losses paid by the ceding insurer, but not yet recovered from the assuming insurers, under the terms and provisions of the policies reinsured under the reinsurance agreement; and

(3) Any other amounts necessary to secure the credit or reduction from liability for reinsurance taken by the ceding insurer;

(b) Where the letter of credit will expire without renewal or be reduced or replaced by a letter of credit for a reduced amount and where the assuming insurer’s entire obligations under the reinsurance agreement remain unliquidated and undischarged ten (10) days prior to the termination date, to withdraw amounts equal to the assuming insurer’s share of the liabilities, to the extent that the liabilities have not yet been funded by the assuming insurer and exceed the amount of any reduced or replacement letter of credit, and deposit those amounts in a separate account in the name of the ceding insurer in a qualified U.S. financial institution apart from its general assets, in trust for such uses and purposes specified in paragraph 5049.a.ii.(a) as may remain after withdrawal and for any period after the termination date.

iii. All of the provisions of paragraph 5049.a. shall be applied without diminution because of insolvency on the part of the ceding insurer or assuming insurer.

b. Nothing contained in paragraph 5049.a. shall preclude the ceding insurer and assuming insurer from providing for:
i. An interest payment, at a rate not in excess of the prime rate of interest, on the amounts held pursuant to paragraph 5049.a.ii.; or

ii. The return of any amounts drawn down on the letters of credit in excess of the actual amounts required for the above or any amounts that are subsequently determined not to be due.

Other Security

5150. A ceding insurer may take credit for unencumbered funds withheld by the ceding insurer in the United States subject to withdrawal solely by the ceding insurer and under its exclusive control.

5254. Credit will not be granted, nor an asset or reduction from liability allowed, to a ceding insurer for reinsurance effected with assuming insurers meeting the requirements of this appendix or otherwise in compliance with this appendix unless the reinsurance agreement:

a. Includes a proper insolvency clause, which stipulates that reinsurance is payable directly to the liquidator or successor without diminution regardless of the status of the ceding company;

b. Includes a provision pursuant to Section [cite state law equivalent to Section 2 of the Credit for Reinsurance Model Law] whereby the assuming insurer, if an unauthorized assuming insurer, has submitted to the jurisdiction of an alternative dispute resolution panel or court of competent jurisdiction within the United States, has agreed to comply with all requirements necessary to give the court or panel jurisdiction, has designated an agent upon whom service of process may be effected, and has agreed to abide by the final decision of the court or panel; and

c. Includes a proper reinsurance intermediary clause, if applicable, which stipulates that the credit risk for the intermediary is carried by the assuming insurer.

Qualified U.S. Financial Institutions

5352. For purposes of paragraphs 1847, 1948.c., 4342 and 4948, a “qualified U.S. financial institution” means an institution that:

a. Is organized or (in the case of a U.S. office of a foreign banking organization) licensed, under the laws of the United States or any state thereof;

b. Is regulated, supervised and examined by U.S. federal or state authorities having regulatory authority over banks and trust companies; and

c. Has been determined by either the commissioner or the Securities Valuation Office of the National Association of Insurance Commissioners to meet such standards of financial condition and standing as are considered necessary and appropriate to regulate the quality of financial institutions whose letters of credit will be acceptable to the commissioner.

5453. A “qualified U.S. financial institution” means, for purposes of those provisions of this appendix specifying those institutions that are eligible to act as a fiduciary of a trust, an institution that:

a. Is organized, or in the case of a U.S. branch or agency office of a foreign banking organization, licensed, under the laws of the United States or any state thereof and has been granted authority to operate with fiduciary powers; and

b. Is regulated, supervised and examined by federal or state authorities having regulatory authority over banks and trust companies.
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/Revision¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>SSAP No. 62 – Revised Property and Casualty Reinsurance</td>
<td>Clarify wording in an existing disclosure, paragraph 116. This does not change the content of the disclosure just eliminates redundant phrase and breaks up two long sentences for readability.</td>
</tr>
<tr>
<td>SSAP No. 86—Derivatives</td>
<td>Proposes to reference SSAP No. 26R for the structured note definition instead of duplicating the definition in SSAP No. 86.</td>
</tr>
<tr>
<td>SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities</td>
<td>Adds two new suffixes for SVO filings that have been carried over from the prior year.</td>
</tr>
</tbody>
</table>

**Status:**

On August 3, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed editorial revisions to SSAP No. 62R—Property and Casualty Reinsurance, SSAP No. 86—Derivatives, and SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, as illustrated below.
1. **SSAP No. 62R, paragraph 116**

The below revisions are for readability and are not intended to change the content of the disclosure.

116. Disclose if the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders. This disclosure is limited to reinsurance contracts with written premium cessions or loss and loss expense reserve cessions described in this paragraph that meet the criteria of paragraph 95.a. or paragraph 95.b. This disclosure excludes cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member.

where:

a. The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or

b. Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates in a separate reinsurance contract.

2. **SSAP No. 86, Exhibit A, paragraph 5g:**

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

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

Footnote 1: The “structured notes” captured within scope of this statement is specific to instruments in which the terms of the agreement make it possible that the reporting entity could lose all or a portion of its original investment amount (for other than failure of the issuer to pay the contractual amounts due). These instruments incorporate both the credit risk of the issuer, as well as the risk of an underlying variable/interest (such as the performance of an equity index or the performance of an unrelated security). Securities that are labeled “principal-protected notes” are captured within scope of this statement if the “principal protection” involves only a portion of the principal and/or if the principal protection requires the reporting entity to meet qualifying conditions in order to be safeguarded from the risk of loss from the underlying linked variable. Securities that may have changing positive interest rates in response to a linked underlying variable or the passage of time, or that have the potential for increased principal repayments in response to a linked variable (such as U.S. Treasury Inflation-Indexed Securities) that do not incorporate risk of original investment/principal loss (outside of default risk) are not captured as structured notes in scope of this statement.
3. **SSAP No. 97, Exhibit A, paragraph 49**

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

Issue: ASU 2019-05, Targeted Transition Relief

Check (applicable entity):

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

Description of Issue: In June 2016, the FASB issued ASU 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which introduced the expected credit losses methodology for the measurement of credit losses on financial assets measured at amortized cost basis, replacing the previous incurred loss methodology. ASU 2016-13 also modified the accounting for available-for-sale debt securities, which must be individually assessed for credit losses when fair value is less than the amortized cost basis.

The FASB noted that financial statement preparers have begun to elect the fair value option on newly originated or purchased financial assets, although those entities historically have measured similar financial assets at an amortized cost basis. This adoption would require the maintenance of dual measurement methodologies for identical or similar financial instruments that are being managed in a similar manner. With this approach, users would not have decision useful information because the financial statements would not be comparable (i.e. a portion of an entity’s financial instruments measured at fair value versus other identical instruments measured at amortized costs that are owned by the same entity).

The amendments in this update provide an alternative accounting treatment to elect the fair value option for certain financial assets previously measured at amortized cost basis. The fair value option in this update does not apply to GAAP classified held-to-maturity debt securities.

Existing Authoritative Literature:
The existing guidance for the fair value is captured SSAP 100R—Fair Value. However, pursuant to statutory accounting, assets are required to be reported at the measurement method stipulated under the applicable SSAP. An election to utilize fair value in lieu of the stipulated measurement method (e.g., amortized cost) is not allowed under statutory accounting.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Significant activity has taken place regarding the analysis of ASU 2016-13: Financial Instruments – Credit Losses. Additional review and consideration is included in agenda item 2016-20.

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

Convergence with International Financial Reporting Standards (IFRS): The IASB issued IFRS 9, Financial Instruments in July 2014 as a response to concerns identified pertaining to the delayed recognition of credit losses; however, the IASB’s stakeholders strongly preferred an impairment model that uses a dual measurement approach, while U.S. stakeholders strongly preferred the current expected credit loss model.

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. 100R to reject ASU 2019-05 for statutory accounting.
This item is proposed to be rejected as ASU 2019-05 provides an alternative accounting treatment for certain financial assets (excluding held-to-maturity debt securities) previously measured at amortized cost. Pursuant to statutory accounting, assets are required to be reported at the measurement method stipulated under the applicable SSAP. An election to utilize fair value in lieu of the stipulated measurement method (e.g., amortized cost) is not allowed under statutory accounting.

**Proposed Revisions to SSAP No. 100R:**


**Staff Review Completed by: Jim Pinegar – June 2019**

**Status:**
On August 3, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 100R—*Fair Value*, as illustrated above, to reject ASU 2019-05, *Targeted Transition Relief* for statutory accounting.

G:\FRS\DATA\Stat Acctg\3. National Meetings\A. National Meeting Materials\2019\Fall\Hearing\8 - 19-28 - ASU 2019-05 - Targeted Transition Relief (Financial Instruments - Credit Losses).docx
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A A

Issue: ASU 2019-06, Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities.

Check (applicable entity):

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

Description of Issue:
In 2014, the FASB issued 1) ASU 2014-02, Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill, and 2) ASU 2014-18, Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination, which simplify the subsequent accounting for goodwill and certain identifiable intangible assets in business combinations. Those amendments were in response to concerns expressed by private companies regarding the cost and complexity of goodwill impairment tests and the accounting for certain identifiable intangible assets. When FASB issued both updates, it acknowledged that the issues addressed were not limited to private companies; they also pertain to not-for-profit entities.

Accordingly, FASB received feedback questioning the relevance and benefit of an impairment-only approach to goodwill and the accounting for identifiable intangible assets acquired in an acquisition by a not-for-profit entity. By providing an accounting alternative, this update will reduce the cost and complexity associated with the accounting for goodwill and the measurement of certain acquired identifiable intangible assets without significantly diminishing decision-useful information in not-for-profit financial statements.

The amendments in this update extend the private company alternatives from Topic 350 (ASU 2014-02) and Topic 805 (ASU 2014-18) to not-for-profit entities. Under this update, an alternative accounting treatment is offered to where if elected, a not-for-profit entity shall amortize goodwill on a straight-line basis over the lesser of 10 years or the demonstrated useful life. Additionally, a not-for-profit entity that elects this accounting alternative is required to make an accounting policy election to test goodwill for impairment at either the entity level or the reporting unit level. A not-for-profit entity is required to test goodwill for impairment when a triggering event occurs that indicates that the fair value of the entity may be below its carrying amount. Finally, certain identifiable intangible assets such as customer related intangibles (i.e. mortgage servicing rights) and noncompete agreements would no longer be separately recognized from goodwill.

Existing Authoritative Literature:
The existing guidance for goodwill and subsequent amortization is referenced in SSAP No. 68—Business Combinations and Goodwill and SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities.

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):
IFRS standards do not provide industry guidance for not-for-profit entities regarding goodwill. However, the IASB is currently reviewing if it should retain the existing impairment only model for the subsequent accounting of goodwill, or reintroduce an amortization method, as noted in IFRS Agenda Paper 18B.
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. 68 and SAP No. 97 to reject ASU 2019-06 for statutory accounting.

While the initial calculation of goodwill was not in scope of ASU 2019-06, this update provides optionality of an alternative accounting treatment for the straight-line amortization of goodwill for not-for-profit entities over the lesser of 10 years or the demonstrated useful life, subject to an impairment analysis performed in the event a triggering event occurs. Additionally, certain other identifiable intangible assets are no longer separately recorded and shall be combined into goodwill. As a point of reference, ASU 2019-06 is an extension of ASU 2014-02 to not-for-profit entities; ASU 2014-02 was previously rejected for SSAP.

This item is proposed to be rejected as ASU 2019-06 provides alternative accounting treatments for goodwill. Optionality treatment is not consistent with SSAP 68, specifically paragraphs 7 & 8, and SAP 97; however current SSAP guidance is similar as goodwill shall be amortized over the period in which the acquiring entity benefits economically, not to exceed 10 years. Additionally, impairment analysis shall occur in the event that a decline in an acquired entity’s fair value, that is other than temporary, may be below its carrying amount.

Proposed Revisions to SSAP No. 68:

20. This statement rejects ASU 2019-06, Intangibles—Goodwill and Other Business Combinations, and Non-for-Profit Entities, ASU 2017-04, Simplifying the Test for Goodwill Impairment, ASU 2016-03, Intangibles—Goodwill and Other, Business Combinations, Consolidation, Derivatives and Hedging; ASU 2014-02, Accounting for Goodwill (a consensus of the Private Company Council), ASU 2012-02, Testing Indefinite-Lived Intangible Assets for Impairment, ASU 2011-08, Testing Goodwill for Impairment and ASU 2010-28, When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts; Accounting Principles Board Opinion No. 16, Business Combinations; FASB Statement No. 38, Accounting for Preacquisition Contingencies of Purchased Enterprises, an amendment of APB Opinion No. 16; Accounting Principles Board Opinion No. 17, Intangible Assets; FASB Statement No. 79, Elimination of Certain Disclosures for Business Combinations by Nonpublic Enterprises; FASB Statement No. 141, Business Combinations; and FASB Statement No. 142, Goodwill and Other Intangible Assets. The following related interpretative pronouncements are also rejected.

Proposed Revisions to SSAP No. 97:

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

Staff Review Completed by: Jim Pinegar – June 2019
**Status:**
On August 3, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 68—Business Combinations and Goodwill* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, as illustrated above, to reject ASU 2019-06, *Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities* for statutory accounting.
Issue: ASU 2019-03, Updating the Definition of Collections

Check (applicable entity):

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

Description of Issue:
The term “collections” in the Master Glossary of the FASB Accounting Standards Codification is not fully aligned with the definition used in the American Alliance of Museums’ (AAM) Code of Ethics for Museums. Collections are to be defined as works of art, historical treasures, or similar assets that meet certain criteria: 1) held for public exhibition / education / research; 2) are protected, cared for, and preserved; 3) are subject to the organization’s policy that requires the use of proceeds from the sale of such items be used to acquire new collection items, the direct care of existing collections, or both.

The AAM definition used, which served as the basis for the guidance on collections in FASB Statement No. 116, Accounting for Contributions Received and Contributions Made, was revised by the AAM after the issuance of Statement 116. The FASB is issuing this update to improve the definition of collections in the Master Glossary by realigning it with the definition used by the AAM. The FASB also is making a technical correction in Topic 360, Property, Plant, and Equipment, to clarify that the accounting and disclosure guidance for collections in Subtopic 958-360, Not-for-Profit Entities—Property, Plant, and Equipment.

Existing Authoritative Literature:
There is no current SAP guidance for business entities that maintain collections. U.S. GAAP guidance for collections, primarily an issue for certain not-for-profit entities, is included in Topic 958.

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):
IFRS standards do not provide industry guidance for entities that maintain collections.

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 2019-03, Updating the Definition of Collections as not applicable to statutory accounting.

This item is proposed to be rejected as not applicable as ASU 2019-03 provides specific guidance, primarily for certain not-for-profit entities that maintain collections, which is not applicable for statutory accounting purposes.

Staff Review Completed by: Jim Pinegar – June 2019
**Status:**
On August 3, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2019-03, *Updating the Definition of Collections* as not applicable to statutory accounting.
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: ASU 2018-08, Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made

Check (applicable entity):

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

Description of Issue:
The FASB issued ASU 2018-08, Not-for-Profit Entities - Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made (ASU 2018-08) in June 2018. Its intent is to clarify and improve the scope and accounting guidance for contributions received and contributions made. ASU 2018-08 should assist entities in evaluating whether transactions should be accounted for as contributions (nonreciprocal transactions) or exchange (reciprocal) transactions and in determining whether the contribution is conditional. Distinguishing between contributions and exchange transactions is important as it determines which guidance to apply.

Diversity in application exists for grants and other similar contracts but is most prevalent for government grants and contracts. It has also been noted that it can be difficult to determine when a contribution is conditional, especially when an entity receives assets accompanied by certain stipulations but with no specified return requirement for when the stipulations are not met. There also isn’t uniformity in assessments of whether the likelihood of failing to meet a condition is remote and in evaluating whether and how remote provisions affect the timing of when a contribution is recognized.

Although accounting for contributions is primarily an issue for not-for-profit entities, the amendments in ASU 2018-08 are applicable to all entities, including business entities, that receive or make contributions of cash and other assets, including promises to give and contributions made. However, the amendments herein do not apply to transfers of assets from government entities to business entities. Contribution revenue may be presented in the financial statements of an entity using different terms (i.e., gift, grant, donation, etc.), but this should not be a factor for determining whether an agreement is within the scope of this guidance.

The amendments in this ASU clarify and improve the current guidance regarding whether a transfer of assets (or the reduction, settlement, or cancellation of liabilities) is a contribution or an exchange transaction. The amendments clarify how an entity determines whether a resource provider is participating in an exchange transaction by evaluating whether the resource provider is receiving commensurate value in return for the resources transferred based on the following:

1. A resource provider is not synonymous with the general public. A benefit received by the public as a result of the assets transferred is not equivalent to commensurate value received by the resource provider.

2. Execution of a resource provider’s mission or the positive sentiment from acting as a donor does not constitute commensurate value received by a resource provider for purposes of determining whether a transfer of assets is a contribution or an exchange.
Existing Authoritative Literature:

SSAP No. 67—Other Liabilities

Amounts Withheld or Retained by Company as Agent or Trustee

7. A reporting entity may, in the normal course of its business, withhold funds as an agent or trustee which will ultimately be paid to others.

8. Amounts withheld or retained by an entity as trustee or agent shall be recorded as a liability when the salaries or other compensation are expensed (paragraphs 8.a. and 8.b.) or the funds are received (paragraphs 8.c. through 8.e.). Examples of such occurrences are:

   a. As an employer, the reporting entity deducts and withholds federal and state income taxes, social security taxes, charitable contributions, savings plan deductions, garnishments, employee contributions to pension plans, employee share of group life and health insurance premiums, and other employee salary withholdings or deductions;

   b. Amounts due under deferred compensation arrangements shall be accrued in accordance with the provisions of SSAP No. 92—Postretirement Benefits Other Than Pensions (SSAP No. 92). Segregated funds (i.e., Rabbi trusts and similar arrangements) shall not be netted against the accrued liability unless the requirements of SSAP No. 64—Offsetting and Netting of Assets and Liabilities (SSAP No. 64) are met.

   c. For a reporting entity that invests in commercial and residential mortgages, the entity may require the mortgagor to prepay real estate taxes and property insurance premiums which the entity will hold in escrow and pay when due;

   d. The reporting entity holds deposits in connection with leases of investment property; and

   e. The reporting entity may receive and hold other funds in a fiduciary capacity.

Remittances and Items Not Allocated

9. Cash receipts cannot always be identified for a specific purpose or, for other reasons, applied to a specific account when received. The reporting entity shall record a liability for these cash receipts when the funds are received. These liability accounts are generally referred to as suspense accounts. Examples include:

   a. Premium payments received with the application for policies which have not yet been issued;

   b. Premium payments in an amount different than the amount billed by the reporting entity; and

   c. Unidentified cash receipts.

Interest Payable

10. Interest payable includes interest on debt, interest on real estate obligations, and approved interest on surplus notes. It also includes interest on funds held as a deposit or security, such as those held by a ceding company against a reinsurer. The amount to be reported is the amount which has accrued and is unpaid at the balance sheet date.

Payable to Parent, Subsidiaries and Affiliates

11. A liability shall be recognized and identified as due to affiliates for expenditures incurred on behalf of the reporting entity by a parent, affiliates, or subsidiaries or for amounts owed through other intercompany transactions. Amounts due to or from affiliates shall be offset and reported net only when the provisions of SSAP No. 64 are met. Examples of these expenses are executive salaries, workers’ compensation insurance premiums, and pension contributions.
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):

Staff Recommendation:
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 2018-08, Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made as not applicable to statutory accounting.

Staff Review Completed by:
Fatima Sediqzad – June 2019

Status:
On August 3, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2018-08, Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made as not applicable to statutory accounting.
This page intentionally left blank.
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: SCA Loss Tracking – Accounting Guidance

Check (applicable entity):

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

Description of Issue:
This agenda item has been drafted to clarify the accounting guidance for SCA losses that result in zero or negative equity in an SCA. Agenda item 2018-09 - SCA Loss Tracking clarified the reporting guidance for SCA losses that result in zero, or negative, equity in an SCA. When reviewing that agenda item, it was identified that there could be uncertainty on the existing provisions that require a negative SCA reporting amount (rather than a zero reporting value). The intent of this agenda item is to clarify the instances that require a negative SCA value and ensure the accounting guidance in SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities for these instances is clear.

Existing Authoritative Literature:

SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets

Guarantees

16. A guarantee contract is a contract that contingently requires the guarantor to make payments (either in cash, financial instruments, other assets, shares of its stock, or provision of services) to the guaranteed party based on changes in the underlying that is related to an asset, a liability, or an equity security of the guaranteed party. Commercial letters of credit and loan commitments, by definition, are not considered guarantee contracts. Also excluded from the definition are indemnifications or guarantees of an entity’s own performance, subordination arrangements or a noncontingent forward contract. This definition could include contingent forward contracts if the characteristics of this paragraph are met.

19. With the exception of the provision for guarantees made to/or on behalf of a wholly-owned subsidiaries in paragraph 18.f. and “unlimited” guarantees in 18.g., this guidance does not exclude guarantees issued as intercompany transactions or between related parties from the initial liability recognition requirement. Thus, unless the guarantee is provided on behalf of a wholly-owned subsidiary or considered “unlimited,” guarantees issued between the following parties are subject to the initial recognition and disclosure requirements:

a. Guarantee issued either between parents and their subsidiaries or between corporations under common control;

b. A parent’s guarantee of its subsidiary’s debt to a third party; and

c. A subsidiary’s guarantee of the debt owed to a third party by either its parent or another subsidiary of that parent.

20. At the inception of a guarantee, the guarantor shall recognize in its statement of financial position a liability for that guarantee. Except as indicated in paragraph 22, the objective of the initial measurement of the liability is the fair value of the guarantee at its inception.

---

1 As practical expedients, when a guarantee is issued in a standalone arm’s-length transaction, the liability recognized at the inception of the guarantee should be the premium received or receivable by the guarantor. When a guarantee is issued as part of a transaction with multiple elements, the liability recognized at the inception of the guarantee should be an estimate of the guarantee’s fair value. In that
21. The issuance of a guarantee obligates the guarantor (the issuer) in two respects: (a) the guarantor undertakes an obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur (the noncontingent aspect) and (b) the guarantor undertakes a contingent obligation to make future payments if those triggering events or conditions occur (the contingent aspect). Because the issuance of a guarantee imposes a noncontingent obligation to stand ready to perform in the event that the specified triggering event occurs, the provisions of paragraph 8 should not be interpreted as prohibiting the guarantor from initially recognizing a liability for that guarantee even though it is not probable that payments will be required under that guarantee.

22. In the event that, at the inception of the guarantee, the guarantor is required to recognize a liability under paragraph 8 for the related contingent loss, the liability to be initially recognized for that guarantee shall be the greater of (a) the amount that satisfies the fair value objective as discussed in paragraph 20 or (b) the contingent liability amount required to be recognized at inception of the guarantee by paragraph 8. For many guarantors, it would be unusual for the contingent liability under (b) to exceed the amount that satisfies the fair value objective at the inception of the guarantee.

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

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

   e. For entities subject to 8.b.i., 8.b.iii. and 8.b.iv. a reporting entity’s share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by an equity method plus advances made by the investor. The reporting entity shall discontinue applying an equity method when the investment (including advances) is reduced to zero\(^2\) and shall not provide for additional losses unless the reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee (guaranteed obligations meeting the definition of liabilities in SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets shall be recorded as liabilities). If the investee subsequently reports net income, the reporting entity shall resume applying an equity method only after its share of that net income equals the share of net losses not recognized during the period that an equity method was suspended;

Disclosures

34. All SCA investments within the scope of this statement (except paragraph 8.b.i. entities) shall include disclosure of the SCA balance sheet value (admitted and nonadmitted) as well as information received from the NAIC in response to the SCA filing (e.g., date and type of filing, NAIC valuation amount, whether resubmission of filing is required). This disclosure shall include an aggregate total of all SCAs (except paragraph 8.b.i. entities) with detail of the aggregate gross value under this statement with the admitted and nonadmitted amounts reflected on the balance sheet. (As noted in paragraph 4, joint ventures, partnerships and limited liability companies are accounted for under the guidance in SSAP No. 48. As such, those entities are not subject to this disclosure.)

   a. For all periods presented, a reporting entity whose shares of losses in an SCA exceeds its investment in the SCA shall disclose its share of losses. (This is required regardless of a guarantee or commitment of future financial support to the SCA.) This disclosure shall include the following:

\(^2\) Refer to the additional guidance related to discontinuance of an equity method in paragraphs 15-17 and INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses.

© 2019 National Association of Insurance Commissioners 2
i. The reporting entity’s accumulated share of the SCA losses not recognized during the period that the equity method was suspended;

ii. The reporting entity’s share of the SCA’s equity, including negative equity;

iii. Whether a guaranteed obligation or commitment for financial support exists; and

iv. The SCA’s reported value.

This disclosure shall apply beginning in the period the SCA’s equity initially falls below zero and shall continue to be disclosed as long as the SCA investment is in a deficit position. Additionally, the reporting entity shall detail in a narrative disclosure whether losses in the SCA have impacted other investments as required by INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses.

### SCA Loss Tracking FN1

<table>
<thead>
<tr>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
</tr>
</thead>
<tbody>
<tr>
<td>SCA Entity</td>
<td>Reporting Entity’s Share of SCA Net Income (Loss)</td>
<td>Accumulated Share of SCA Net Income (Losses)</td>
<td>Reporting Entity’s Share of SCA’s Equity, Including Negative Equity</td>
<td>Guaranteed Obligation / Commitment for Financial Support (Yes / No)</td>
<td>SCA Reported Value FN2</td>
</tr>
<tr>
<td>................................</td>
<td>................</td>
<td>........</td>
<td>.................</td>
<td>........</td>
<td>........</td>
</tr>
<tr>
<td>................................</td>
<td>................</td>
<td>........</td>
<td>.................</td>
<td>........</td>
<td>........</td>
</tr>
<tr>
<td>................................</td>
<td>................</td>
<td>........</td>
<td>.................</td>
<td>........</td>
<td>........</td>
</tr>
<tr>
<td>................................</td>
<td>................</td>
<td>........</td>
<td>.................</td>
<td>........</td>
<td>........</td>
</tr>
<tr>
<td>................................</td>
<td>................</td>
<td>........</td>
<td>.................</td>
<td>........</td>
<td>........</td>
</tr>
<tr>
<td>................................</td>
<td>................</td>
<td>........</td>
<td>.................</td>
<td>........</td>
<td>........</td>
</tr>
<tr>
<td>................................</td>
<td>................</td>
<td>........</td>
<td>.................</td>
<td>........</td>
<td>........</td>
</tr>
<tr>
<td>................................</td>
<td>................</td>
<td>........</td>
<td>.................</td>
<td>........</td>
<td>........</td>
</tr>
</tbody>
</table>

**NOTE:** FN1 - This disclosure is only required for SCAs in which the reporting entity’s share of losses exceed the investment in an SCA, (the SCA investment is in a negative equity position). This disclosure shall apply beginning in the period the investment in the SCA equity initially falls below zero and shall continue to be disclosed as long as the SCA investment is in a negative equity position. The disclosure is required whenever an investment in an SCA entity is in a negative equity position, and in the first year subsequent to the negative equity position in which a positive equity position has been attained.

FN2 - For Column 6, as detailed in SSAP No. 97, (unless the entity is subject to statutory adjustments under paragraph 9), once the reporting entity’s share of losses equals or exceeds the investment in the SCA, the SCA shall be reported at zero, with discontinuation of the equity method, unless there is a guaranteed obligation or a commitment for future financial support. If there is a guaranteed obligation or a commitment for future financial support, the guarantee requirement shall be recognized pursuant to SSAP No. 5R, and the reporting entity shall report the investment in the SCA reflecting their share of losses as a contra-asset. *(Disclosure of the guarantee or commitment would be captured in Note 14 and is not duplicated in this disclosure.)*

**SSAP No. 97, Exhibit C – Implementation Questions and Answers**

© 2019 National Association of Insurance Commissioners 3
7. **Q** - Is it possible for an SCA investment valued using an equity method to be reported as a negative value?

7.1 **A** - Yes, the equity method noninsurance SCA could have a negative equity. SSAP No. 97 paragraph 8.b.ii. relating to noninsurance SCA entities requires some assets to be reported as a negative value (nonadmitted) in paragraph 9. For example an 8.b.ii. SCA subsidiary that is only holding furniture, which is nonadmitted, would be reflected with negative equity to the extent the value of the nonadmitted asset(s) exceed(s) reported equity. It should be noted that although SSAP No. 97, paragraph 13.e. discusses some situations in which the equity method should be discontinued, this does not apply to SCA entities, which meet the requirements of paragraph 8.b.ii. In addition, SSAP No. 97, paragraph 13.e. lists some situations where the equity method would result in a valuation that is less than zero; examples are if reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee, in these cases, the valuation of the investment in subsidiary could be a negative value.

8. **Q** - Paragraph 13.e. of SSAP No. 97, lists some situations where the equity method should be discontinued. If the equity method is discontinued, does the reporting entity cease tracking equity losses?

8.1 **A** - No, the reporting entity does not cease tracking losses related to the investment in the SCA if an equity method is discontinued. If the equity method is discontinued, follow the guidance in paragraphs 15-17 and INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses (INT 00-24).

8.2 INT 00-24 lists situations that might require the reporting entity to write down other investments in the SCA subsidiary, such as loans, because of continuing losses in the SCA investment. Paragraphs 15-17 provides guidance to assist in determining whether prior losses are being funded if the reporting entity purchases additional stock, etc. after suspending the equity method. Paragraphs 15-17 in INT 00-24 note that even if the equity method is not being applied, the investment should be tracked to determine if additional losses have to be applied to other items and to determine if the investment in the SCA has a future recovery.

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 Statutory Accounting Principles (E) Working Group previously adopted agenda item 2018-09 – SCA Loss Tracking, which incorporated an additional disclosure to track an SCA’s losses.

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

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

Staff Recommendation:
Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, as detailed below, to clarify the existing reporting requirements for an SCA in a loss position. Staff would also request comments from regulators and interested parties regarding additional situations that require negative reporting.

**Proposed Revisions:**

SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities
13. On at least a quarterly basis, the procedures set forth below shall be followed by a reporting entity in applying an equity method of accounting (as described in paragraphs 8.b.i. through 8.b.iv.), as applicable, to investments in SCA entities:

   e. For entities subject to 8.b.i., 8.b.ii., 8.b.iii. and 8.b.iv. a reporting entity’s share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by an equity method plus advances made by the investor. The reporting entity shall discontinue applying an equity method when the investment (including advances) is reduced to zero and shall not provide for additional losses unless the situations in paragraph 13.e.i. or paragraph 13.e.ii. exist. If the investee subsequently reports net income, the reporting entity shall resume applying an equity method only after its share of that net income equals the share of net losses not recognized during the period that an equity method was suspended. In situations in which negative equity is reported (paragraph 13.e.i. and paragraph 13.e.ii.), the book adjusted carrying value for the investment in the SCA shall reflect the reporting entity’s negative equity value (reflecting the reporting entity’s share of the SCA losses). (This would be reported as a contra-asset.)

   i. In all instances in which the limited statutory adjustments required by paragraph 9 results in a negative equity valuation of the investment. (This would apply to 8.b.ii and 8.b.iv entities.)

   ii. When the reporting entity has guaranteed obligations or committed further financial support to an SCA. Recognition of the negative equity in the SCA is in addition to the guarantee liability required under SSAP No. 5R. (This applies to all SCA entities.)

Staff Review Completed by:
Fatima Sediqzad - NAIC Staff
July 2018

Status:
On August 4, 2018, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, as shown above, to clarify the existing reporting requirements for when the reporting entity has a negative equity valuation in an SCA investment.

On November 15, 2018, the Statutory Accounting Principles (E) Working Group re-exposed this agenda item and directed NAIC staff to work with interested parties and research applicable U.S. GAAP guidance to consider revisions to existing guidance that requires negative subsidiary, controlled and affiliated (SCA) entity reporting when there is a guarantee or commitment to provide financial support.

On April 6, 2019, the Statutory Accounting Principles (E) Working Group exposed revisions to SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, as detailed below, to revise the existing reporting requirements for when a reporting entity has a negative value in an SCA investment when the reporting entity has provided a financial commitment or guarantee. The illustration from the existing INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses is retained. Refer to the additional guidance related to discontinuance of an equity method in paragraphs 15-17 and INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses.

© 2019 National Association of Insurance Commissioners
Losses has also been moved to SSAP No. 97, in its entirety, as a new exhibit. This INT provides examples of how losses in an SCA shall be applied to other investments once the SCA equity investment has been halted at zero.

Spring 2019 National Meeting Exposure:

SSAP No. 97—Subsidiary, Controlled and Affiliated Entities:

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

   e. For entities subject to 8.b.i., 8.b.ii., 8.b.iii. and 8.b.iv. a reporting entity’s share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by an equity method plus advances made by the investor. The reporting entity shall discontinue applying an equity method when the investment (including advances) is reduced to zero and shall not provide for additional losses, while still continuing to track the amount of unreported equity method losses, until any future equity method income can be reported. If the entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee, such as guaranteed obligations meeting the definition of liabilities in SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5R), they shall be recorded as liabilities. If the entire loss is recognized under SSAP No. 5R, it does not also need to be recognized under SSAP No. 97. However, if there is a guarantee or commitment, and the entire loss is not recognized under SSAP No. 5R, the reporting entity shall not stop at zero, and shall recognize a negative value of the SCA. If the investee subsequently reports net income, the reporting entity shall resume applying an equity method only after its share of that net income equals the share of net losses not recognized during the period that an equity method was suspended;

Footnote 2: Refer to the additional guidance related to discontinuance of an equity method in paragraphs 15-17 and INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses. As detailed in INT 00-24, a reporting entity’s share of losses in an SCA shall be applied to other investments held in the SCA once the SCA (common stock) investment has been reduced to zero.

EXHIBIT F – ILLUSTRATION OF THE APPLICATION OF INT 00-24

XYZ Investment in ABC Company

1. ABC Company is a life insurance company, formed January 2, 20X1 to sell health insurance in the state of New York. On January 2, 20X1, XYZ Insurance Company invested $500,000 in ABC, and purchased 100,000 shares of common stock at par, and 40,000 shares of preferred stock at par. ABC Preferred stock is non-voting, 5% cumulative.

2. XYZ determined it has obtained a controlling interest in ABC as XYZ owns 50% of the voting interests of ABC. XYZ accounted for its investment in ABC Insurance Company under the statutory equity method of accounting. The following table is selected information from the financial statements of ABC Insurance Company.

<table>
<thead>
<tr>
<th></th>
<th>1/2/20X1</th>
<th>12/31/20X1</th>
<th>12/31/20X2</th>
<th>12/31/20X3</th>
<th>12/31/20X4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital and Surplus:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common stock, $1 par</td>
<td>$ 200,000</td>
<td>$ 200,000</td>
<td>$ 200,000</td>
<td>$ 200,000</td>
<td>$ 200,000</td>
</tr>
</tbody>
</table>

© 2019 National Association of Insurance Commissioners 6
200,000 shares issued and outstanding
Preferred stock, $10 par, 100,000 shares issued and outstanding
Surplus Notes $ 500,000 $ 500,000 $ 500,000
Unassigned Funds $ 130,000 ($180,000) ($630,000) ($1,430,000)
(Surplus)
Total Capital and Surplus $1,200,000 $1,330,000 $1,520,000 $ 1,070,000 $ 270,000

20X5 – 20X9
12/31/20X5 12/31/20X6 12/31/20X7 12/31/20X8 12/31/20X9

Capital and Surplus:
Common stock, $1 par, 200,000 shares issued and outstanding
Preferred stock, $10 par, 100,000 shares issued and outstanding
Surplus Notes $ 500,000 $1,000,000 $1,000,000 $1,000,000 $1,000,000
Unassigned Funds ($1,980,000) ($1,830,000) ($1,280,000) ($430,000) $ 820,000
(Surplus)
Total Capital and Surplus ($280,000) $ 370,000 $ 920,000 $1,770,000 $3,020,000

3. At 1/2/20X1, XYZ recorded the following entry to record its investment in ABC:

Investment in ABC Common stock $ 100,000
Investment in ABC Preferred stock $ 400,000
Cash $ 500,000

To record initial investment in ABC Insurance Company.

4. During the year ended 12/31/20X1, ABC had statutory net income before dividends of $200,000. At 12/31/20X1, ABC declared and paid a 5% preferred dividend, and a common stock dividend of $.10 per share. XYZ recorded the following entries:

Cash $ 20,000
Dividend Income $ 20,000

To record preferred dividend income from ABC Insurance Company for 20X1.

Investment in ABC Common stock $ 75,000
Unrealized Gain/Loss $ 75,000

To record 20X1 unrealized gain on investment in ABC Common. (($200,000 - $50,000) * 50%)

Cash $ 10,000
Unrealized Gain/Loss $ 10,000
Dividend Income $ 10,000
Investment in ABC Common stock $ 10,000

To record 20X1 dividend on ABC Common. (100,000 shares * $.10)

5. During the year ended 12/31/20X2, ABC issued an 8% surplus note of $500,000. XYZ purchased 100% of the surplus note. During that same year, ABC incurred a statutory net loss before dividends of $250,000. At 12/31/20X2, ABC declared and paid a 5% preferred dividend, and a common stock dividend of $.05 per share. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:
**Investment in ABC Surplus Notes**  
Cash $ 500,000  
**To record investment in ABC Insurance Company surplus notes.**

Cash $ 20,000  
Dividend Income $ 20,000  
**To record preferred dividend income from ABC Insurance Company for 20X2.**

Unrealized Gain/Loss $ 150,000  
Investment in ABC Common stock $ 150,000  
**To record 20X2 unrealized loss on investment in ABC Common. ((-$250,000 - $50,000) * 50%)**

Cash $ 5,000  
Unrealized Gain/Loss $ 5,000  
Dividend Income $ 5,000  
Investment in ABC Common stock $ 5,000  
**To record 20X2 dividend on ABC Common. (100,000 shares * $.05)**

6. During the year ended 12/31/20X3, ABC Insurance Company incurred a statutory net loss before dividends of $400,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Dividends Receivable $ 20,000  
Dividend Income $ 20,000  
**To record preferred dividend income from ABC Insurance Company for 20X3.**

Unrealized Gain/Loss $ 182,000  
Investment in ABC Preferred stock $ 172,000  
Investment in ABC Common stock $ 10,000  
**To record 20X3 unrealized loss on investment in ABC Common and Preferred.**

Total net loss and preferred stock dividend ($450,000).  
Common stock component reduces the Investment in ABC Common stock component to $0. (20,000 * 50%)  
Total net loss and preferred dividend (-$400,000 - $50,000) $450,000  
Less amount used to reduce common stock investment to $0 20,000  
Amount remaining to be allocated to investment in preferred 430,000  
XYZ ownership % of preferred 40%  
ii. XYZ reduction in investment in preferred $172,000

7. During the year ended 12/31/20X4, ABC Insurance Company incurred a statutory net loss before dividends of $750,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Dividends Receivable $ 20,000  
Dividend Income $ 20,000  
**To record preferred dividend income from ABC Insurance Company for 20X4.**

Unrealized Gain/Loss $ 458,000
To record 20X4 unrealized loss on investment in ABC Preferred and Surplus Notes.

Total net loss and preferred stock dividend ($800,000).
Common stock component reduces the Investment in ABC Preferred stock component to $0. (570,000 * 40%)
Preferred stock component calculated as:
- Total net loss and preferred dividend (-$750,000 - $50,000) $800,000
- Less amount used to reduce preferred stock investment to $0 570,000
- Amount remaining to be allocated to investment in surplus note 230,000
- XYZ ownership % of surplus note 100%
  iii. XYZ reduction in investment in ABC Surplus Notes $230,000

During the year ended 12/31/20X5, ABC Insurance Company incurred a statutory net loss before dividends of $500,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Dividends Receivable $20,000
  Dividend Income $20,000
To record preferred dividend income from ABC Insurance Company for 20X5.

Unrealized Gain/Loss $270,000
  Investment in ABC Surplus note $270,000
To record 20X5 unrealized loss on investment in ABC Surplus Notes.

Total ABC net loss and preferred stock dividend (-$500,000 - $50,000).
Surplus Note component calculated as:
- Total net loss and preferred dividend (-$500,000 - $50,000) $550,000
- XYZ ownership % of ABC Surplus Note 100%
- Amount of unrealized loss recognized in 20X5 $270,000
  iv. Amount of unrealized loss suspended $280,000

Since XYZ has not guaranteed any liabilities of ABC, the reduction they would recognize is limited to their remaining investment in ABC Surplus Notes. Therefore, they would only recognize a 20X5 unrealized loss on their investment in ABC of $270,000.

During the year ended 12/31/20X6, ABC Insurance Company realigned their marketing efforts and modified the products they were selling. ABC also issued an additional 8% surplus note of $500,000. This surplus note was purchased by an unaffiliated third party. During the year ended 12/31/X6, ABC Insurance Company had statutory net income before dividends of $200,000. ABC Insurance Company did not declare any dividends on common stock, but declared and paid current and dividends in arrears on preferred. XYZ recorded the following entries:

Cash $80,000
  Dividends Receivable $60,000
  Dividend Income $20,000
To record preferred dividend income from ABC Insurance Company for 20X6, and receipt of preferred dividends receivable for 20X3, 20X4 and 20X5.
11. XYZ did not record any change in their investment in ABC Surplus Notes, ABC Preferred or ABC Common, since ABCs' net income after preferred dividends did not exceed the losses accumulated during the period that XYZ suspended recording unrealized losses.

12. The following amounts were tracked:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total ABC net income and preferred stock dividend ($200,000 - $50,000).</td>
<td></td>
</tr>
<tr>
<td>Surplus Note component calculated as:</td>
<td></td>
</tr>
<tr>
<td>Total net income and preferred dividend ($200,000 - $50,000)</td>
<td>$150,000</td>
</tr>
<tr>
<td>XYZ ownership % of ABC Surplus Note</td>
<td>50%</td>
</tr>
<tr>
<td>Amount of unrealized loss suspended in 20X5</td>
<td>$75,000</td>
</tr>
<tr>
<td>Remaining amount of unrealized loss suspended</td>
<td>$280,000</td>
</tr>
</tbody>
</table>
<pre><code>                                                             | $205,000 |
</code></pre>

13. During the year ended 12/31/20X7, ABC Insurance Company had statutory net income before dividends of $600,000. At 12/31/20X7, ABC declared and paid a 5% preferred dividend. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$20,000</td>
</tr>
<tr>
<td>Dividend Income</td>
<td>$20,000</td>
</tr>
<tr>
<td>To record preferred dividend income from ABC Insurance Company for 20X7.</td>
<td></td>
</tr>
<tr>
<td>Investment in ABC Surplus Notes</td>
<td>$70,000</td>
</tr>
<tr>
<td>Unrealized Gain/Loss</td>
<td>$70,000</td>
</tr>
<tr>
<td>To record 20X7 unrealized gain on investment in ABC Surplus Notes.</td>
<td></td>
</tr>
<tr>
<td>Total ABC net income and preferred stock dividend ($600,000 - $50,000).</td>
<td></td>
</tr>
<tr>
<td>Surplus Note component calculated as:</td>
<td></td>
</tr>
<tr>
<td>Total net income and preferred dividend ($600,000 - $50,000)</td>
<td>$550,000</td>
</tr>
<tr>
<td>XYZ ownership % of ABC Surplus Note</td>
<td>50%</td>
</tr>
<tr>
<td>Remaining amount of unrealized loss suspended in 20X5</td>
<td>$275,000</td>
</tr>
</tbody>
</table>
<pre><code>   | v. 20X7 amount of unrealized gain on investment in ABC Surplus Note         | $205,000 |
</code></pre>
<p>| Investment in ABC Surplus Notes                                            | $425,000 |
| Unrealized Gain/Loss                                                        | $425,000 |
| To record 20X8 unrealized gain on investment in ABC Surplus Notes.           |          |</p>

14. During the year ended 12/31/20X8, ABC Insurance Company had statutory net income before dividends of $900,000. At 12/31/20X8, ABC declared and paid a 5% preferred dividend. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$20,000</td>
</tr>
<tr>
<td>Dividend Income</td>
<td>$20,000</td>
</tr>
<tr>
<td>To record preferred dividend income from ABC Insurance Company for 20X8.</td>
<td></td>
</tr>
<tr>
<td>Total ABC net income and preferred stock dividend ($900,000 - $50,000).</td>
<td></td>
</tr>
<tr>
<td>Surplus Note component calculated as:</td>
<td></td>
</tr>
<tr>
<td>Total net income and preferred dividend ($900,000 - $50,000)</td>
<td>$850,000</td>
</tr>
<tr>
<td>XYZ ownership % of ABC Surplus Note</td>
<td>50%</td>
</tr>
</tbody>
</table>
<pre><code>   | vi. 20X8 amount of unrealized gain on investment in ABC Surplus Note         | $425,000 |
</code></pre>
<p>| Investment in ABC Surplus Notes                                            | $425,000 |
| Unrealized Gain/Loss                                                        | $425,000 |
| To record 20X8 unrealized gain on investment in ABC Surplus Notes.           |          |</p>
15. During the year ended 12/31/20X9, ABC Insurance Company had statutory net income, before interest on surplus notes and dividends, of $1,400,000. The Commissioner approved one year’s interest payment on the surplus notes. At 12/31/20X9, ABC declared and paid a 5% preferred dividend, and a $.10 dividend per share on Common stock. XYZ recorded the following entries:

```
Cash                      $ 20,000
_____ Dividend Income          $ 20,000

To record preferred dividend income from ABC Insurance Company for 20X9.

Cash                      $ 40,000
_____ Interest Income         $ 40,000

To record surplus notes interest income from ABC Insurance Company for 20X9. ($500,000 * 8%)

Investment in ABC Surplus Notes $ 5,000
Investment in ABC Preferred Stock $ 400,000
Investment in ABC Common Stock $ 130,000
_____ Unrealized Gain/Loss       $ 535,000

To record 20X9 unrealized gain on investment in ABC Common, Preferred and Surplus Notes.
Components computed as follows:

Total Net Income net of preferred stock dividend and interest on surplus notes $ 1,270,000
($1,400,000 - $50,000 - $80,000)
Less amount needed to restore investment in surplus notes ($ 10,000)
Amount available for preferred stock and common stock investment restoration $ 1,260,000
Amount needed to restore preferred stock component ($1,000,000)
Amount available to restore common stock component $ 260,000

Surplus Notes component ($10,000 * 50%) $ 5,000
Preferred Stock component ($1,000,000 * 40%) $ 400,000
vii. Common stock component ($260,000 * 50%) $ 130,000

Cash                      $ 10,000
_____ Unrealized Gain/Loss       $ 10,000
_____ Dividend Income           $ 10,000
_____ Investment in ABC Common stock $ 10,000

To record 20X9 dividend on ABC Common. (100,000 shares * $.10)
```

On August 3, 2019, the Statutory Accounting Principles (E) Working Group exposed revisions to SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets and SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, as illustrated below, to require a financial commitment or guarantee for a subsidiary, controlled, or affiliated entity to be recognized as a non-contingent guarantee liability. These proposed revisions differ from the prior exposure as they would capture the entire financial guaranty or commitment for an SCA within scope of SSAP No. 5R and report a zero value for SCAs with a negative equity value.

**SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets**

8. An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations if both of the following conditions are met:

   a. Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the statutory
financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and

b. The amount of loss can be reasonably estimated.

18. The following types of guarantees are exempted from the initial liability recognition in paragraphs 20-25, but are subject to the disclosure requirements in paragraphs 29-32. For the guarantees addressed in paragraphs 18f and 18g, recognition of a contingent guarantee may be required subsequent to initial recognition in accordance with paragraph 24a:

a. Guarantee that is accounted for as a derivative instrument, other than credit derivatives within SSAP No. 86;

b. Guarantee for which the underlying is related to the performance of nonfinancial assets that are owned by the guaranteed party, including product warranties;

c. Guarantee issued in a business combination that represents contingent consideration;

d. Guarantee in which the guarantor’s obligation would be reported as an equity item;

e. Guarantee by an original lessee that has become secondarily liable under a new lease that relieved the original lessee from being the primary obligator;

f. Guarantees (as defined in paragraph 16) made to/or on behalf of directly or indirectly wholly-owned insurance or non-insurance subsidiaries; and

g. Intercompany and related party guarantees that are considered “unlimited” (e.g., typically in response to a rating agency’s requirement to provide a commitment to support).

19. With the exception of the provision for guarantees made to/or on behalf of a wholly-owned subsidiaries in paragraph 18.f. and “unlimited” guarantees in 18.g., this guidance does not exclude guarantees issued as intercompany transactions or between related parties from the initial liability recognition requirement. Thus, unless the guarantee is provided on behalf of a wholly-owned subsidiary or considered “unlimited,” guarantees issued between the following parties are subject to the initial recognition and disclosure requirements:

d. Guarantee issued either between parents and their subsidiaries or between corporations under common control;

e. A parent’s guarantee of its subsidiary’s debt to a third party; and

f. A subsidiary’s guarantee of the debt owed to a third party by either its parent or another subsidiary of that parent.

20. At the inception of a guarantee, the guarantor shall recognize in its statement of financial position a liability for that guarantee. Except as indicated in paragraph 22, the objective of the initial measurement of the liability is the fair value of the guarantee at its inception.

Footnote: As practical expedients, when a guarantee is issued in a standalone arm’s-length transaction, the liability recognized at the inception of the guarantee should be the premium received or receivable by

---

5 The exclusion for wholly-owned subsidiaries includes guarantees from a parent to, or on behalf of, a direct wholly-owned insurance or non-insurance subsidiary as well as guarantees made from a parent to, or on behalf of, an indirect wholly-owned insurance or non-insurance subsidiary. The “wholly-owned” exclusion in paragraph 18.f. does not include guarantees issued from one subsidiary to another subsidiary, regardless if both subsidiaries are wholly-owned (directly or indirectly) by a parent company.
the guarantor. When a guarantee is issued as part of a transaction with multiple elements, the liability recognized at the inception of the guarantee should be an estimate of the guarantee’s fair value. In that circumstance, guarantors should consider what premium would be required by the guarantor to issue the same guarantee in a standalone arm’s-length transaction.

21. The issuance of a guarantee obligates the guarantor (the issuer) in two respects: (a) the guarantor undertakes an obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur (the noncontingent aspect) and (b) the guarantor undertakes a contingent obligation to make future payments if those triggering events or conditions occur (the contingent aspect). Because the issuance of a guarantee imposes a noncontingent obligation to stand ready to perform in the event that the specified triggering event occurs, the provisions of paragraph 8 should not be interpreted as prohibiting the guarantor from initially recognizing a liability for that guarantee even though it is not probable that payments will be required under that guarantee.

22. In the event that, at the inception of the guarantee, the guarantor is required to recognize a liability under paragraph 8 for the related contingent loss, the liability to be initially recognized for that guarantee shall be the greater of (a) the amount that satisfies the fair value objective as discussed in paragraph 20 or (b) the contingent liability amount required to be recognized at inception of the guarantee by paragraph 8. For many guarantors, it would be unusual for the contingent liability under (b) to exceed the amount that satisfies the fair value objective at the inception of the guarantee.

23. The offsetting entry pursuant to the liability recognition at the inception of the guarantee depends on the circumstances in which the guarantee was issued. Examples include:

   a. If the guarantee was issued in a standalone transaction for a premium, the offsetting entry would the consideration received.

   b. If the guarantee was issued in conjunction with the sale of assets, a product, or a business, the overall proceeds would be allocated between the consideration being remitted to the guarantor for issuing the guarantee and the proceeds from that sale. That allocation would affect the calculation of the gain or loss on the sale transaction.

   c. If a residual value guarantee were provided by a lessee-guarantor when entering into an operating lease, the offsetting entry would be reflected as prepaid rent, which would be nonadmitted under SSAP No. 29.

   d. If a guarantee were issued to an unrelated or related party for no consideration on a standalone basis, the offsetting entry would be to expense.

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

   a. In situations in which a reporting entity has provided a financial guarantee or commitment to support a subsidiary, controlled or affiliated entity (SCA), and the reporting entity’s share of losses in the SCA exceed the equity method carrying amount of the SCA (resulting in a negative equity value in the SCA), the reporting entity shall adjust the initially recognized guarantee obligation to
reflect the greater of the then-current fair value of the guarantee or the negative equity position. (For guarantees captured in paragraphs 18f and 18g, this guidance requires recognition of a contingent guaranty when negative equity exists in an SCA.) The recognized guarantee liability shall not exceed the maximum amount of the financial guarantee or commitment provided by the reporting entity. The guidance in paragraphs 24 and 25 shall be followed for recognizing a contingent liability and subsequent re-recognition of a noncontingent liability as applicable.

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

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

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

e. For entities subject to 8.b.i., 8.b.ii, 8.b.iii, and 8.b.iv. a reporting entity’s share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by an equity method plus advances made by the investor. The reporting entity shall discontinue applying an equity method when the investment (including advances) is reduced to zero and shall not provide for additional losses, while still continuing to track the amount of unreported equity method losses, until any future equity method income can be reported. If the reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee, the provisions of such guaranteed obligations meeting the definition of liabilities in SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets shall be followed (SSAP No. 5R); they shall be recorded as liabilities. As the entire equity method loss (subject to the financial guarantee / commitment) shall be is recognized under SSAP No. 5R, it does not also need to be recognized under SSAP No. 97. If the investee subsequently reports net income, the reporting entity shall resume applying an equity method only after its share of that net income equals the share of net losses not recognized during the period that an equity method was suspended;

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

35. All SCA investments within the scope of this statement (except paragraph 8.b.i. entities) shall include disclosure of the SCA balance sheet value (admitted and nonadmitted) as well as information received from the NAIC in response to the SCA filing (e.g., date and type of filing, NAIC valuation amount, whether resubmission of filing is required). This disclosure shall include an aggregate total of all SCAs (except paragraph 8.b.i. entities) with detail of the aggregate gross value under this statement with the admitted and nonadmitted amounts reflected on the balance sheet. (As noted in paragraph 4, joint ventures, partnerships and limited liability companies are accounted for under the guidance in SSAP 48. As such, those entities are not subject to the disclosures in this statement, unless specifically directed by SSAP No. 48.)

a. For all periods presented, a reporting entity whose shares of losses in an SCA exceeds its investment in the SCA shall disclose its share of losses. (This is required regardless of a
guarantee or commitment of future financial support to the SCA.) This disclosure shall include the following:

i. The reporting entity’s accumulated share of the SCA losses not recognized during the period that the equity method was suspended;

ii. The reporting entity’s share of the SCA’s equity, including negative equity;

iii. Whether a guaranteed obligation or commitment for financial support exists; and

iv. The SCA’s reported value

The amount of the recognized guarantee under SSAP No. 5R.

**2019 Fall National Meeting Proposed Guidance for Exposure**

**SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets - (Industry edits are shaded.)**

8. An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations if both of the following conditions are met:

a. Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the statutory financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and

b. The amount of loss can be reasonably estimated.

18. The following types of guarantees are exempted from the initial liability recognition in paragraphs 20-25, but are subject to the disclosure requirements in paragraphs 29-32. For the guarantees addressed in paragraphs 18f and 18g, recognition of a contingent guarantee may be required subsequent to initial recognition in accordance with paragraph 24a:

a. Guarantee that is accounted for as a derivative instrument, other than credit derivatives within SSAP No. 86;

b. Guarantee for which the underlying is related to the performance of nonfinancial assets that are owned by the guaranteed party, including product warranties;

c. Guarantee issued in a business combination that represents contingent consideration;

d. Guarantee in which the guarantor’s obligation would be reported as an equity item;

e. Guarantee by an original lessee that has become secondarily liable under a new lease that relieved the original lessee from being the primary obligator;

f. Guarantees (as defined in paragraph 16) made to/or on behalf of directly or indirectly wholly-owned insurance or non-insurance subsidiaries8; and

---

8 The exclusion for wholly-owned subsidiaries includes guarantees from a parent to, or on behalf of, a direct wholly-owned insurance or non-insurance subsidiary as well as guarantees made from a parent to, or on behalf of, an indirect wholly-owned insurance or non-insurance subsidiary. The “wholly-owned” exclusion in paragraph 18.f.f does not include guarantees issued from one subsidiary to another subsidiary, regardless if both subsidiaries are wholly-owned (directly or indirectly) by a parent company.
19. With the exception of the provision for guarantees made to/or on behalf of a wholly-owned subsidiaries in paragraph 18.f. and “unlimited” guarantees in 18.g., this guidance does not exclude guarantees issued as intercompany transactions or between related parties from the initial liability recognition requirement. Thus, unless the guarantee is provided on behalf of a wholly-owned subsidiary or considered “unlimited,” guarantees issued between the following parties are subject to the initial recognition and disclosure requirements:

a. Guarantee issued either between parents and their subsidiaries or between corporations under common control;

b. A parent’s guarantee of its subsidiary’s debt to a third party; and

c. A subsidiary’s guarantee of the debt owed to a third party by either its parent or another subsidiary of that parent.

20. At the inception of a guarantee, the guarantor shall recognize in its statement of financial position a liability for that guarantee. Except as indicated in paragraph 22, the objective of the initial measurement of the liability is the fair value of the guarantee at its inception.

Footnote: As practical expedients, when a guarantee is issued in a standalone arm’s-length transaction, the liability recognized at the inception of the guarantee should be the premium received or receivable by the guarantor. When a guarantee is issued as part of a transaction with multiple elements, the liability recognized at the inception of the guarantee should be an estimate of the guarantee’s fair value. In that circumstance, guarantors should consider what premium would be required by the guarantor to issue the same guarantee in a standalone arm’s-length transaction.

21. The issuance of a guarantee obligates the guarantor (the issuer) in two respects: (a) the guarantor undertakes an obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur (the noncontingent aspect) and (b) the guarantor undertakes a contingent obligation to make future payments if those triggering events or conditions occur (the contingent aspect). Because the issuance of a guarantee imposes a noncontingent obligation to stand ready to perform in the event that the specified triggering event occurs, the provisions of paragraph 8 should not be interpreted as prohibiting the guarantor from initially recognizing a liability for that guarantee even though it is not probable that payments will be required under that guarantee.

22. In the event that, at the inception of the guarantee, the guarantor is required to recognize a liability under paragraph 8 for the related contingent loss, the liability to be initially recognized for that guarantee shall be the greater of (a) the amount the satisfies the fair value objective as discussed in paragraph 20 or (b) the contingent liability amount required to be recognized at inception of the guarantee by paragraph 8. For many guarantors, it would be unusual for the contingent liability under (b) to exceed the amount that satisfies the fair value objective at the inception of the guarantee.

23. The offsetting entry pursuant to the liability recognition at the inception of the guarantee depends on the circumstances in which the guarantee was issued. Examples include:

a. If the guarantee was issued in a standalone transaction for a premium, the offsetting entry would the consideration received.
b. If the guarantee was issued in conjunction with the sale of assets, a product, or a business, the overall proceeds would be allocated between the consideration being remitted to the guarantor for issuing the guarantee and the proceeds from that sale. That allocation would affect the calculation of the gain or loss on the sale transaction.

c. If a residual value guarantee were provided by a lessee-guarantor when entering into an operating lease, the offsetting entry would be reflected as prepaid rent, which would be nonadmitted under SSAP No. 29.

d. If a guarantee were issued to an unrelated or related party for no consideration on a standalone basis, the offsetting entry would be to expense.

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

27. In situations in which a reporting entity has provided a financial guarantee or commitment to support a subsidiary, controlled or affiliated entity (SCA), and the reporting entity’s share of losses in the SCA exceed the equity method carrying amount of the SCA (resulting in a negative equity value in the SCA), the reporting entity shall adjust the initially recognized guarantee obligation to reflect the greater impact of (i) the then-current fair value liability for or of the guarantee or (ii) the negative equity position, limited to the maximum amount of the financial guarantee or commitment provided by the reporting entity. (For this guidance requires the recognition of a guarantee liability for guarantees captured in paragraphs 18f and 18g, this guidance requires recognition of a contingent guaranty. The recognized guarantee liability shall not exceed the maximum amount of the financial guarantee or commitment provided by the reporting entity. The guidance in paragraphs 24 and 2520 through 26 shall be followed for the recognition of recognizing a contingent liability and subsequent re-recognition of a noncontingent liability, as applicable.)

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

SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities—No industry edits to this section

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

e. For entities subject to 8.b.i., 8.b.ii., 8.b.iii. and 8.b.iv. a reporting entity’s share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by an equity method plus advances made by the investor. The reporting entity shall discontinue applying an equity method
when the investment (including advances) is reduced to zero\(^\text{10}\) and shall not provide for additional losses, while still continuing to track the amount of unreported equity method losses, until any future equity method income can be reported. If the reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee, the provisions of such as guaranteed obligations meeting the definition of liabilities in \(\text{SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets}\) shall be followed (SSAP No. 5R), they shall be recorded as liabilities. If As the entire equity method loss (subject to the financial guarantee / commitment) shall be recognized under SSAP No. 5R, it does not also need to be recognized under SSAP No. 97. If the investee subsequently reports net income, the reporting entity shall resume applying an equity method only after its share of that net income equals the share of net losses not recognized during the period that an equity method was suspended;

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

35. All SCA investments within the scope of this statement (except paragraph 8.b.i. entities) shall include disclosure of the SCA balance sheet value (admitted and nonadmitted) as well as information received from the NAIC in response to the SCA filing (e.g., date and type of filing, NAIC valuation amount, whether resubmission of filing is required). This disclosure shall include an aggregate total of all SCAs (except paragraph 8.b.i. entities) with detail of the aggregate gross value under this statement with the admitted and nonadmitted amounts reflected on the balance sheet. (As noted in paragraph 4, joint ventures, partnerships and limited liability companies are accounted for under the guidance in SSAP No. 48. As such, those entities are not subject to the disclosures in this statement, unless specifically directed by SSAP No. 48.)

a. For all periods presented, a reporting entity whose shares of losses in an SCA exceeds its investment in the SCA shall disclose its share of losses. (This is required regardless of a guarantee or commitment of future financial support to the SCA.) This disclosure shall include the following:

i. The reporting entity’s accumulated share of the SCA losses not recognized during the period that the equity method was suspended;

ii. The reporting entity’s share of the SCA’s equity, including negative equity;

iii. Whether a guaranteed obligation or commitment for financial support exists; and

iv. The SCA’s reported value, The amount of the recognized guarantee under SSAP No. 5R.

Proposed New Exhibit F – This is not new guidance, it pulls in prior guidance from INT 00-24

**EXHIBIT F – ILLUSTRATION OF THE APPLICATION OF INT 00-24**

**XYZ Investment in ABC Company**

1. **ABC Company is a life insurance company, formed January 2, 20X1 to sell health insurance in the state of New York. On January 2, 20X1, XYZ Insurance Company invested $500,000 in ABC, and purchased**
100,000 shares of common stock at par, and 40,000 shares of preferred stock at par. ABC Preferred stock is non-voting, 5% cumulative.

2. XYZ determined it has obtained a controlling interest in ABC as XYZ owns 50% of the voting interests of ABC. XYZ accounted for its investment in ABC Insurance Company under the statutory equity method of accounting. The following table is selected information from the financial statements of ABC Insurance Company.

<table>
<thead>
<tr>
<th></th>
<th>20X1 – 20X4</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1/2/20X1</td>
<td>12/31/20X1</td>
<td>12/31/20X2</td>
<td>12/31/20X3</td>
<td>12/31/20X4</td>
</tr>
<tr>
<td>Capital and Surplus:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common stock, $1 par, 200,000 shares issued and outstanding</td>
<td>$200,000</td>
<td>$200,000</td>
<td>$200,000</td>
<td>$200,000</td>
<td>$200,000</td>
</tr>
<tr>
<td>Preferred stock, $10 par, 100,000 shares issued and outstanding</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Surplus Notes</td>
<td></td>
<td>$500,000</td>
<td>$500,000</td>
<td>$500,000</td>
<td></td>
</tr>
<tr>
<td>Unassigned Funds (Surplus)</td>
<td></td>
<td>$130,000</td>
<td>($180,000)</td>
<td>($630,000)</td>
<td>($1,430,000)</td>
</tr>
<tr>
<td>Total Capital and Surplus</td>
<td>$1,200,000</td>
<td>$1,330,000</td>
<td>$1,520,000</td>
<td>$1,070,000</td>
<td>$270,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>20X5 – 20X9</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital and Surplus:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common stock, $1 par, 200,000 shares issued and outstanding</td>
<td>$200,000</td>
<td>$200,000</td>
<td>$200,000</td>
<td>$200,000</td>
<td>$200,000</td>
</tr>
<tr>
<td>Preferred stock, $10 par, 100,000 shares issued and outstanding</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Surplus Notes</td>
<td></td>
<td>$500,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Unassigned Funds (Surplus)</td>
<td>($1,980,000)</td>
<td>($1,830,000)</td>
<td>($1,280,000)</td>
<td>($430,000)</td>
<td>$820,000</td>
</tr>
<tr>
<td>Total Capital and Surplus</td>
<td>($280,000)</td>
<td>$370,000</td>
<td>($920,000)</td>
<td>$1,770,000</td>
<td>$3,020,000</td>
</tr>
</tbody>
</table>

3. At 1/2/20X1, XYZ recorded the following entry to record its investment in ABC:

Investment in ABC Common stock | $100,000
Investment in ABC Preferred stock | $400,000
Cash | $500,000

To record initial investment in ABC Insurance Company.

4. During the year ended 12/31/20X1, ABC had statutory net income before dividends of $200,000. At 12/31/20X1, ABC declared and paid a 5% preferred dividend, and a common stock dividend of $.10 per share. XYZ recorded the following entries:

Cash | $20,000
Dividend Income | $20,000

To record preferred dividend income from ABC Insurance Company for 20X1.

Investment in ABC Common stock | $75,000
Unrealized Gain/Loss | $75,000

To record 20X1 unrealized gain on investment in ABC Common. (($200,000 - $50,000) * 50%)
<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$10,000</td>
</tr>
<tr>
<td>Unrealized Gain/Loss</td>
<td>$10,000</td>
</tr>
<tr>
<td>Dividend Income</td>
<td></td>
</tr>
<tr>
<td>Investment in ABC Common stock</td>
<td>$10,000</td>
</tr>
</tbody>
</table>

To record 20X1 dividend on ABC Common. (100,000 shares * $.10)

5. During the year ended 12/31/20X2, ABC issued an 8% surplus note of $500,000. XYZ purchased 100% of the surplus note. During that same year, ABC incurred a statutory net loss before dividends of $250,000. At 12/31/20X2, ABC declared and paid a 5% preferred dividend, and a common stock dividend of $.05 per share. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

- **Investment in ABC Surplus Notes** $500,000
  - **Cash** $500,000
  To record investment in ABC Insurance Company surplus notes.

- **Cash** $20,000
  - **Dividend Income** $20,000
  To record preferred dividend income from ABC Insurance Company for 20X2.

- **Unrealized Gain/Loss** $150,000
  - **Investment in ABC Common stock** $150,000
  To record 20X2 unrealized loss on investment in ABC Common. (($-250,000 - $50,000) * 50%)

- **Cash** $5,000
  - **Unrealized Gain/Loss** $5,000
  - **Dividend Income** $5,000
  - **Investment in ABC Common stock** $5,000
  To record 20X2 dividend on ABC Common. (100,000 shares * $.05)

6. During the year ended 12/31/20X3, ABC Insurance Company incurred a statutory net loss before dividends of $400,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

- **Dividends Receivable** $20,000
  - **Dividend Income** $20,000
  To record preferred dividend income from ABC Insurance Company for 20X3.

- **Unrealized Gain/Loss** $182,000
  - **Investment in ABC Preferred stock** $172,000
  - **Investment in ABC Common stock** $10,000
  To record 20X3 unrealized loss on investment in ABC Common and Preferred.

**Total net loss and preferred stock dividend ($450,000).**

- **Common stock component reduces the Investment in ABC Common stock component to $0. (20,000 * 50%)**
- **Total net loss and preferred dividend (-$400,000 - $50,000)** $450,000
- **Less amount used to reduce common stock investment to $0** $20,000
- **Amount remaining to be allocated to investment in preferred** $430,000
7. During the year ended 12/31/20X4, ABC Insurance Company incurred a statutory net loss before dividends of $750,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

- Dividends Receivable $20,000
- Dividend Income $20,000

To record preferred dividend income from ABC Insurance Company for 20X4.

- Unrealized Gain/Loss $458,000
- Investment in ABC Preferred stock $228,000
- Investment in ABC Surplus note $230,000

To record 20X4 unrealized loss on investment in ABC Preferred and Surplus Notes.

- Total net loss and preferred stock dividend ($800,000).
- Common stock component reduces the Investment in ABC Preferred stock component to $0. (570,000 * 40%)
- Preferred stock component calculated as:
  - Total net loss and preferred dividend (-$750,000 - $50,000) $800,000
  - Less amount used to reduce preferred stock investment to $0 570,000
  - Amount remaining to be allocated to investment in surplus note 230,000
  - XYZ ownership % of surplus note 100%
  - XYZ reduction in investment in ABC Surplus Notes $230,000

8. During the year ended 12/31/20X5, ABC Insurance Company incurred a statutory net loss before dividends of $500,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

- Dividends Receivable $20,000
- Dividend Income $20,000

To record preferred dividend income from ABC Insurance Company for 20X5.

- Unrealized Gain/Loss $270,000
- Investment in ABC Surplus note $270,000

To record 20X5 unrealized loss on investment in ABC Surplus Notes.

- Total ABC net loss and preferred stock dividend (-$500,000 - $50,000).
- Surplus Note component calculated as:
  - Total net loss and preferred dividend (-$500,000 - $50,000) $550,000
  - XYZ ownership % of ABC Surplus Note 100%
  - Amount of unrealized loss recognized in 20X5 $270,000
  - Amount of unrealized loss suspended $280,000

9. Since XYZ has not guaranteed any liabilities of ABC, the reduction they would recognize is limited to their remaining investment in ABC Surplus Notes. Therefore, they would only recognize a 20X5 unrealized loss on their investment in ABC of $270,000.

10. During the year ended 12/31/20X6, ABC Insurance Company realigned their marketing efforts and modified the products they were selling. ABC also issued an additional 8% surplus note of $500,000. This surplus note was purchased by an unaffiliated third party. During the year ended 12/31/20X6, ABC
Insurance Company had statutory net income before dividends of $200,000. ABC Insurance Company did not declare any dividends on common stock but declared and paid current and dividends in arrears on preferred. XYZ recorded the following entries:

\[
\begin{align*}
\text{Cash} & \quad \text{Dividends Receivable} & \quad \text{Dividend Income} \\
\quad 80,000 & \quad 60,000 & \quad 20,000
\end{align*}
\]

To record preferred dividend income from ABC Insurance Company for 20X6, and receipt of preferred dividends receivable for 20X3, 20X4 and 20X5.

11. XYZ did not record any change in their investment in ABC Surplus Notes, ABC Preferred or ABC Common, since ABCs' net income after preferred dividends did not exceed the losses accumulated during the period that XYZ suspended recording unrealized losses.

12. The following amounts were tracked:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total ABC net income and preferred stock dividend ($200,000 - $50,000)</td>
<td>$150,000</td>
</tr>
<tr>
<td>Surplus Note component calculated as:</td>
<td></td>
</tr>
<tr>
<td>Total net income and preferred dividend ($200,000 - $50,000)</td>
<td>$150,000</td>
</tr>
<tr>
<td>XYZ ownership % of ABC Surplus Note</td>
<td>50%</td>
</tr>
<tr>
<td>Amount of unrealized loss suspended in 20X5</td>
<td>$75,000</td>
</tr>
<tr>
<td>Remaining amount of unrealized loss suspended</td>
<td>$280,000</td>
</tr>
<tr>
<td></td>
<td>$205,000</td>
</tr>
</tbody>
</table>

13. During the year ended 12/31/20X7, ABC Insurance Company had statutory net income before dividends of $600,000. At 12/31/20X7, ABC declared and paid a 5% preferred dividend. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

\[
\begin{align*}
\text{Cash} & \quad \text{Dividend Income} \\
\quad 20,000 & \quad 20,000
\end{align*}
\]

To record preferred dividend income from ABC Insurance Company for 20X7.

\[
\begin{align*}
\text{Investment in ABC Surplus Notes} & \quad \text{Unrealized Gain/Loss} \\
\quad 70,000 & \quad 70,000
\end{align*}
\]

To record 20X7 unrealized gain on investment in ABC Surplus Notes.

\[
\begin{align*}
\text{Total ABC net income and preferred stock dividend ($600,000 - $50,000),} & \\
\text{Surplus Note component calculated as:} & \\
\text{Total net income and preferred dividend ($600,000 - $50,000)} & \quad 550,000 \\
\text{XYZ ownership % of ABC Surplus Note} & \quad 50%  \\
\text{Amount of unrealized loss suspended in 20X5} & \quad 275,000  \\
\text{Remaining amount of unrealized loss suspended} & \quad 205,000  \\
\text{20X7 amount of unrealized gain on investment in ABC Surplus Note} & \quad 170,000
\end{align*}
\]

14. During the year ended 12/31/20X8, ABC Insurance Company had statutory net income before dividends of $900,000. At 12/31/20X8, ABC declared and paid a 5% preferred dividend. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

\[
\begin{align*}
\text{Cash} & \quad \text{Dividend Income} \\
\quad 20,000 & \quad 20,000
\end{align*}
\]

To record preferred dividend income from ABC Insurance Company for 20X8.
Total ABC net income and preferred stock dividend ($900,000 - $50,000).

Surplus Note component calculated as:

- Total net income and preferred dividend ($900,000 - $50,000) $850,000
- XYZ ownership % of ABC Surplus Note 50%
- 20X8 amount of unrealized gain on investment in ABC $425,000

Investment in ABC Surplus Notes $425,000

Unrealized Gain/Loss $425,000

To record 20X8 unrealized gain on investment in ABC Surplus Notes.

16. During the year ended 12/31/20X9, ABC Insurance Company had statutory net income, before interest on surplus notes and dividends, of $1,400,000. The Commissioner approved one year’s interest payment on the surplus notes. At 12/31/20X9, ABC declared and paid a 5% preferred dividend, and a $.10 dividend per share on Common stock. XYZ recorded the following entries:

Cash $20,000

Dividend Income $20,000

To record preferred dividend income from ABC Insurance Company for 20X9.

Cash $40,000

Interest Income $40,000

To record surplus notes interest income from ABC Insurance Company for 20X9. ($500,000 * 8%)

Investment in ABC Surplus Notes $5,000
Investment in ABC Preferred Stock $400,000
Investment in ABC Common Stock $130,000

Unrealized Gain/Loss $535,000

To record 20X9 unrealized gain on investment in ABC Common, Preferred and Surplus Notes. Components computed as follows:

Total Net Income net of preferred stock dividend and interest on surplus notes $1,270,000

($1,400,000 - $50,000 - $80,000)

Less amount needed to restore investment in surplus notes ($10,000)

Amount available for preferred stock and common stock investment restoration $1,260,000

Amount needed to restore preferred stock component ($1,000,000)

Amount available to restore common stock component $260,000

Surplus Notes component ($10,000 * 50%) $5,000

Preferred Stock component ($1,000,000 * 40%) $400,000

Common stock component ($260,000 * 50%) $130,000

Cash $10,000

Unrealized Gain/Loss $10,000

Dividend Income $10,000

Investment in ABC Common stock $10,000

To record 20X9 dividend on ABC Common. (100,000 shares * $.10)
Statutory Issue Paper No. 1XX

Preferred Stock

STATUS
Exposure Draft – December 7, 2019

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

Type of Issue:
Common Area

SUMMARY OF ISSUE

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

2. The substantive revisions to SSAP No. 32 (illustrated in Exhibit A) under the Investment Classification Project, detailed within this issue paper, reflect the following key elements:
   
   a. Improves preferred stock definitions, with inclusion of information from U.S. generally accepted accounting principles (GAAP) for classifying preferred stock as redeemable or perpetual. The revisions also incorporate a new exhibit to capture various terms prevalent in preferred stock.
   
   b. Revises the measurement guidance to ensure appropriate, consistent measurement based on the type of preferred stock held and the terms of the preferred stock. The revisions also incorporate guidance for mandatory convertible preferred stock.
   
   c. Incorporates revisions to clarify impairment guidance as well as guidance for dividend recognition and redemption of preferred stock with the issuer.

DISCUSSION

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

Preferred Stock Definitions

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

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

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

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

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

5-7. Although the historical definition of preferred stock in SSAP No. 32 is comparable to current market terms, this issue paper recommends revisions to incorporate the NASDAQ definition as it is more encompassing of the characteristics of preferred stocks.

Definitions and Classification as Redeemable or Perpetual Preferred Stock

6-8. The accounting guidance of SSAP No. 32 varies based on whether preferred stock is considered to be “redeemable” or “perpetual.” The historical definitions of redeemable and perpetual within SSAP No. 32R reflected the following:

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

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

7-9. In comparing these terms to current U.S. GAAP, the guidance in the FASB Accounting Standards Codification (ASC), which is also consistent with Securities Exchange Commission (SEC) guidance, is more detailed in identifying the requirements for classification as redeemable preferred stock:

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

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

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

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

Definition of Restricted Stock:

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

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

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

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

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

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

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

**Accounting and Reporting of Preferred Stock**

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

16.18. The changes reflected in the revised SSAP No. 32 continue to differentiate accounting and reporting guidance by whether a reporting entity maintains an AVR and on the type of preferred stock (redeemable or perpetual). However, revisions have been incorporated to clarify the accounting and reporting of mandatory convertible preferred stock and to update the measurement basis for each type of preferred stock:

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

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

c. For mandatory convertible preferred stock, guidance has been incorporated to require measurement at fair value, not to exceed any stated call price, in the periods prior to conversion. This guidance is applicable regardless if the preferred stock would be classified as redeemable or perpetual and is applicable regardless of NAIC designation. This guidance requires the preferred stock to be measured at the same measurement basis that would be required once converted to common stock. This prevents overstatement in the financial statements at the time of conversion.

d. For exchange traded funds which qualify for preferred stock treatment from the NAIC SVO, the revisions clarify that these investments shall always be treated as perpetual preferred stock. This classification is appropriate as the fund would not qualify as a redeemable preferred stock with a stated term that allows for amortization.

Impairment of Preferred Stock

\subsection{47.19.} The prior guidance in SSAP No. 32 included different guidance for determining other-than-temporary impairment (OTTI) based on whether the preferred stock was redeemable or perpetual. Although this division has been retained, modifications have been reflected as follows:

\begin{enumerate}
\item[a.] For redeemable preferred stock, guidance has been captured to require assessment of OTTI whenever mandatory redemption rights or sinking fund requirements do not occur. Although preferred stock may indicate “required” elements, failing to provide dividends, or contribute to a sinking fund, may not be considered an act of default or require liability recognition from the issuer. Not receiving preferred stock provisions does not turn the holder of preferred stock into a creditor, and a redemption right cannot force a company to redeem shares. However, if an issuer fails to comply with “required” components, reporting entities should assess whether the preferred stock is other-than-temporarily impaired.

\item[b.] For perpetual preferred stock, the other-than-temporary impairment guidance has been revised to mirror guidance for other equity investments (e.g., common stock). As perpetual preferred stock will be reported at fair value, upon recognition of an OTTI, any unrealized losses will be realized, and the-then current fair value will become the new cost basis. Subsequent variations in fair value are treated as unrealized gains or losses.

\item[b-c.] Comments received from interested parties noted that proposed impairment guidance for perpetual preferred stock could be enhanced if written similar to existing impairment guidance in SSAP No. 30R—Unaffiliated Common Stock. Final proposed language in Exhibit A mimics the language in SSAP No. 30R.
\end{enumerate}

Preferred Stock Income / Redemption

\subsection{48.20.} The guidance in this issue paper incorporates revisions to clarify the reporting of dividend income from preferred stock. This guidance clarifies that dividends shall be recognized in the form received (cash,
preferred stock, common stock), at fair value, with differences between fair value and the dividend receivable recognized as gains or losses. Subsequent to initial recognition, the asset received shall follow the applicable statutory accounting statement. For example, dividends received in the form of common stock shall be captured in SSAP No. 30—Unaffiliated Common Stock.

Additionally, this issue paper incorporates new guidance to clarify the reporting when preferred stock is reacquired or redeemed by the issuing entity. Pursuant to this guidance, regardless of how an issuer reacquires the stock (either at market value or pre-set call / redemption price), the reporting entity would recognize any difference between the book/adjusted carrying value and the consideration received as a realized gain or loss.

Disclosures

Although this issue paper incorporates various accounting and reporting changes for preferred stock, there have been no revisions incorporated to the existing disclosure requirements.

Effective Date

The adoption of this issue paper by the Statutory Accounting Principles (E) Working Group, and the substantively revised statement of statutory accounting principles (SSAP) occurred on _______. The substantive revisions to SSAP No. 32R are detailed in Exhibit A of this issue paper and reflected in the substantively-revised SSAP No. 32R—Preferred Stock. The effective date of the guidance will be identified in the SSAP. Users of the Accounting Practices & Procedures Manual should note that issue papers are not represented in the Statutory Hierarchy (see Section IV of the Preamble) and therefore the conclusions reached in this issue paper should not be applied until the corresponding SSAP has been adopted by the Plenary of the NAIC.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

- SSAP No. 32R—Preferred Stock
EXHIBIT A - REVISIONS TO SSAP No. 32—Preferred Stock

Preferred Stock

SCOPE OF STATEMENT

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

2. Investments in preferred stock of entities captured in SSAP No. 97—Investments of in subsidiaries, controlled or affiliated entities or SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies, including as well as preferred stock interests of certified capital companies (CAPCO) per INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO) are included within the scope of this statement. The requirement to file investments in preferred stock of certain subsidiaries, controlled or affiliated entities with the NAIC pursuant to SSAP No. 97 does not affect the application of the accounting under this statement.

SUMMARY CONCLUSION

3. Preferred stock, which may or may not be publicly traded, is a security that represents ownership of a corporation and gives the holder a claim, prior to the claim of common stockholders on earnings and also generally on assets in the event of liquidation. Most preferred stock pays a fixed dividend that is paid prior to the common stock dividend, stated in a dollar amount or as a percentage of par value. Preferred stock does not usually carry voting rights. Preferred stock has characteristics of both common stock and debt, defined as any class or series of shares the holders of which have any preference, either as to the payment of dividends or distribution of assets on liquidation, over the holder of common stock (as defined in SSAP No. 30R—Unaffiliated Common Stock) issued by an entity. Preferred stock shall include:

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

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

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

---

1 Preferred stock shall be classified by its characteristics. For example, a preferred stock that is named “redeemable perpetual preferred stock” shall be reported as either “redeemable” or “perpetual” preferred stock based on whether the characteristics of paragraph 3a are met.
Exchange Traded Funds, which qualify for preferred stock treatment, as identified in Part Six, Section 2, of the Purposes and Procedures Manual of the NAIC Investment Analysis Office. SVO-Identified Preferred Stock ETFs shall follow the accounting provisions for perpetual preferred stock.

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

6. Mandatory sinking fund preferred stock is defined as redeemable preferred stock subject to a 100% mandatory sinking fund, annual installments of which will (a) commence not more than 10 years from the date of issue or December 31, 1978, if outstanding on that date; (b) be not less than 2% of the number of shares issued (or outstanding on December 31, 1978, if issued prior to that date); (c) provide for the redemption of the entire issue over a period not longer than 40 years from the date of issue, or December 31, 1978, if outstanding on that date. Redeemable preferred stock which is subject to a 100% mandatory sinking fund, but which does not, at date of issue or December 31, 1978, if outstanding at that time, meet one or more of the other requirements above, shall be considered as mandatory sinking fund preferred stock at the time the deficiency is cured through the passage of time or otherwise.

7. PIK preferred stock is defined as redeemable preferred stock on which, at the option of the issuer, dividends can be paid in additional securities rather than cash.

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

9. Restricted preferred stock is defined as a security either redeemable or perpetual preferred stock that must be traded in compliance with special Securities Exchange Commission (SEC) regulations concerning its purchase and resale. These restrictions generally result from affiliate ownership, merger and acquisition (M&A) activity and underwriting activity. Pursuant to the SEC, restricted securities are securities acquired in an unregistered, private sale from the issuing company or from an affiliate of the issuer. They typically bear a “restrictive” legend clearly stating that the holding may not resell the stock in the public marketplace unless the sale is exempt from the SEC’s registration requirements. Restricted preferred stock is generally considered an admitted asset; however, admittance may be limited based on the degree of restriction in accordance with SSAP No. 4—Assets and Nonadmitted Assets. Restricted preferred stock shall be coded as restricted in the investment schedule and disclosed pursuant to SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures, for which sale is restricted by governmental or contractual requirement (other than in connection with being pledged as collateral) except where that requirement terminates within one year or if the holder has the power by contract or otherwise to cause the requirement to be met within one year. Any portion of the security that can be reasonably expected to qualify for sale within one year is not considered restricted.

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

---

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

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

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

Amortization

13. Redeemable preferred stock purchased at a premium shall be amortized to reduce the carrying value to the call or redemption value over the period to the call or earliest redemption date, whichever produces the lowest asset value (yield to worst). Redeemable preferred stock purchased at a discount shall be accreted to increase the carrying value to par value or redemption price over the period to maturity or the latest redemption date.

14. PIK preferred stock shall be amortized to the lower of the call price or par value, measured in either case at the end of the stock dividend period and based on all of the shares expected to be held at the end of that period, including those received as dividends.

15.9. Amortization (and accretion) of the premium and discount arising at acquisition shall be calculated using the interest method and shall be reported as increases or decreases in dividends collected during the year through investment income.

Balance Sheet Amount

16. The NAIC Securities Valuation Office assigns preferred stocks NAIC designations (NAIC designation 1 through 6) in accordance with the Purposes and Procedures Manual of the NAIC Investment Analysis Office, and that NAIC designation is published in accordance with the SVO compilation instructions in the Purposes and Procedures Manual.

10. Preferred stock shall be valued based on (a) the underlying characteristics of the security (redeemable, perpetual, or mandatory convertible), (b) the quality rating of the security, expressed as an NAIC designation pursuant to paragraph 15, and (c) whether an asset valuation reserve (AVR) is maintained by the reporting entity.

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

b. Step-up preferred stock (a security with the structure of a preferred stock, that has the cash flow characteristics of a debt instrument) is considered a security with characteristics of both debt and equity, and the accounting and valuation of such securities shall be consistent with SVO guidelines as stipulated in the Purposes and Procedures Manual of the NAIC Investment Analysis Office.
17. For reporting entities required to maintain an AVR, the accounting for unrealized gains and losses shall be in accordance with SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve (SSAP No. 7). For reporting entities not required to maintain an AVR, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus).

a. Reporting Entities That Do Not Maintain An AVR

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

ii. Highest-quality or high-quality perpetual preferred stocks (NAIC designations 1 and 2), which have characteristics of equity securities, shall be reported at fair value, not to exceed any stated call price. All other perpetual preferred stocks (NAIC designations 3 to 6) shall be reported at the lower of cost or fair value.

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

iv. For preferred stocks reported at fair value, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus).

b. For reporting entities that maintain an AVR:

Reporting Entities That Do Maintain An AVR

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

ii. Highest-quality, high-quality or medium quality perpetual preferred stocks (NAIC designations 1 to 3), which have characteristics of equity securities, shall be valued at fair value, not to exceed any stated call price. All other perpetual preferred stocks (NAIC designations 4 to 6) shall be reported at the lower of cost or fair value.

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

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

18.11. An other-than-temporary (INT 06-07) impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of the security—preferred stock in effect at the date of acquisition. An assessment of other-than-temporary impairment shall occur whenever mandatory redemption rights or sinking fund requirements do not occur. A decline in fair value which is other-than-temporary includes situations where the reporting entity has made a decision to sell a security—the preferred stock prior to its maturity at an amount below its carrying value (i.e., amortized cost). If it is determined that a decline in the fair value of a redeemable preferred stock is other-than-temporary, an impairment loss shall be recognized as a realized loss equal to the entire difference between the redeemable preferred stock’s carrying value and its fair value at the balance sheet date of the reporting period for which the assessment is made. The measurement of the impairment loss shall not include partial recoveries of fair value subsequent to the balance sheet date. For reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7.

19.12. In periods subsequent to the recognition of other-than-temporary impairment loss for a redeemable preferred stock, the reporting entity shall account for the other-than-temporarily impaired preferred stocksecurity as if the preferred stocksecurity had been purchased on the measurement date of the other-than-temporary impairment, and in accordance with paragraph 19 or paragraph 21, as applicable. The fair value of the redeemable preferred stock on the other-than-temporary impairment measurement date shall become the new cost basis of the redeemable preferred stock and the new cost basis shall not be adjusted for subsequent recoveries in fair value. The discount or reduced premium recorded for the preferred stocksecurity, based on the new cost basis, shall be amortized over the remaining life of the preferred stocksecurity in the prospective manner based on the amount and timing of future estimated cash flows. The preferred stocksecurity shall continue to be subject to impairment analysis for each subsequent reporting period. Future declines in fair value which are determined to be other-than-temporary shall be recorded as realized losses.

Impairment of Perpetual Preferred Stock

20.13. For any decline in the fair value of perpetual preferred stock which is determined to be if it is determined that a decline in the fair value of a perpetual preferred stock is other-than-temporary (INT 06-07), the then-current fair value shall reflect the new cost basis of the preferred stock, with prior unrealized losses recognize as realized losses. Subsequent fluctuations in fair value shall be recorded as unrealized gains or losses. Future declines which are determined to be other-than-temporary shall be recognized as realized losses, the perpetual preferred stock shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. An impairment loss shall be recognized as a realized loss equal to the entire difference between the perpetual preferred stock’s carrying value and its fair value at the balance sheet date of the reporting period for which the assessment is made. The measurement of the impairment loss shall not include partial recoveries of fair value subsequent to the balance sheet date. For reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7. Subsequent fluctuations in fair value shall be recorded as unrealized gains or losses. Future declines which are determined to be other-than-temporary shall be recognized as realized losses. A decline in fair value which is other-than-temporary includes situations where the reporting entity has made a decision to sell a preferred stocksecurity at an amount below its carrying value.

21. In periods subsequent to the recognition of an other-than-temporary impairment loss for a perpetual preferred stock, the reporting entity shall account for the other-than-temporarily impaired security as if the security had been purchased on the measurement date of the other-than-temporary impairment, and in accordance with paragraph 20 or paragraph 22, as applicable. The fair value of the perpetual preferred stock on the measurement date shall become the new cost basis of the perpetual preferred stock and the new cost
basis shall not be adjusted for subsequent recoveries in fair value. Future declines in fair value which are
determined to be other than temporary, shall be recorded as realized losses.

Income

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

Redemption of Preferred Stock

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

22. Dividends on mandatorily redeemable preferred stock shall be accrued to the redemption price,
even if not declared, using the interest method over the period ending on the redemption date.

23. Cash dividends paid on PIK stock during the stock dividend period shall be accounted for as a
reduction in the investment.

Exchanges and Conversions

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

Disclosures

25. The following disclosures regarding preferred stocks shall be made in the financial statements:
   a. Fair values in accordance with SSAP No. 100R—Fair Value (SSAP No. 100R);
   b. Concentrations of credit risk in accordance with SSAP No. 27;
   c. Basis at which the preferred stocks are stated; and
   d. A description, as well as the amount, of preferred stock that is restricted and the nature of
      the restriction.
e. For each balance sheet presented, all preferred stocks in an unrealized loss position for which other-than-temporary declines in value have not been recognized

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

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

f. The disclosures in (i) and (ii) above should be segregated by those preferred stocks that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer using fair values determined in accordance with SSAP No. 100R.

g. As of the date of the most recent balance sheet presented, additional information should be included describing the general categories of information that the investor considered in reaching the conclusion that the impairments are not other-than-temporary.

h. When it is not practicable to estimate fair value, the investor should disclose the following additional information, if applicable, as of each date for which a statement of financial position is presented in its annual financial statements:

iii. The aggregate carrying value of the investments not evaluated for impairment, and

iv. The circumstances that may have a significant adverse effect on the fair value.

26.18. Refer to the Preamble for further discussion regarding disclosure requirements. The disclosure requirements of paragraphs 3117.b., 3117.e., 3117.f., 3117.g. and 3117.h. shall be included in the annual audited statutory financial reports only.

**Relevant Literature**


**Effective Date and Transition**

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

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

**REFERENCES**

**Other**

- *Purposes and Procedures Manual of the NAIC Investment Analysis Office*
- NAIC Valuation of Securities product prepared by the Securities Valuation Office

**Relevant Issue Papers**

- *Issue Paper No. 32—Investments in Preferred Stock (excluding investments in preferred stock of subsidiary, controlled, or affiliated companies)*
- *Issue Paper No. 131—Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment*
- *Issue Paper No. 1XX—Preferred Stock*
EXHIBIT A – GLOSSARY

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Term Preferred Stock – Preferred stock with a mandatory redemption requirement (maturity date) captured in the definition of redeemable preferred stock.
Statement of Statutory Accounting Principles No. 32R

Preferred Stock

STATUS

Type of Issue ............................................ Common Area
Issued ....................................................... Initial Draft
Effective Date ........................................... TBD
Affects ..................................................... No other pronouncements
Affected by .............................................. No other pronouncements
Interpreted by .......................................... INT 06-02; INT 06-07
Relevant Appendix A Guidance ........ None

SCOPE OF STATEMENT

SUMMARY CONCLUSION

REFERENCES

EXHIBIT A – GLOSSARY

SCOPE OF STATEMENT

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

2. Investments in preferred stock of entities captured in SSAP No. 97—Investments in subsidiaries, controlled or affiliated entities or SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies, as well as preferred stock interests of certified capital companies per INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO) are included within the scope of this statement. The requirement to file investments in preferred stock of certain subsidiaries, controlled or affiliated entities with the NAIC pursuant to SSAP No. 97 does not affect the application of the accounting under this statement.
SUMMARY CONCLUSION

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

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

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

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

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

5. Restricted preferred stock is defined as either redeemable or perpetual preferred stock that must be traded in compliance with special Securities Exchange Commission (SEC) regulations concerning its purchase and resale. These restrictions generally result from affiliate ownership, merger and acquisition (M&A) activity and underwriting activity. Pursuant to the SEC, restricted securities are securities acquired in an unregistered, private sale from the issuing company or from an affiliate of the issuer. They typically bear a “restrictive” legend clearly stating that the holding may not resell the stock in the public marketplace unless the sale is exempt from the SEC’s registration requirements. Restricted preferred stock is generally considered an admitted asset; however, admittance may be limited based on the degree of restriction in accordance with SSAP No. 4—*Assets and Nonadmitted Assets*. Restricted preferred stock shall be coded as restricted in the investment schedule and disclosed pursuant to SSAP No. 1—*Accounting Policies, Risks & Uncertainties, and Other Disclosures*.

---

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

2 This definition of restricted stock does not preclude a “restricted asset” classification for any preferred stock that is restricted (e.g., not under the exclusive control of the entity) by actions of the reporting entity or others. For example, if a reporting entity has pledged preferred stock, or used preferred stock in securities lending / repo transactions, the preferred stock shall be coded and disclosed as restricted stock pursuant to SSAP No. 1.
6. Preferred stocks meet the definition of assets as defined in SSAP No. 4—Assets and Nonadmitted Assets and are admitted assets to the extent they conform to the requirements of this statement.

Acquisitions and Sales

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

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

Amortization

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

Balance Sheet Amount

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

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

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

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

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

iv. For preferred stocks reported at fair value, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus).

b. For reporting entities that maintain an AVR:
i. Highest-quality, high-quality or medium quality redeemable preferred stocks (NAIC designations 1 to 3) shall be valued at amortized cost. All other redeemable preferred stocks (NAIC designations 4 to 6) shall be reported at the lower of amortized cost or fair value.

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

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

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

Impairment of Redeemable Preferred Stock

11. An other-than-temporary (INT 06-07) impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of the preferred stock in effect at the date of acquisition. An assessment of other-than-temporary impairment shall occur whenever mandatory redemption rights or sinking fund requirements do not occur. A decline in fair value which is other-than-temporary includes situations where the reporting entity has made a decision to sell the preferred stock prior to its maturity at an amount below its carrying value (i.e., amortized cost). If it is determined that a decline in the fair value of a redeemable preferred stock is other-than-temporary, an impairment loss shall be recognized as a realized loss equal to the entire difference between the redeemable preferred stock’s carrying value and its fair value at the balance sheet date of the reporting period for which the assessment is made. The measurement of the impairment loss shall not include partial recoveries of fair value subsequent to the balance sheet date. For reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7.

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

Impairment of Perpetual Preferred Stock

13. For any decline in the fair value of perpetual preferred stock which is determined to be other-than-temporary (INT 06-07), the perpetual preferred stock shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. For reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7. Subsequent fluctuations in fair value shall be recorded as unrealized gains or losses. Future declines which are determined to be other-than-temporary shall be recognized as realized losses. A decline in fair value which is other-than-temporary includes situations where the reporting entity has made a decision to sell a preferred stock at an amount below its carrying value.
Income

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

Redemption of Preferred Stock

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

Exchanges and Conversions

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

Disclosures

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

   a. Fair values in accordance with SSAP No. 100R—Fair Value (SSAP No. 100R);
   b. Concentrations of credit risk in accordance with SSAP No. 27;
   c. Basis at which the preferred stocks are stated; and
   d. A description, as well as the amount, of preferred stock that is restricted and the nature of the restriction.
   e. For each balance sheet presented, all preferred stocks in an unrealized loss position for which other-than-temporary declines in value have not been recognized
      i. The aggregate amount of unrealized losses (that is, the amount by which cost or amortized cost exceeds fair value) and
      ii. The aggregate related fair value of preferred stocks with unrealized losses.
   f. The disclosures in (i) and (ii) above should be segregated by those preferred stocks that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer using fair values determined in accordance with SSAP No. 100R.
   g. As of the date of the most recent balance sheet presented, additional information should be included describing the general categories of information that the investor considered in reaching the conclusion that the impairments are not other-than-temporary.
h. When it is not practicable to estimate fair value, the investor should disclose the following additional information, if applicable, as of each date for which a statement of financial position is presented in its annual financial statements:

i. The aggregate carrying value of the investments not evaluated for impairment, and

ii. The circumstances that may have a significant adverse effect on the fair value.

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

Relevant Literature


Effective Date and Transition

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

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

REFERENCES

Other

• Purposes and Procedures Manual of the NAIC Investment Analysis Office
• NAIC Valuation of Securities product prepared by the Securities Valuation Office
Relevant Issue Papers

- Issue Paper No. 32—Investments in Preferred Stock (excluding investments in preferred stock of subsidiary, controlled, or affiliated companies)
- Issue Paper No. 131—Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment
- Issue Paper No. 1XX—Preferred Stock
EXHIBIT A – GLOSSARY

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Term Preferred Stock – Preferred stock with a mandatory redemption requirement (maturity date) captured in the definition of redeemable preferred stock.
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Update Reporting Deposit-Type Contracts

Check (applicable entity):

- Modification of existing SSAP
- New Issue or SSAP
- Interpretation

<table>
<thead>
<tr>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>☒</td>
<td>☒</td>
<td>☒</td>
</tr>
</tbody>
</table>

Description of Issue: This agenda item has been drafted in response to questions identified by the Financial Stability (EX) Task Force in developing liquidity disclosure changes to the 2019 life blank, and the noted inability to fully identify and assess deposit-type contracts - (particularly guaranteed investment contracts) - within the statutory financial statements. From information received, it appears that in some instances deposit-type contracts are being reported along with life contracts in Exhibit 5 – Aggregate Reserves for Life Contracts or in Exhibit 6 – Aggregate Reserves for Accident and Health Contracts, rather than in Exhibit 7 – Deposit-Type Contracts.

This issue has been raised as payout requests for deposit-type contracts are significantly different than payouts generated by an insured event (mortality or morbidity). The Task Force identified that information on liabilities, particularly those that can be called with little or no surrender penalty, must be known to properly complete liquidity assessments.

After various discussions, it is anticipated that guaranteed investment contracts (GICs) are reported as a life contract or accident and health contract (and not a deposit-type contract) for one of the following reasons:

- The GIC was a “supplemental” contract formed from the proceeds of a life / A&H insurance contract.
- The GIC, although absent mortality or morbidity risk, was written on a life / A&H insurance “paper.”
- The state insurance department has approved the GIC to be classified as a life / A&H insurance contract.
- Contracts may be designed as GICs, but could potentially have mortality / morbidity components, which qualifies the contract to be reported as a life or A/H insurance contract.

The purpose of this agenda item is to solicit information regarding the reporting of GICs (and other deposit-type contracts) as life or A/H contracts in the reporting exhibits, and consider revisions to statutory accounting and reporting instructions to ensure that information regarding all GICs can be separately identifiable and aggregated from the financial statements.

Existing Authoritative Literature:

SSAP No. 50—Classifications of Insurance or Managed Care Contracts

5. Insurance contracts providing any protection against death, disability, accident or illness in which the reporting entity assumes mortality or morbidity risk shall be classified as life or accident and health contracts, as applicable. Managed care contracts provide defined health care services to subscribers, members or policyholders, collectively referred to hereafter as subscribers, in return for fixed, periodic premiums (usually paid monthly) that are generally due at or before the beginning of the coverage period and shall be classified as health contracts. Contracts which insure against damage to property by an insured peril or damage or injury to the insured or third parties, generally over a fixed/limited period of time, shall be classified as property and casualty contracts. Contracts in which the reporting entity does not assume any mortality, morbidity, health benefit costs incurred, or casualty risk and which act exclusively as investment vehicles shall be...
classified as deposit-type contracts. Such classification shall be made at the inception of the contract and shall not change.

14. Supplementary contracts with life contingencies are a type of agreement between the insurance company and either the insured or the beneficiary, usually to provide for full or partial settlement of the amount payable upon the termination of an original contract. Generally, the proceeds are paid over the lifetime of one or more beneficiaries. This differs from a supplementary contract without life contingencies under which the proceeds are paid over a definite period without regard to the life of the beneficiary.

Deposit-Type Contracts

43. Deposit-type contracts do not incorporate insurance risk. Contracts issued by insurers that do not incorporate risk from the death or disability of policyholders (mortality or morbidity risk) are more comparable to financial or investment instruments issued by other financial institutions than to insurance contracts.

44. Deposit-type contracts shall include contracts without any life or disability contingencies, including, but not limited to, certain types of the following policy categories:

a. Supplemental contracts
b. Lottery payouts
c. Structured settlements
d. Guaranteed interest contracts
e. Income settlement options
f. Dividend and coupon accumulations
g. Annuities certain
h. Premium and other deposit funds
i. Funding Agreements without well-defined class-based (e.g. age, gender) annuity purchase rates defining either specific or maximum purchase rate guarantees (see SSAP No. 15, paragraph 19, paragraph 20 of this statement and SSAP No. 52—Deposit-Type Contracts, paragraph 21.)

45. Under deposit-type contracts, the policyholder may assume all, some, or none of the investment risk, depending on the contract terms. Amounts can be deposited in lump sum, or periodically as allowed by the policy contract. Deposit-type contracts would include annuities certain, whose income payments have no reference to life contingencies and benefits are paid over a specified period (i.e., 10 years, 20 years, etc.).

SSAP No. 51R—Life Contracts

Policy Reserves

15. Statutory policy reserves shall be established for all unmatured contractual obligations of the reporting entity arising out of the provisions of the insurance contract. Where separate benefits are included in a contract, a reserve for each benefit shall be established as required in Appendix A-820. These statutory policy reserves have historically been calculated as the excess of the present value of future benefits to be paid to or on behalf of policyholders less the present value of future net premiums. For policies issued on or after the operative date of the Valuation Manual, these formulaic calculations will be supplemented for some policies with more advanced deterministic and stochastic reserve methodologies to better reflect company experience, possible economic conditions and inherent policy
risks. Statutory policy reserves meet the definition of liabilities as defined in SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5R). The actuarial methodologies referred to in paragraph 16 meet the criteria required for reasonable estimates in SSAP No. 5R.

16. The reserving methodologies and assumptions used in computation of policy reserves shall meet the provisions of Appendices A-820 and A-822. Policies written prior to the operative of the Valuation Manual shall additionally follow the actuarial guidelines found in Appendix C of this Manual. Policies written on or after operative of the Valuation Manual shall additionally follow the Valuation Manual and be subject to the actuarial guidelines referenced therein. Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.

Supplemental Benefits
40. In addition to the basic policy benefit, the insurance contract may provide supplemental benefits. Supplemental benefits include, but are not limited to, accidental death benefits and waiver of premium benefits. If the terms of the contract provide for these benefits, appropriate reserves shall be established in accordance with the applicable standards within the Accounting Practices and Procedures Manual.

SSAP No. 52—Deposit-Type Contracts

2. As discussed in SSAP No. 50, deposit-type contracts are those contracts that do not subject the reporting entity to any risks arising from policyholder mortality or morbidity. A mortality or morbidity risk is present if, under the terms of the contract, the reporting entity is required to make payments or forego required premiums contingent upon the death or disability (in the case of life and disability insurance contracts) or the continued survival (in the case of annuity contracts) of a specific individual or group of individuals.

3. Deposit-type contracts frequently grant policyholders significant discretion over the amount and timing of deposits and withdrawals. Reporting entities are frequently granted significant discretion over amounts that accrue to or that are assessed against policyholders.

4. Due to the absence of mortality and/or morbidity risk and the discretionary characteristics noted in paragraph 3, the accounting principles for income recognition and policy reserves for deposit-type contracts differ from the accounting for life contracts set forth in SSAP No. 51R—Life Contracts, accident and health contracts established in SSAP No. 54R—Individual and Group Accident and Health Contracts, and credit insurance contracts as discussed in SSAP No. 59—Credit Life and Accident and Health Insurance Contracts.

5. Categories of contracts that may not subject the reporting entity to risks arising from policyholder mortality or morbidity include, but are not limited to, certain types of the following policy categories:
   a. Supplemental contracts
   b. Lottery payouts
   c. Structured settlements
   d. Guaranteed interest contracts
   e. Income settlement options
   f. Dividend and coupon accumulations
   g. Annuities certain
   h. Premium and other deposit funds
Income Recognition
6. Contracts issued by a reporting entity that do not incorporate mortality or morbidity risk shall not be accounted for as insurance contracts. Amounts received as payments for such contracts shall not be reported as revenues but shall be recorded directly to an appropriate policy reserve account.\(^{(\text{INT 00-03}})}\)

Policy Reserves
7. Statutory policy reserves shall be established for all contractual obligations of the reporting entity arising out of the provisions of the contract. Where separate benefits are included in a contract, a reserve for each benefit shall be established as required in Appendix A-820. Statutory policy reserves meet the definition of liabilities as defined in SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5R). The actuarial methodologies referred to in paragraph 8 meet the criteria required for reasonable estimates in SSAP No. 5R.

8. The reserving methodologies and assumptions used in computation of policy reserves shall meet the provisions of Appendices A-820 and A-822, and the actuarial guidelines found in Appendix C of this Manual. Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.

9. The policy reserve for contracts without life contingencies where the future benefits are fixed and guaranteed (e.g., certain supplemental contracts, lottery payouts, structured settlements, guaranteed interest contracts, income settlement options, annuities certain, and unmatured coupon accumulations) shall be based on the present value of the future guaranteed benefits discounted at the valuation interest rate. The policy reserve for all other contracts (e.g., certain premium and other deposit funds, and dividend and matured coupon accumulations) shall be based on the accumulated amounts paid plus an income accumulation based on the contract provisions, less any withdrawals and applicable surrender charges.

10. Statutory policy reserves for those group annuity contracts or other contracts that, in whole or in part, establish the insurer’s obligations by reference to a segregated portfolio of assets not owned by the insurer shall be established in accordance with the guidance in Appendix A-695. Statutory policy reserves for those contracts with nonlevel premiums or benefits, or contracts with secondary guarantees shall be established in accordance with the guidance in Appendix A-830. Statutory policy reserves for those group life contracts utilizing a separate account that meet the requirements outlined in paragraph 1 of Appendix A-200 shall be computed in accordance with the guidance in that appendix.

11. Policy reserves shall be increased for reinsurance assumed and decreased for reinsurance ceded as further described in SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance.

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 2018-28: Updates to Liquidity Disclosures, and proposed revisions to SSAP No. 51R—Life Contracts, SSAP No. 52—Deposit-Type Contracts and SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance, were adopted by the SAPWG during the Fall 2018 National Meeting. This agenda item was developed in response to Financial Stability (Ex) Task Force recommendations to enhance existing disclosures on annuity actuarial reserves and deposit-type liabilities.

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


Staff Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose this agenda item with a request for comments on why GICs, or other deposit-type contracts, are reported in Exhibit 5 – Life Contracts or Exhibit 6 – Accident and Health Contract,
instead of Exhibit 7 – Deposit Type Contracts. With exposure, a referral will be sent to the Life Actuarial Task Force to inform them of the inquiry and request their comments. Although NAIC staff recommends delaying revisions to statutory accounting or reporting instructions until better knowing why these classifications occur, it is anticipated that clarification may be considered to ensure that separate reserve recognition, which is already required in SSAP No. 51R, requires separate reporting on the appropriate exhibit.

Staff Review Completed by:
Julie Gann, NAIC Staff – January 2019

Status:
On April 6, 2019, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed this agenda item with a request for comments on why guaranteed investment contracts (GICs), or other deposit-type contracts, are reported in Exhibit 5 – Life Contracts or Exhibit 6 – Accident and Health Contract, instead of Exhibit 7 – Deposit Type Contracts. With exposure, the Working Group directed a referral to the Life Actuarial (A) Task Force to inform them of the exposure and request comments.

On August 3, 2019, the Statutory Accounting Principles (E) Working Group exposed this agenda item with the inclusion of the items and questions noted below, with a request for additional comments from industry and state insurance regulators, and directed notifications of the exposure with a request for comments to the Financial Stability (EX) Task Force and the Life Actuarial (A) Task Force on the reporting of insurance contracts that do not have a mortality or morbidity risk.

1. Classification at Issuance – The interested parties noted that because a contract was life-contingent at issue, it is reported in Exhibit 5, and then it remains in Exhibit 5 after the death of the annuitant.

   Question – Is it appropriate to classify products based on original issuance when the original risks are no longer present in the contract? Is this simply past industry practice, or is there direction that prevents reclassification to the category that most appropriately reflects the risk? Preliminary information received from the Financial Stability (EX) Task Force (FSTF) staff has noted that this practice will make it more difficult to properly aggregate and assess deposit-type contracts, and that this assessment is important as the payouts for deposit-type contracts are significantly different than payouts generated by an insured event. The Task Force has identified that information on liabilities, particularly those that can be called quickly with little or no surrender penalty, is of critical importance to liquidity assessments.

2. State Approval – The interested parties noted that state insurance departments have the discretion to approve or require a contract to be classified as a life or A/H insurance contract.

   Question – If a state directs reporting differently than what is stipulated in the AP&P Manual, is that being captured as a permitted or prescribed practice? (The provisions in SSAP No. 1 require permitted / prescribed practice reporting when it results in different statutory reporting. Examples included in SSAP No. 1 include gross or net presentation, financial statement reporting lines, etc.)

3. Annuity Guidance – The interested parties cited existing annuity guidance in paragraph 20 of SSAP No. 50—Classifications of Insurance or Managed Care Contracts. Per this guidance, contracts containing well-defined class-based (e.g., age / gender) annuity purchase rates used in defining either a specific or maximum purchase rate guarantee would constitute an annuity contract containing a life contingency that would require it to be classified as a life contract.

   Question – NAIC staff agrees with the citation from interested parties on annuities in paragraph 20 of SSAP No. 50—Classifications of Insurance or Managed Care Contracts. However, with the intent to have more explicit product breakouts to allow for better assessment, is it time to clarify / revise this guidance to
result with the appropriate breakouts created by FSTF? It was noted that the current concepts were established a long time ago and there is a focus on non-traditional insurance liabilities (which includes funding agreements) for liquidity risk assessment as they can have higher run risk.

4. **Materiality of Issue** – Although the interested parties cite a “common” scenario, without information in the financial statements, there is no current ability to identify the extent contracts with no remaining mortality or morbidity risk are reflected as life contracts.

**Question** – To what extent are deposit-type contracts captured in an exhibit other than Exhibit 7? Is it possible to receive information from companies regarding this population for assessment purposes?

*Excerpt from SSAP No. 50, paragraph 20:*

1. An annuity contract is an arrangement whereby an annuitant is guaranteed to receive a series of stipulated amounts commencing either immediately or at some future date. The contract shall be issued to or for the benefit of an identifiable individual or group of individuals. *Such a contract containing well-defined class-based (e.g., age, gender) annuity purchase rates used in defining either a specific or maximum purchase rate guarantee would constitute an annuity contract containing a life contingency that would require it to be classified as a life contract.* Some examples of contracts issued for the benefit of a group of individuals include pension plan sponsors purchasing contracts for the benefit of their plan participants, employers or associations purchasing contracts for the benefit of their employees or members, and collective trusts purchasing contracts for the benefit of participating pension plans and their plan participants. The main types of annuity contracts with life contingencies are discussed below.

   a. A deferred annuity provides for the accumulation of funds to be applied at some future period designated by the policyholder. Premium payments can be made in a lump sum amount (single premium deferred annuity), or periodically (flexible or fixed premium deferred annuity) as allowed by the policy contract. At the end of the accumulation period, the policyholder may elect to receive a lump sum distribution or may elect to receive periodic payments for life, or over a specific period, or some combination thereof;

   b. A variable annuity is an annuity which includes a provision for benefit payments which vary in accordance with the rate of return of the underlying investment portfolio selected by the policyholder. The considerations for a variable annuity are usually invested in a separate account in which the value of the contract share varies according to the performance of the separate account before the commencement of annuity payments as well as after. Premium payments can be made in lump sum amounts or periodically as allowed by the policy contract. A minimum death benefit is often guaranteed during the annuity consideration accumulation period and these contracts are, therefore, classified as life contracts;

   c. A straight-life annuity provides for periodic payments to the annuitant as long as the annuitant lives. Death of the annuitant constitutes completion of the contract and no further payments are made by the insurance company;

   d. A life annuity with a period certain works essentially the same way as the straight-life annuity as the annuitant receives periodic payments for as long as the annuitant lives. However, if the annuitant dies before the end of the specified “certain” period, payments are continued to a beneficiary until the specified number of “certain” payments (i.e., the specified period in the contract) is completed;

   e. A refund annuity is similar to the life annuity with a period certain in which the annuitant receives periodic payments for as long as the annuitant lives. There are two variants of this type of annuity. Under the cash refund annuity, a lump-sum payment is made at the death of the annuitant equal to the excess, if any, of the purchase price of the annuity over the sum of the annuity payments made to date of death. The installment refund annuity provides that
annuity payments are to continue to a beneficiary after the death of the annuitant until the sum of all payments made equals the purchase price;

f. A joint and survivorship annuity provides for the continuation of payments after the death of one of the annuitants during the lifetime of the surviving annuitant.

Updates for 2019 Fall National Meeting:

NAIC staff recommend exposing agenda item 2019-08 to: 1) request feedback on the inclusion of a footnote excerpt for Exhibit 5 to disclose cases when a mortality risk is no longer present or a significant factor – i.e. due to a policyholder electing a payout benefit, 2) request feedback on circumstances where a morbidity risk is no longer present or a significant factor for Exhibit 6 items and whether a similar footnote disclosure would be appropriate, and 3) industry input for instruction clarifications regarding the classifications of deposit-type contracts captured in Exhibit 7.

Proposed Exhibit 5 Footnote Disclosure:

<table>
<thead>
<tr>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valuation Standard</td>
<td>Total</td>
<td>Industrial</td>
<td>Ordinary</td>
<td>Credit</td>
<td>Group</td>
</tr>
<tr>
<td>Life Insurance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Annuities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Supplementary Contracts with Life Contingencies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accidental Death Benefits</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disability – Active Lives</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disability – Disabled Lives</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Miscellaneous Reserves</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(a) Included in the above table are amounts that originally contained a mortality risk. Amounts that no longer contain a mortality risk are $__________ in Column 2 (Life Insurance), $__________ in Column 2 (Annuities), $__________ (Supplementary Contracts with Life Contingencies), $__________ (Accidental Death Benefits), $__________ (Disability – Active Lives), $__________ (Disability – Disabled Lives), $__________ (Miscellaneous Reserves).

Exhibit 7 Classification Instructions:

Instructions for Exhibit 7 (Deposit-Type Contracts) are detailed below. NAIC staff believes ambiguity exists in reporting categories and definition improvements would benefit financial statement preparers and users. NAIC staff request industry input on the definitional terms and suggestions for improvement/clarification to ensure items are appropriately captured and reported without the risk of category (column) crossover.

This exhibit is intended to capture information about the activity, before and after any reinsurance, for deposit-type contracts. Include supplementary contracts without life contingencies, annuities certain, income settlements options, premium and deposit funds, and other contracts as defined in SSAP No. 52—Deposit-Type Contracts.

- Column 2: Guaranteed Interest Contracts – contracts that do not subject the reporting entity to any mortality or morbidity risk
• Column 3: Annuities Certain – amounts settled under contracts without any mortality or morbidity risk, e.g., certain immediate annuity contracts amounts associated with lottery payouts, structured settlements, income settlement options or other amounts where payments are for a fixed period or amount. To exclude amounts reported in Column 2 or 4.

• Column 4: Supplemental Contracts (without life contingencies) - amounts resulting from proceeds settled under a settlement option provision of a life or annuity contract without any mortality or morbidity risk.

• Column 5: Dividend Accumulations or Refunds - amounts held on account related to contracts without any mortality or morbidity risk.

• Column 6: Premium and Other Deposit Funds - amounts not reported elsewhere in this exhibit for contracts that do not incorporate any mortality or morbidity risk.
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Accounting for “Other” Derivatives

Check (applicable entity):

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

Description of Issue:
This agenda item has been drafted to consider statutory accounting guidance for derivatives that are not used in hedging transactions, income generation transactions or replication (synthetic asset) transactions. This agenda item was directed with the adoption of agenda item 2018-18, Structured Notes, as it was noted that structured notes captured within scope of SSAP No. 86—Derivatives, would be unlikely to be used in the transactions with existing recognition and measurement guidance in SSAP No. 86.

Although the guidance of SSAP No. 86 is limited to the derivatives captured in the noted transactions (hedging, income generation or replication), the reporting schedule for derivatives (Schedule DB) currently includes an “other” derivative reporting category. Although this agenda item clarifies the accounting (measurement) value for these derivatives, as detailed within the proposed revisions, “other” derivatives do not qualify as admitted assets under the SSAP. Derivatives classified as “other” shall only be admitted in accordance with state investment laws that provide prescribed practices that permit admittance. These prescribed practices shall be detailed in Note 1. Derivatives reported in the “hedging-other” are derivatives subject to the “hedging” guidance in SSAP No. 86 and are not intended to be captured by this agenda item. This agenda item is strictly for the derivatives reported as “other” derivatives.

Existing Authoritative Literature:
SSAP No. 86—Derivatives establishes statutory accounting principles for derivative instruments and hedging, income generation and replication (synthetic asset) transactions using selected concepts outlined in FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities.

Although the scope of SSAP No. 86 references “all derivative instruments” recognition and measurement provisions are only provided for specific transactions identified in paragraph 3:

3. This statement addresses the recognition of derivatives and measurement of derivatives used in:
   a. Hedging transactions;
   b. Income generation transactions; and
   c. Replication (synthetic asset) transactions.

4. “Derivative instrument” means an agreement, option, instrument or a series or combination thereof:
   a. To make or take delivery of, or assume or relinquish, a specified amount of one or more underlying interests, or to make a cash settlement in lieu thereof; or
   b. That has a price, performance, value or cash flow based primarily upon the actual or expected price, level, performance, value or cash flow of one or more underlying interests.
Activity to Date (issues previously addressed by the Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Revisions have recently adopted to SSAP No. 86 and additional revisions are expected to consider ASU 2017-12, Derivatives and Hedging. Recent revisions include:

- Ref #2016-48 – Incorporated disclosures for financing derivatives.
- Ref# 2018-08 – Incorporate guidance to include structured notes in scope.
- Ref #2018-30 – Incorporated hedge documentation and assessment efficiencies from ASU 2017-12.

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

Convergence with International Financial Reporting Standards (IFRS):
U.S. GAAP and IFRS are consistent that all derivatives are reported at fair value, with changes recognized through income unless there is an election to apply hedge accounting. With hedge accounting, under IFRS and U.S. GAAP, derivatives are still reported at fair value, but the gain/loss may be recognized through other comprehensive income (instead of income).

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. 86—Derivatives to include recognition and measurement guidance for derivatives that do not qualify as hedging, income generation or replication transactions. In addition to the proposed revisions specific for “other” derivatives, revisions are reflected in the headers to separate the application of existing guidance.

Working Group Question – With the language proposed, admittance of “other” derivatives under state investment laws will require a prescribed practice disclosure in Note 1. Working Group comments are requested on whether the language in the SSAP should permit admittance under state investment law. If this language was included, then a prescribed practice detailed in Note 1 would not be required.

Proposed Revisions to SSAP No. 86—Derivatives:

3. This statement addresses the recognition of derivatives and measurement of derivatives used in:
   a. Hedging transactions;
   b. Income generation transactions; and
   c. Replication (synthetic asset) transactions.
   d. Other Derivatives – (Derivatives that are not used in hedging, income generation or replication transactions.)

Impairment

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

Recognition of Derivatives Recognition and Measurement of Derivatives Used in Hedging Transactions

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

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

Derivatives Used in Hedging Transactions

49.20. Derivative instruments used in hedging transactions that meet the criteria of a highly effective hedge shall be considered an effective hedge and are permitted to be valued and reported in a manner that is consistent with the hedged asset or liability (referred to as hedge accounting). For instance, assume an entity has a financial instrument on which it is currently receiving income at a variable rate but wishes to receive income at a fixed rate and thus enters into a swap agreement to exchange the cash flows. If the transaction qualifies as an effective hedge and a financial instrument on a statutory basis is valued and reported at amortized cost, then the swap would also be valued and reported at amortized cost. Derivative instruments used in hedging transactions that do not meet or no longer meet the criteria of an effective hedge, or that meet the required criteria but the entity has chosen not to apply hedge accounting, shall be accounted for at fair value and the changes in the fair value shall be recorded as unrealized gains or unrealized losses (referred to as fair value accounting).

Recognition and Measurement of Derivatives Used in Income Generation Transactions

General

43.44. Income generation transactions are defined as derivatives written or sold to generate additional income or return to the reporting entity. They include covered options, caps, and floors (e.g., a reporting entity writes an equity call option on stock that it already owns).

Recognition and Measurement of Derivatives Used in Replication (Synthetic Asset) Transactions

53.54. Replication (Synthetic Asset) transaction means a derivative transaction entered into in conjunction with other investments in order to reproduce the investment characteristics of otherwise permissible investments. A derivative transaction entered into by an insurer as a hedging or income generation transaction shall not be considered a replication (synthetic asset) transaction.

Staff Review Completed by: Julie Gann – April 2019

On May 29, 2019, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 86—Derivatives, as shown above, to include recognition and measurement guidance for derivatives that do not qualify as hedging, income generation or replication transactions.

On August 3, 2019, the Statutory Accounting Principles (E) Working Group re-exposed revisions to SSAP No. 86—Derivatives, as illustrated above, to clarify that “other” derivatives not used in hedging, income generation or replication shall be reported at fair value and do not qualify as admitted assets.

G:\FRS\DATA\Stat Acctg\3. National Meetings\A. National Meeting Materials\2019\Fall\Hearing\16 - 19-18 - SSAP No. 86 - Other Derivatives.docx

© 2019 National Association of Insurance Commissioners
This page intentionally left blank.
Issue: Reinsurance Credit

Check (applicable entity):

- Modification of existing SSAP: P/C, Life, Health
- New Issue or SSAP: P/C, Life, Health
- Interpretation: P/C, Life, Health

Description of Issue:
Regulators brought to the attention of the Working Group concerns regarding short-duration health reinsurance contracts which were termed quota share treaties but had features that limited the reinsurer’s risk. Concerns were noted that the reinsurance contracts were reported as meeting the “risk transfer” requirements under statutory accounting, but were not meeting “risk-transfer” requirements under U.S. GAAP. In addition, concerns were raised on whether similar reinsurance contracts that may meet risk transfer requirements for statutory accounting were taking a larger reinsurance accounting benefit than appropriate because the risk limiting features in the reinsurance contracts were limiting the actual amount of risks transferred. The Working Group directed NAIC staff to research and prepare an agenda item for subsequent discussion. Subsequent to this direction, the Working Group also received a referral from the Financial Analysis (E) Working Group noting additional concerns with short-duration contracts in particular and with a request that reinsurance disclosures designed to identify contracts with risk limiting features or noncompliant contracts that are required for SSAP No. 62R also be in SSAP No. 61R (See Activity to Date).

This agenda item addresses reinsurance risk transfer and accounting issues for clarification in statutory accounting primarily focused on reinsurance of short-duration products.

Overview of SSAP No. 61R (See Authoritative Literature in appendix for quotes of referenced material)

1. The scope of SSAP No. 61R is reinsurance of life deposit type and accident and health contracts.
2. While the majority of life contracts are long-duration, health has both long-duration (examples are long-term care and long-term disability) and short-duration products (example is group comprehensive health).
3. SSAP No. 61R explicitly quotes more of the FAS 113 long-duration contract risk transfer guidance.
4. Because SSAP No. 61R has more of a life contract (long-duration) focus it does not explicitly quote as much of short-duration risk transfer guidance from U.S. generally accepted accounting principles (GAAP) as SSAP No. 62R—Property and Casualty Reinsurance.
5. SSAP No. 61R adopts the following:
   a. GAAP guidance - FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts (FAS 113) with modifications; FAS 113 provides general risk transfer guidance but the majority of the guidance is different based on the classification categories of long-duration contracts and short-duration contracts. (FAS 113 requirements were incorporated into FASB codification primarily in ASC 944-20 and the key risk transfers aspects of FAS 113 are unchanged by FASB codification.)
   b. Appendix A-791—Life and Health Reinsurance Agreements (Appendix A-791) is based on NAIC Model Law 791—Life and Health Reinsurance Agreements (Model 791). It provides criteria for reinsurance accounting for proportional reinsurance contracts (see additional detail in following pages). Reinsurance contracts which receive reinsurance accounting under Appendix A-791 do not contain identified features which negate risk transfer. In addition, Appendix A-791 identifies significant risk categories by line of business that must be 100% ceded. The major risk categories are morbidity, mortality, lapse, credit quality, reinvestment and disintermediation. The current version of Model 791 was adopted by the NAIC in 1992.
c. Appendix A-785 is based on NAIC Model Law 785- Credit for Reinsurance (Model 785) which contains detailed information regarding when collateral is required and what types of collateral are acceptable in order to obtain credit for reinsurance. In general, collateral is required for unauthorized reinsurers and there is a sliding scale of collateral required for certified reinsurers. Model 785 is not the focus of this agenda item.

**SSAP No. 61R adopts FAS 113 with modifications** *(See Authoritative Literature in appendix for quotes of referenced material)*

SSAP No. 61R, paragraph 78, adopts FAS 113 with modifications noting that the statutory accounting principles established, reflect much more detailed guidance which differ substantially from GAAP. The documented list of statutory accounting modifications from FAS 113 includes 7 listed topics which are summarized below:

1. Reinsurance accounting reserve credits reduce reserves for policies, claims and unpaid claims (¶78.a.);
2. First year and renewal ceding commissions on indemnity reinsurance of new business are recognized as income and ceding commissions on ceded in-force business are included in the calculation of initial gain or loss (¶78b);
3. Initial gains on indemnity reinsurance of in-force blocks of business have unique accounting treatment which restricts the gains to the ceding entity until profits emerge (¶78d).
4. SSAP No. 61R prohibits recognition of a gain or loss in connection with the sale, transfer or reinsurance of an in-force block of business between affiliated entities in a non-economic transaction (¶78e).
5. SSAP No. 61R requires that a liability be established through a provision reducing surplus for unsecured reinsurance recoverables from unauthorized reinsurers (¶78f).
6. SSAP No. 61R prescribes offsetting certain reinsurance premiums (¶78g).
7. SSAP No. 61R, paragraph 78 explicitly notes the modifications to the FAS 113 risk transfer requirements regarding differences in GAAP and SAP classification of investment contracts, but does not note other modifications. The modification identifies contracts with insignificant mortality or morbidity risk.(¶78c).

78c. As discussed in SSAP No. 50, statutory accounting defines deposit-type contracts as those contracts which do not include any mortality or morbidity risk. GAAP defines investment contracts as those that do not subject the insurance enterprise to significant policyholder mortality or morbidity risk. (The distinction is any mortality or morbidity risk for statutory purposes vs. significant mortality or morbidity risk for GAAP purposes.) Therefore, a contract may be considered an investment contract for GAAP purposes, and that same contract may be considered other than deposit-type for statutory purposes. A reinsurance treaty covering contracts that have insignificant mortality or morbidity risk (i.e., contracts classified as other than deposit-type contracts for statutory purposes, but investment contracts for GAAP purposes) that does not transfer that mortality or morbidity risk, but does transfer all of the significant risk inherent in the business being reinsured (e.g., lapse, credit quality, reinvestment or disintermediation risk) qualifies for reinsurance accounting for statutory reporting purposes, but would not qualify for reinsurance accounting treatment for GAAP purposes;

**A-791** *(See Authoritative Literature in appendix for quotes of referenced material)*

The Model 791 proceedings citations (formerly known as the legislative history) notes that in 1985 the model was developed to prohibit reinsurance surplus aid abuses. Major revisions to Model 791 which are consistent with Appendix A-791, were adopted in 1992. The intent of the 1992 revisions was to provide more information to regulators on risk transfer, liability transfer and other considerations in regard to “surplus aid” reinsurance contracts in order to promote more uniformity in their treatment. Included as part of the revision was a name change from “Model Regulation—Life Reinsurance Agreements” to “Life and Health Reinsurance Agreements Model Regulation.” While a review of the minutes, proceedings citations and the model indicate that Model 791 includes accident and health within its scope; most of the guidance in Model 791 is focused on life and the small amount of health specific guidance provided is secondary.
Scope – Appendix A-791 excludes assumption reinsurance, yearly renewable term reinsurance and certain non-proportional reinsurance such as stop loss or catastrophe reinsurance. Appendix A-791 refers the reader to paragraphs 19 and 20 of SSAP No. 61R for yearly renewable term reinsurance and non-proportional reinsurance. Therefore, the primary focus of Appendix A-791 is proportional reinsurance agreements.

The preamble to Model 791 notes that there are legitimate forms of surplus relief and forms that are improper. This preamble is similar to paragraph 2.k. of Appendix A-791, but includes additional information regarding intent. This preamble paragraph was noted in the 1992 minutes as significant to enforcing the provisions of the model; however, this paragraph is not included in Appendix A-791.

Appendix A-791 includes reinsurance contract provisions or functions that require deposit accounting by prohibiting reinsurance reserve credit (loss reserve reductions) or establishment of assets related to the reinsurance contracts that contain specified clauses and or functions. Loss reserve reductions and establishment of admitted reinsurance assets is referred to as reinsurance accounting or reinsurance credit. Appendix A-791 also contains a chart which notes “significant risks” inherent in lines of business reinsured. It notes that 100% of the identified significant risks must be reinsured to allow any reinsurance accounting treatment. Appendix A-791, paragraphs 2, 4, and 5 seek to ensure that the reinsurer has taken on the risks that result in the reinsurer “standing in the shoes” meaning that the reinsurer is in the same economic position as the ceding entity. Appendix A-791 also provides guidance that contract features which result in “impermanent” risk transfer or surplus aid which result in deposit accounting.

Summary of Appendix A-791, by paragraph is below:

Appendix A-791, paragraph 2 provides a list of items that can prohibit reinsurance accounting (resulting in deposit accounting instead). If any of the noted conditions are present in substance or effect, then the ceding entity is prohibited from establishing assets or reducing liabilities based on that reinsurance contract.

a. Renewal expense allowances are not enough to cover future administrative expenses (unless a liability is established for the present value of the shortfall).
b. Ceding insurer can be deprived of surplus/assets at the reinsurer’s option or automatically on the occurrence of an event (termination for nonpayment of premium or other amounts due is an exception).
c. **Ceding insurer is required to reimburse the reinsurer for negative experience under the contract.** Exceptions: netting losses against gains for experience refunds and payments upon voluntary recapture. It notes that a reinsurer cannot force recapture by excessive premium increases.
d. The ceding insurer must, at scheduled points in time terminate or recapture the contract.
e. **The reinsurance agreement has the possibility of payments from the ceding company that exceed the direct premiums charged to the insured.**
f. **The treaty does not transfer 100% of the identified significant risks inherent in the business being reinsured.** A table of product types and significant risks are identified (morbidity, mortality, lapse, credit quality, reinvestment, disintermediation). Short-duration health is required to transfer all of the morbidity and lapse risks.
g. The assets are not transferred or are not put in a segregated account when credit quality, reinvestment, and disintermediation risk are required to be transferred.
h. Settlements are made less frequently than quarterly.
i. The ceding company must make warranties not reasonably related to the business being reinsured
j. The ceding company must make warranties about the future performance of the business being reinsured.
k. The reinsurance agreement is entered into for the principal purpose of producing significant surplus aid for the ceding insurer, typically on a temporary basis, while not transferring all of the significant risks inherent in the business reinsured and, in substance or effect; the expected potential liability to the ceding insurer remains basically unchanged.

Paragraph 3 provides accounting guidance regarding reinsurance of in-force blocks of business, which requires
restriction of surplus gains until profits emerge

Paragraphs 4-5 are contract features that are required to be present to achieve reinsurance accounting.

Paragraph 4: Letter of intent (or signed treaty) must be in place before the as-of date of the financial statement in order to apply reinsurance accounting.

Paragraph 5: Treaty must be signed within 90 days after the execution of a letter of intent.

Appendix A-791 also contains questions and answers for certain paragraphs that were incorporated from actuarial guideline JJJ. The questions and answers provide practical implementation information and are helpful regarding intent of some items. The rest of Actuarial Guideline JJJ was incorporated in Actuarial Guideline 33 Determining CARVM Reserves for Annuity Contracts with Elective Benefits, to provide guidance on elective versus non-elective benefits and language which described integrated benefit streams. Therefore, Actuarial Guideline JJJ does not currently exist as a separate guideline.

**Current Issues**

**FAS 113 and Appendix A-791**

The FAS 113 risk transfer guidance is adopted by reference, and is also affected by the modifications to FAS 113 listed in SSAP No. 61R. Such modifications include the differences between GAAP and SAP classification of certain contracts, such as contracts that statutory accounting classifies as other than deposit type contracts and GAAP classifies as investment type contracts. Appendix A-791 plays a crucial role in the application of risk transfer guidance for proportional life and health reinsurance contracts. However, both the FAS 113 and Appendix A-791 have to be reviewed in conjunction with each other. The interaction of SSAP No. 61R guidance with Appendix A-791 needs to be more explicit in SSAP No. 61R.

Appendix A-791 creates differences between GAAP and SAP definitions of risk transfer for proportional life and health reinsurance contracts. The SAP risk transfer threshold for proportional life and health reinsurance contracts can be either higher or lower than GAAP depending on the facts and circumstances. The different standard in Appendix A-791 applies to products that both GAAP and SAP classify as an insurance contract, and to products in which there are differences in insurance or non-insurance classification between GAAP and SAP. The provisions of Appendix A-791 result in reinsurance accounting only for proportional reinsurance contracts that 1) do not result in “impermanent” surplus and 2) result in the reinsurer being in a relatively equivalent economic position as the direct writer. Below are some examples of the different results that can occur:

1. GAAP and SAP are different - For a proportional reinsurance on products that both GAAP and SAP classify as an insurance contract, Appendix A-791 creates a different standard for determining risk transfer than GAAP. This standard can be either higher or lower than GAAP risk transfer requirements depending on the facts and circumstances.
   a. Appendix A-791 requires 100% of identified significant risks to be transferred.
   b. Appendix A-791 has several features that are prohibited in reinsurance contracts and also requires certain contractual features. These requirements and prohibitions are to ensure that the reinsurer is in a similar economic position as the ceding entity.
   c. Appendix A-791 does not require reasonable possibility of significant loss to the reinsurer for proportional reinsurance contracts; however, as noted above, a reinsurance contract that complies with Appendix A-791 will result in a reinsurer that is in a similar economic position as the ceding entity.
To the extent a proportional reinsurance contract does not transfer 100% of the identified risks SAP has a higher threshold, because GAAP would allow reinsurance accounting for reinsurance contracts with less than 100% of the identified significant risks provided the reinsurer has reasonable possibility of loss. For these reinsurance contracts SAP (Appendix A-791) would require deposit accounting.

To the extent that a proportional contract transfers 100% of the identified risks and the reinsurer does not have a reasonable possibility of loss, SAP has a lower threshold because it would allow reinsurance accounting and GAAP would require deposit accounting.

To the extent that a proportional contract has reasonable possibility of loss to the reinsurer, but the reinsurance contract contains features prohibited by Appendix A-791, the SAP standard would require deposit accounting and be stricter than GAAP which would allow reinsurance accounting.

2. SAP allows reinsurance accounting in situations that GAAP prohibits - For a life or health product that GAAP classifies as an investment contract and SAP classifies as an insurance contract, SAP allows proportional reinsurance contracts which are compliant with Appendix A-791 to receive reinsurance accounting treatment. GAAP prohibits reinsurance accounting for these underlying products because the products do not contain sufficient insurance risk. This is an intentional difference between SSAP No. 61R and FAS 113 and was necessary because some products are classified as life or other than deposit type insurance in statutory accounting based on the inclusion of any mortality or morbidity risk. The same products would likely be classified as an investment type contract for GAAP because the morbidity and mortality risk is not significant. SSAP No. 61R notes that a FAS 113 modification allows the transfer of risk for other than deposit type products if the reinsurance contract transfers 100% of the identified significant risks of the contract. Under FAS 113 such a reinsurance contract would not be classified as an investment contract, and not as insurance, due to the insignificant insurance risk. This is an intentional difference that can result in reinsurance accounting treatment for statutory accounting but not for GAAP.

Nonproportional Guidance in SSAP No. 61R

The rest of the text on risk transfer in SSAP No. 61R includes some of the FAS 113 long-duration guidance, and the rest of FAS 113 is adopted with the noted modifications by reference. SSAP No. 62R is more explicit on evaluation of non-proportional contracts and contains more of the FAS 113 short-duration risk transfer guidance. As a result, SSAP No. 62R is clearer than SSAP No. 61R regarding risk transfer for reinsurance contracts which transfer less than all of the insurance risks, such as non-proportional reinsurance contracts. SSAP No. 61R, paragraph 38, notes that reinsurance accounting for non-proportional reinsurance contracts is determined in a way that is similar to how property and casualty reinsurance accounting is determined. This agenda item recommends additional language on nonproportional contracts for SSAP No., 61R.

Amount of Reinsurance Accounting Credit

Additional language in SSAP No. 61R and SSAP No. 62R is recommended to clarify that reinsurance contracts which pass reinsurance risk transfer can and will result in different reinsurance accounting credit (financial benefits) based on the terms and circumstances of the reinsurance contracts. There appears to be a misunderstanding that passing risk transfer always results in full proportional reinsurance accounting credit. However, a reinsurance contract which passes risk transfer still has to have the amount of reinsurance accounting credit separately determined. An example of this concept is that a catastrophe reinsurance treaty can pass risk transfer and still result in no initial reinsurance accounting credit. Principles-based guidance on the separate calculation of the reinsurance accounting credit would be beneficial for SSAP No. 61R and SSAP No. 62R.

Provisions of Appendix A-791 that Prohibit Reinsurance Accounting

a. Expected potential liability remains unchanged
Some of the short-duration reinsurance contracts that were brought to the attention of the Working Group were noted as RBC relief treaties and had a primary purpose of providing capital relief (as opposed to surplus relief). These reinsurance contracts were noted as not having an impact to the ceding entity’s expected liabilities – (e.g., the total liabilities were basically unchanged). Reflecting reinsurance accounting for a proportional reinsurance treaty when the surplus of the ceding entity remain basically unchanged in substance or effect would seem to be a violation of Appendix A-791, paragraph 2.k. Appendix A-791 Life and Health Reinsurance agreements prohibit reducing reinsurance liabilities of establishing reinsurance assets of a ceding entity if:

k. The reinsurance agreement is entered into for the principal purpose of producing significant surplus aid for the ceding insurer, typically on a temporary basis, while not transferring all of the significant risks inherent in the business reinsured and, in substance or effect, the expected potential liability to the ceding insurer remains basically unchanged.

b. All (100%) of the identified significant risks

Note that Appendix A-791, paragraph 2.f. requires all (100%) of the identified significant risks to be transferred. To the extent that the reinsuring clause or risk limiting features prevent all of the significant risk identified being transferred, the contract would not be eligible for reinsurance accounting treatment under Appendix A-791.

c. Proportional versus non-proportional reinsurance contracts

Appendix A-791 is for proportional reinsurance contracts and SSAP No. 61R includes additional guidance on risk transfer for non-proportional reinsurance contracts. SSAP No. 61R, paragraph 38 on non-proportional reinsurance, notes that reinsurance accounting credit is determined in a way that is similar to the way property and casualty reinsurance accounting credit is determined. This is because these modes of reinsurance more closely follow property and casualty indemnification principles than life insurance formula basis and these coverages are very similar to excess insurance on property and casualty products. In determining the appropriate reserve credit, the probability of a loss penetrating to the reinsurer's level of coverage (using reasonable assumptions) must be multiplied by the expected amount of recovery. That means that the determination of the amount of acceptable reinsurance accounting credit should take into account the amounts that the reinsurer is reasonably expected to pay.

Reinsurance contracts with large sliding scale commissions, loss corridors and other risk limiting features raise questions regarding whether a reinsurance contract that starts out as being labeled proportional, is proportionate in substance, or if the risk limiting features cause the contract to perform more like a non-proportional contract. Barron’s dictionary of Insurance Terms notes proportional reinsurance is:

A type of reinsurance whereby the reinsurer shares losses in the same proportion as it shares premium and policy amounts.

The FAWG referral, noted in the activity to date section, provides a similar concern and seems to describe a contract that would not be compliant with Appendix A-791 paragraphs 2.k. and 2.f.:

Some of the short-duration health reinsurance contracts that regulators have brought to the attention of the Working Group and noted by the Financial Analysis (E) Working Group utilize loss corridors, sliding scale commissions, or other risk-limiting features to significantly limit the risk transferred to the reinsurer. Often these limitations result in a quota share reinsurance agreement operating more like an excess of loss reinsurance agreement, but the ceding insurer is accounting for the contract as if full, proportional reinsurance were in place. In certain cases, the ceding insurers have lost millions of dollars on certain blocks of business and even reached insolvency, while the reinsurers have continued to recognize profits on the contracts.
Some treaties that were labeled as proportional do not operate proportionately when the risk limiting features in total are considered and some treaties seem to be taking a larger reinsurance accounting credit than the risk transferred under the contract indicates or are taking a reinsurance accounting credit when transfer is not indicated. **Note that classifying a contract as proportional when it is not, or taking a reinsurance accounting credit when a contract is not compliant with SSAP No. 61R and Appendix A-791, can result in either an inappropriate reinsurance accounting credit or result in a reinsurance accounting credit that is greater than allowed when the cash flows of the contract are evaluated for the possibility of loss.**

**Disclosure (See Authoritative Literature in appendix for quotes of referenced material)**

The short-duration health reinsurance contracts that were brought to the attention of the Working Group members have risk limiting features. **SSAP No. 62R—Property and Casualty Reinsurance**, paragraphs 93-98, began requiring audited disclosures in the statutory annual statement interrogatories and supplements related to reinsurance contracts with risk limiting features in 2006. The purpose of the disclosures is to identify certain reinsurance contracts with risk limiting features with provisions that limit losses below the stated quota share percentage or delay timely reimbursement for further regulatory review. The disclosures also require reporting entities to affirm that they have verified risk transfer in the reinsurance contracts which received prospective reinsurance accounting credit.

The FAWG referral noted health disclosure concerns noting:

> While P&C insurers are required to disclose some of these features in the interrogatories, health insurers are not, and FAWG continues to be surprised by the fact that GAAP seems to prevent some of these contracts from being recorded as meeting risk transfer requirements while SAP may not. Although the number of P&C companies reporting these features and differences in GAAP/SAP reporting may be limited, they appear to be more prevalent in troubled company situations and are being offered by otherwise well-regarded reinsurers.

This agenda item recommends additional disclosures for SSAP No. 61R

**Existing Authoritative Literature:**

- SSAP No. 61R—Life, Deposit-Type, and Accident and Health Reinsurance
- SSAP No. 62R—Property and Casualty Reinsurance
- Statement of Financial Accounting Standards No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts
- Appendix A-791 Life and Health Reinsurance Agreements

In researching reinsurance risk transfer in SSAP No. 61R, staff notes the following key points:

- SSAP No. 61R, paragraph 78 adopts the FAS 113 with modifications.
- FAS 113 requirements were incorporated into FASB codification primarily in ASC 944-20 and the key risk transfers aspects of FAS 113 are unchanged by FASB codification.
- SSAP No. 61R includes a risk transfer discussion that is similar to the long-duration risk transfer discussion in FAS 113, however slightly more GAAP text on risk transfer was explicitly incorporated into SSAP No. 62R.
- In addition to the FAS 113 risk transfer requirements, SSAP No. 61R, paragraph 79 incorporates requirements from the Credit for Reinsurance (Model 785) and the Life and Health Reinsurance (Model 791).
- Model 785 contains detailed information regarding when collateral is required and what types of collateral are acceptable in order to obtain credit for reinsurance. In general, collateral is required for unauthorized reinsurers and there is a sliding scale of collateral required for certified reinsurers.
- Model 791 contains examples of contract clauses that negate risk transfer and identifies significant insurance risk that must be ceded in full. (summarized above)
- Model 791 excludes yearly renewable term (YRT) which is a type of life reinsurance under which the risks, but not the permanent plan reserves, are transferred to the reinsurer for a premium that varies each year with the amount at risk and the ages of the insured. Although the model excludes YRT, most of the requirements from paragraph 2 and 3 of A-791 are required to be followed in SSAP No. 61R. This agenda item is not focused on Yearly Renewable Term reinsurance contracts.

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

At the 2016 Fall National Meeting the chair of the Working Group, Mr. Bruggeman stated that he had been contacted by a regulator regarding the application of reinsurance risk transfer under SSAP No. 61R—Life, Deposit-Type, and Accident and Health Reinsurance. The Working Group directed NAIC staff to research this issue and, if necessary, prepare an interpretation or draft changes to SSAP No. 61R for future discussion. In providing more detail on the issue, Mr. Bruggeman stated that reporting entities may be concluding that risk-transfer requirements under U.S. GAAP are higher than the risk-transfer requirements under SSAP No. 61R. As both requirements are based on the same standard in Statement of Financial Accounting Standards No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts, he stated that this reporting entity interpretation is difficult to substantiate. NAIC staff was directed to provide subsequent information on their research.

Risk Limiting Features (E) Working Group was inactive in 2016, but it is charged with reviewing risk transfer guidance for property and casualty reinsurance. This group will re-activate this year and work on clarifying aspects of Financial Condition Examiner’s Handbook and Financial Analysis Handbook guidance.

The Financial Analysis (E) Working Group (FAWG) provided a referral to the Statutory Accounting Principles (E) Working Group in April 2017, which also noted and risk limiting features concerns and including for property and casualty entities and concerns regarding health disclosures. The following provides a summary of this referral:

The referral notes that the FAWG has recently discussed a number of troubled and potentially troubled insurers that have participated in quota share/proportional reinsurance contracts with significant risk-limiting features. In many of these situations, the motivation for the contracts appears to be surplus relief, without a significant amount of insurance risk being transferred to the reinsurer. The contracts often utilize loss corridors, sliding scale commissions, or other risk-limiting features to significantly limit the risk transferred to the reinsurer. Often these limitations result in a quota share reinsurance agreement operating more like an excess of loss reinsurance agreement, but the ceding insurer is accounting for the contract as if full, proportional reinsurance were in place. In certain cases, the ceding insurers have lost millions of dollars on certain blocks of business and even reached insolvency, while the reinsurers have continued to recognize profits on the contracts. While P&C insurers are required to disclose some of these features in the interrogatories, health insurers are not, and FAWG continues to be surprised by the fact that GAAP seems to prevent some of these contracts from being recorded as meeting risk transfer requirements while SAP may not. Although the number of P&C companies reporting these features and differences in GAAP/SAP reporting may be limited, they appear to be more prevalent in troubled company situations and are being offered by otherwise well-regarded reinsurers. Therefore, FAWG suggests further changes to SAP to prevent these situations.

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

Staff Review Completed by:
Robin Marcotte, NAIC Staff - July 2017

Staff Recommendation:
NAIC staff recommends that the Working Group receive the referral from the Financial Analysis (E) Working Group, move this item to the active listing, categorized as nonsubstantive, and expose revisions to SSAP No. 61R, SSAP No. 62R, Appendix A-791 and the Master Glossary as illustrated in Exhibit A (omitted from the 2019 Summer National Meeting Materials for brevity). The recommended course of action is summarized below, and the related revisions are illustrated on the following pages. The draft revisions and the noted exposure questions are recommended for exposure.

1. **Risk transfer clarifications SSAP No. 61R—Life and Health Reinsurance** – Expose clarifications to the guidance in SSAP No. 61R that emphasize categorizing reinsurance contracts correctly as either being proportional or non-proportional and make more explicit the interaction between Appendix A-791 which identifies the significant risks that must be 100% transferred for proportional reinsurance contracts and the remaining SSAP No. 61R risk transfer guidance. The proposed revisions also emphasize that the reinsurance accounting credit taken for reinsurance contracts that meet risk transfer criteria in SSAP No. 61R/ Appendix A-791 is only for the portion of risks actually transferred. Reinsurance credit should take into account all features of a contract including deductibles, loss ratio corridors, a loss cap, aggregate limits or any similar provisions.

2. **Risk transfer clarifications SSAP No. 62R—Property and Casualty Reinsurance** – Expose clarifications to the risk transfer guidance in SSAP No. 62R to make the existing guidance more clear reinsurance accounting credit taken for reinsurance contracts that meet risk transfer criteria only for the portion of risks actually transferred. These clarifications are intended to be consistent with the existing concepts highlighted in the SSAP No. 62R, paragraph 93 disclosure. This guidance notes that reinsurance contracts, which contain features that limit the reinsurer’s losses below the stated quota share percentage (e.g. a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions), should reduce the amount of reinsurance accounting credit taken by the effects of any applicable limiting provision(s).

3. **Disclosures** – Expose disclosures, for 2018 reporting year in SSAP No. 61R based on the existing reinsurance disclosures in SSAP No. 62R in paragraphs 93-98 (adapted as needed using concepts from A-791). The disclosures would be to assist regulators in identifying reinsurance contracts that may require from additional regulatory scrutiny regarding risk transfer and or compliance with A-791.

   Exposure questions- Request comments regarding the scoping of the disclosures in SSAP No. 61R.

4. **Updates to terminology** –
   a. Expose updates to the glossary in SSAP No. 61R for specific terms including the definition of proportional and non-proportional.
   b. Expose clarifications to the existing descriptions of proportional and nonproportional in SSAP No. 62R, paragraph 5 which are consistent with the proposed revisions to SSAP No. 61R (along with edits to subparagraph numbering).
   c. Expose updates to the Master Glossary to define how to classify short-duration and long-duration for statutory accounting. These are GAAP terms (quoted in Authoritative literature) which have historically not been adopted in statutory accounting, however, recent updates to SSAP No. 35R also referenced this terminology.

   Exposure questions – Request comments on the current SSAP No. 61R glossary definitions, which are currently defined in a life specific context: coinsurance, modified coinsurance and retention. Request comments on if adding short-duration and long-duration terms (modified for statutory accounting
differences in classification) to the Master Glossary would be useful especially in the context of adopted GAAP guidance.

5. **Appendix A-791 updates to include the Model 791 preamble** – Expose updates to Appendix A-791 to incorporate language from the preamble of Model Law 791. This language from the model is indicative of the intent behind the Model, which was to prevent reinsurance accounting for reinsurance contracts that provide temporary surplus aid without transferring all of the significant risks so that the expected potential liability of the ceding insurer remains “basically unchanged.” This includes much of the existing language in paragraph 2.k. of Appendix A-791, but also provides additional detail regarding intent.

Exposure questions – Request comments on whether additional clarifications are needed on the interaction of Appendix A-791 and the risk transfer guidance or if the proposed changes to SSAP No. 61R are sufficient. Would adding to the questions and answers in A-791 regarding application be useful? If so, what questions should be addressed?

**Status:**

On August 6, 2017, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance, SSAP No. 62R—Property and Casualty Reinsurance and Appendix A-791—Life and Health Reinsurance, as illustrated in Exhibit A (omitted from the 2019 Summer National Meeting Materials for brevity), to clarify reinsurance contracts risk transfer requirements and to provide clarifications that reinsurance accounting credit for contracts that pass risk transfer is only for the amount of risk ceded. The agenda item also updates terminology and incorporates new SSAP No. 61R disclosures to assist in reviewing contracts, similar to existing disclosures in SSAP No. 62R.

On November 6, 2017, the Statutory Accounting Principles (E) Working Group received comments. The Working Group provided the following direction for the next phase of work on this project:

1. NAIC staff was directed to work with Working Group and industry representatives to hold informal drafting calls to refine the exposure drafts for future Working Group consideration. The bi-weekly calls will generally be separate (P/C and Life) as feasible, with some combined calls for consistency issues.

2. The previously exposed revisions to add the GAAP definitions of short duration and long duration contracts to the master glossary would be removed going forward, as the comments from the Interested Parties and the ACLI responded that the proposed additional definitions were not helpful.

3. The suggested revisions to SSAP No. 62R, paragraph 29 on non-proportional reinsurance credit proposed by the interested parties provide a better starting point to redraft this paragraph. NAIC staff was directed to use this language and work with the informal drafting groups to add some non-proportional examples in the next phase of discussion. The proposed starting point language for SSAP No. 62R, paragraph 29 is as follows:

   29. Reporting entities shall not record reinsurance credit for non-proportional reinsurance until such time as losses have been incurred on the underlying business, which exceed the attachment point of the applicable reinsurance contract(s).

**Recommendation for 2018 Summer National Meeting Discussion**

The Informal Property and Casualty Drafting Group and an Informal Life and Health Drafting Group both of which include regulators and industry representatives have held several calls and recommend exposing the revisions described below:
1. **Informal Property and Casualty Drafting Group** - The drafting group recommends updates to SSAP No. 62R—Property and Casualty Reinsurance to incorporate GAAP guidance to be more consistent with ASC topic 994-20. The proposed revisions specifically incorporate more guidance from FASB Emerging Issues Task Force No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises (EITF 93-6) and its related interpretation EITF D-035, FASB Staff Views on Issue No. 93-6, "Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises." SSAP No. 62R already, adopts EITF 93-6 with modification; however, it is incorporated by reference rather than explicitly quoted. As the informal drafting groups agrees that SSAP No. 62R intends to match GAAP to the extent feasible, the drafting group has recommended revisions to SSAP No. 62R text, and the existing Appendix to assist with addressing the concerns noted in the agenda item. These concerns include ensuring that credit for reinsurance reported by the cedant is not greater than the amount of risk ceded.

Although the subgroup views the revisions as consistent updates, because of the extent of revisions, NAIC staff recommends categorizing these revisions to SSAP No. 62R as substantive and exposing the revisions to SSAP No. 62R as reflected in agenda item 2017-28 - Attachment Q1. (The attachment has several drafting notes to assist with review. These drafting notes are not planned to be in the final document.) During the exposure period, input on the effective date is also requested.

2. **Informal Life and Health Drafting Group** – The primary issue under discussion is how to provide clear pointers from SSAP No. 61R—Life and Health Reinsurance to the Appendix A-791 guidance so that users understand which contracts are subject to the guidance in the appendix, and to identify the contracts which not subject to the appendix. The challenge is providing clear guidance that does not conflict with the existing appendix A-791, which is an accreditation standard model law. The Informal Life and Health Drafting Group recommends a partial exposure to obtain wider feedback on the scope of Appendix A-791 and proposed disclosures. The Informal Life and Health Drafting Group has prepared updates to the Appendix A-791 Q&A to assist with further defining the applicability of the Appendix. The drafting group will continue to work on revisions to the body of the statement, but believes feedback on the exposed QA revisions will assist with drafting further revisions. In addition, the drafting group has prepared disclosures for exposure also.

NAIC staff recommends exposing revisions to the SSAP No. 61R disclosure and the A-791 Q&A as reflected in agenda item 2017-28 - Attachment Q2. The Informal Life and Health Drafting Group is not recommending adoption of these revisions until the other revisions to the guidance in SSAP No. 61R are developed.

On August 4, 2018, the Statutory Accounting Principles (E) Working Group:

1. Exposed substantive revisions to SSAP No. 62R—Property and Casualty Reinsurance to incorporate guidance from EITF 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises and from EITF D-035, FASB Staff Views on Issue No. 93-6. (Drafting notes are not planned to be in the final document.) The Working Group also requested, input on the effective date. See separate document.

2. Exposed nonsubstantive revisions to SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance to incorporate disclosures. The proposed revisions also update the question-and-answer guidance in Appendix A-791—Life and Health Reinsurance Agreements to clarify the applicability of A-791. Note that the exposure includes a request for comments on whether the proposed disclosures adequately address the Financial Analysis (E) Working Group referral with a notation, that the feedback will assist with ongoing drafting group work. See Exhibit B (omitted from the 2019 Summer National Meeting Materials for brevity).

Comments are requested on the following items related to the exposed SSAP No. 61R disclosures:
1. The drafting group discussion determined that the prior exposure for SSAP No. 61R, paragraph 83, which was based on SSAP No. 62, paragraph 94 with modifications to be consistent with A-791 was repetitive on compliance with A-791. The subgroup reviewed existing paragraph 94-a-d, in SSAP No. 62R and determined it was not useful in the context of SSAP No. 61R. Regulator and industry input is requested on any additional contract features that should be identified for disclosure.

2. The FAWG, requested disclosures similar to existing disclosures in SSAP No. 62R—Property and Casualty Reinsurance for SSAP No. 61R. However, the existing SSAP No. 62R disclosures could not copied into SSAP No. 61R exactly because of variations between product types and the Appendix A-791. Regulator input is requested regarding whether proposed disclosures would be sufficient to address regulatory concerns and or the FAWG request.

3. Comments are requested regarding contracts identified for disclosure in paragraph 85 should be identified in the annual statement reinsurance schedule S with a signifier to avoid repeating details in the annual statement note, which may be in the statement schedule.

On November 15, 2018, the Statutory Accounting Principles (E) Working Group adopted, as final, substantive revisions to SSAP No. 62R that clarify the determination of reinsurance credit and incorporate language from EITF 93-6, Accounting for Multi-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises and EITF D-035, FASB Staff Views on Issue No. 93-6, with a January 1, 2019 effective date. The Working Group directed NAIC staff to draft an issue paper documenting the substantive revisions. The Working Group directed that comments received from Connecticut and New Jersey regarding SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance and Appendix A-791 be forwarded to the informal Life and Health Reinsurance Drafting Group for subsequent consideration.

On April 6, 2019, the Statutory Accounting Principles (E) Working Group exposed revisions to an issue paper to document for historical purposes the adopted revisions to SSAP No. 62R—Property and Casualty Reinsurance. Also, on April 6, 2019, the Working Group received an update from the Informal Life and Health Reinsurance Drafting Group, noting the following:

Prior Actions - At the 2018 Fall National Meeting, the Working Group heard comments on the exposure recommended by the informal life and health reinsurance drafting group. The revisions proposed updates to the A-791 Life and Health Reinsurance QA to clarify the applicability of A-791 and expand questions and answers to address business that has a statutorily required medical loss ratio or similar refund / rebate. In addition, the exposure proposed revised disclosures as requested by the Financial Analysis (E) Working Group. The Working Group directed the subgroup to expand their work to address group term life yearly renewable term (YRT) comments raised in comment letters from two states.

Interim Activity - The informal drafting group updated the membership to address the YRT issues raised and has held four calls. The YRT issues related to group term life risk that were raised are complex. While the informal drafting group does not have a recommendation for exposure at this time, they are making steady progress and appreciate the active engagement from regulators and industry. The primary areas that are being considered for updating are to the A-791 QA guidance and to the YRT guidance in SSAP No. 61R—Life and Health Reinsurance, paragraph 19. The drafting group will continue to hold calls on this topic in the interim and intends to have something to recommend for exposure by the 2019 Summer National Meeting.

Recommendation for 2019 Summer National Meeting Discussion

Receive Report of Interim Activity
The YRT issues related to group term life risk that were raised are complex. The informal drafting group is making steady progress and appreciates the active engagement from regulators and industry. The primary areas
that were discussed in the interim were on updating the A-791 QA guidance and to the YRT guidance in SSAP No. 61R—Life and Health Reinsurance, paragraph 19.

The Informal Drafting Life and Health Reinsurance Drafting Group met 4 times during the interim year primarily focused on YRT issues. Additional meeting will continue as the Drafting Group works to address YRT issues also works on other topics such as non proportional reinsurance.

The informal drafting group reviewed prior exposures and their comments and recommends exposure of the following:

1. **SSAP No. 61R Disclosures** - These disclosures were previously exposed and the comments on the prior exposure have been reviewed by the drafting group. The disclosures are to address the request from the Financial Analysis (E) Working Group for life and health reinsurance contracts to have disclosure, which identify contracts with certain features including, risk limiting features. similar to existing disclosures in SSAP No. 62R—Property and Casualty Reinsurance for SSAP No. 61R. However, the existing SSAP No. 62R disclosures could not copied into SSAP No. 61R exactly because of variations between product types and the Appendix A-791. The drafting group also recommends notifying the Financial Analysis (E) Working Group of the exposure.

2. **Two updates to the Appendix A-791 question and answers (QA)**

   a. The informal life and health reinsurance-drafting group identified that the existing phrase “certain non-proportional reinsurance arrangements” in the current A-791 could benefit from additional guidance to promote consistent application. The proposed revisions to the answer below are to help identify non-proportional contracts, which are not subject to the Appendix A-791. The drafting group also reviewed the comments from Connecticut received from the August 2018 exposure and determined not to incorporate the YRT/RBC comments at this time as the YRT discussion is ongoing.

   b. The proposed Appendix A-791 question and answer regarding business that has a statutorily required medical loss ratio or similar refund / rebate. This item was previously exposed, and no questions were received. The drafting group did not recommend any additional revisions.

3. **Add A-791 QA under paragraph 2c on YRT**

   Regarding the YRT issues, industry drafted a Q&A in relation to paragraph 2c of A-791 for consideration. The regulator members agreed to the suggested approach to add the Q&A but eliminated the second part of the Answer that would continue to allow the reinsurer to charge premiums in excess of the underlying direct proportionate premium if the ceding entity established a liability for the excess amount. After further discussion, the regulator and industry members of the subgroup could not come to agreement.

   The industry members prefer to seek ways to explicitly allow the group term life YRT reinsurance contracts to exceed the amount of the underlying direct proportionate premium. The most recent industry proposal was to allow this, provided the ceding entity establishes a liability for the amount of reinsurance premium in excess of the direct premium. Industry discussed the commercial reasoning and argued that risk would still be transferred.

   The regulator members continued to question whether such group term life YRT contracts appropriately transferred risk if a reinsurer could charge premiums in excess of the underlying direct proportionate premium. It was noted that these contracts generally included other risk limiting features such as loss carry forward provisions and would typically not pass risk transfer requirements under GAAP. They also noted concerns that codifying the industry proposed exception in statutory accounting could result in
unintended consequences and appeared to be designed address a commercial concern. Therefore, the regulator members proposed to accept the Q&A drafted by the industry but without wording that would allow reinsurers to charge premiums in excess of the underlying direct proportionate premium. The regulator members of the drafting group have requested exposure of the guidance to allow for specific concerns to be raised and addressed. This guidance provides that group term life YRT contracts which exceed the underlying direct premium are unreasonable and violate the provisions of paragraph 2c of A-791, and therefore, would not be subject to reinsurance accounting.

**August 2019 Recommendation:**

NAIC Staff recommends that the Working Group receive the drafting group recommendation on interim activity and expose for comment the following items which are illustrated below:

1. **Disclosures, (previously exposed)** Concurrent with the exposure, NAIC staff recommends that the Working Group also notify the Financial Analysis (E) Working Group of the exposure as the disclosures were originally developed at their request.

2. **The two A-791 QA items one the topic of certain nonproportional reinsurance contracts covered under the A-791 and medical loss ratios (previously exposed – the drafting group reviewed the comments).**

3. **Regulator proposed revisions to add A-791 QA under paragraph 2c regarding group term life YRT reinsurance contracts. (which are not supported by industry members).**

On August 3, 2019, the Statutory Accounting Principles (E) Working Group adopted, as final, *Issue Paper No. 162—Property and Casualty* to document for historical purposes the revisions related to *SSAP No. 62R—Property and Casualty Reinsurance*, which was adopted at the 2018 Fall National Meeting.

In addition to the issue paper adoption, on August 3, 2019, the Working Group also exposed for comment the following items which are illustrated below:

1. **Disclosures, (previously exposed) and, directed notification to the Financial Analysis (E) Working Group of the exposure as the disclosures were originally developed at their request.**

2. **The two A-791 QA items related to certain nonproportional reinsurance contracts” covered under the A-791 and medical loss ratios (previously exposed – the drafting group reviewed the comments).**

3. **Regulator proposed revisions to add A-791 QA under paragraph 2c regarding group term life YRT reinsurance contracts.**

**Illustration of proposed revisions to SSAP No. 61R and A-791 exposed on August 3, 2019:**

1. The revisions to *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* to incorporate disclosures proposed for exposure are as follows:

   *Drafting Note: These disclosures were previously exposed, the shading is for minor edits recommended by the drafting group on June 11, 2019*

   *December 2019 Drafting Note: The disclosure paragraph numbering was updated from 81 – 87 as exposed to be 78 to 84 to reflect that the following disclosures will be inserted before existing paragraph 78. In addition, recommendations for Fall National meeting is illustrated language for Fall 2019 discussion illustrating the proposed December 31, 2020 effective date for the new disclosures.*
78. Disclosures for paragraphs 82-87, which are required to be included with the annual audit report financial statements beginning with the period ended December 31, 201X regarding reinsurance contracts. The disclosures required within paragraphs 82-87 shall be included in accompanying supplemental schedules of the annual audit report beginning in year-end 201X. These disclosures shall be limited to reinsurance contracts entered into, renewed or amended on or after January 1, 1996. This limitation applies to the annual audit report only and does not apply to the statutory annual statement interrogatories and the property and casualty reinsurance summary supplemental filing. (Drafting Note: From SSAP No. 62R, paragraph 92)

79. Disclose any reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) subject to A-791 that includes a provision, which limits the reinsurer’s assumption of significant risks identified as in A-791. Examples of risk limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. If true, indicate the number of reinsurance contracts to which such provisions apply. For contracts subject to A-791, indicate if deposit accounting was applied for all contracts, which limit significant risks. (Drafting Note: Similar to SSAP No. 62R, paragraph 93, and is also relevant to A-791 evaluations.)

80. Disclose any reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) not subject to A-791, for which reinsurance accounting was applied and includes a provision that limits the reinsurer’s assumption of risk. Examples of risk limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. If true, indicate the number of reinsurance contracts to which such provisions apply. If affirmative, indicate if the reinsurance credit was reduced for the risk limiting features. (Drafting Note: Similar to SSAP No. 62R, paragraph 93.)

81. Disclose if any reinsurance contracts which contain features (except reinsurance contracts with a federal or state facility) described below which result in delays in payment in form or in fact:

   a. Provisions which permit the reporting of losses, or settlements are made, less frequently than quarterly or payments due from the reinsurer are not made in cash within ninety (90) days of the settlement date (unless there is no activity during the period). (Drafting Note: From SSAP No. 62R, paragraph 94.e. and Appendix A-791, paragraph 2.e.)

   b. Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity. (Drafting Note: From SSAP No. 62R, paragraph 94.f., also relevant to risk transfer guidance in SSAP No. 61R)

82. Disclose if the reporting entity has reflected reinsurance accounting credit for any contracts not subject to Appendix A-791 and not yearly renewable term, which meet the risk transfer requirements of SSAP No. 61R and identify the type of contracts and the reinsurance contracts.

   a. Assumption Reinsurance – new for the reporting period.

   b. Non-proportional reinsurance, which does not result in significant surplus relief. If yes, indicate if the insured event(s) triggering contract coverage has been recognized.

83. Disclose if the reporting entity ceded any risk which is not subject to A-791 and not yearly renewable term reinsurance, under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either: (Drafting Note: From SSAP No. 62R, paragraph 97)

   a. Accounted for that contract as reinsurance under statutory accounting principles (“SAP”) and as a deposit under generally accepted accounting principles (“GAAP”); or
b. Accounted for that contract as reinsurance under GAAP and as a deposit under SAP.

84. If affirmative disclosure is required for paragraph 86, explain why the contract(s) is treated differently for GAAP and SAP. (Drafting Note: From SSAP No. 62R, paragraph 98)

Drafting Note - These disclosures are expected to begin at existing paragraph 77 in SSAP No. 61R. The paragraph numbering will be updated in the final draft.

2. Proposed updates to A-791 QA (previously exposed)

a. Update to A-791 QA under paragraph 1 to address the phrase “certain non-proportional”

1. This Appendix shall not apply to assumption reinsurance, yearly renewable term reinsurance or certain non-proportional reinsurance such as stop loss or catastrophe reinsurance.

Q – Aside from assumption reinsurance, what other types of reinsurance are exempt from the accounting requirements?

A – Yearly renewable term (YRT) and certain nonproportional reinsurance arrangements, such as stop loss and catastrophe reinsurance are exempt because these do not normally provide significant surplus relief and therefore are outside the scope of this Appendix. If a catastrophe arrangement takes a reserve credit for actual losses beyond the attachment point or the unearned premium reserve (UPR) of the current year's premium, there will most likely be no regulatory concern.

Similarly, if a YRT treaty provides incidental reserve credits for the ceding insurer's net amount at risk for the year with no other allowance to enhance surplus, there will most likely be no regulatory concern. For purposes of this exemption, a treaty labeled as YRT does not meet the intended definition of YRT if the surplus relief in the first year is greater than that provided by a YRT treaty with zero first year reinsurance premium and no additional allowance from the reinsurer.

Additional pertinent information applicable to all YRT treaties and to non-proportional reinsurance arrangements is contained in paragraphs 19 and 20 of SSAP No. 61R.

To further elaborate on the phrase "certain non-proportional reinsurance" in paragraph 1, the beginning of the answer notes that contracts such as stop-loss and catastrophe do not normally provide significant surplus relief, and are therefore not subject to the accounting guidance in Appendix A-791. Non-proportional reinsurance agreements are considered not to provide significant surplus relief if they possess all of the following features. For the purposes of defining these features, the term "triggering event" means the event or sequence of events that would lead to a loss being reimbursable by the reinsurer pursuant to the terms of the reinsurance agreement.

1. The triggering event has not occurred at the time of the inception of the reinsurance agreement.

2. The triggering event is materially less likely than not to occur during each settlement period of the reinsurance agreement.

3. There is no initial reinsurance credit for ceded policy reserves and any reinsurance expense allowance or commission is reported so that surplus is not impacted until the related premium is reported as earned.

These criteria shall be evaluated separately for each measurement period under the reinsurance agreement, where the measurement period is that period of time for which the direct writer's experience is used to determine the amounts owed to and from the reinsurer. If there are carry-forwards of experience debits or credits from one calendar year to the next, then those multiple years will be considered one settlement period.
The fact that the triggering event does eventually occur, is not itself evidence that the second criterion above has not been met. The criterion should be evaluated based on reasonable expectations rather than posteriori results.

b. New Appendix A-791 question and answer regarding business that has a statutorily required medical loss ratio or similar refund / rebate.

Q: If a company cedes health insurance business that is subject to a Medical Loss Ratio (MLR), or similar statutorily required refunds / rebates, must the reinsurer participate in the payment of any refunds / rebates?

A: The reinsurer needs to participate in the payment of its share of any statutorily required MLR or similar refund or rebate based on loss ratio calculations to the extent that the experience of the health business reinsured, during the period that it is reinsured, contributes to the calculation of the refund. Although the payment of such a refund based on the experience of business that is currently reinsured could result in a reduction of surplus on the part of the ceding insurer, if the reduction in surplus of the ceding insurer is entirely attributable to the experience prior to the effective date of the reinsurance, then it is outside of the contract requirements. Accordingly, such a provision should not cause a reinsurance agreement to be out of compliance with Appendix A-791 of the Accounting Practices and Procedure Manual. It is recognized that some refund calculations may involve multiple years.

Furthermore, just as an experience refund is not considered in the determination as to whether a reinsurance agreement is proportional, the requirement for the payment of a refund to policyholders based on a Medical Loss Ratio requirement should also not be considered.

Note: This Q&A only applies to refunds related to a statutory MLR or similar refund or rebate requirement for health insurance and should not be applied to any other situation.

3. Regulator Proposed Revisions Regarding YRT

Suggested new Q&A on group term life YRT for placement under paragraph 2c of A-791

2c. The ceding insurer is required to reimburse the reinsurer for negative experience under the reinsurance agreement, except that neither offsetting experience refunds against current and prior years' losses under the agreement nor payment by the ceding insurer of an amount equal to the current and prior years' losses under the agreement upon voluntary termination of in force reinsurance by the ceding insurer shall be considered such a reimbursement to the reinsurer for negative experience. Voluntary termination does not include situations where termination occurs because of unreasonable provisions which allow the reinsurer to reduce its risk under the agreement. An example of such a provision is the right of the reinsurer to increase reinsurance premiums or risk and expense charges to excessive levels forcing the ceding company to prematurely terminate the reinsurance treaty;

Q: If group term life business is reinsured under a YRT reinsurance agreement (which includes risk limiting features such as with an experience refund provision which offsets refunds against current and/or prior years' losses (i.e., a "loss carryforward" provision), under what circumstances would any provisions of the reinsurance agreement be considered "unreasonable provisions which allow the reinsurer to reduce its risk under the agreement" thereby violating subsection 2.c.?

A: Unlike individual life insurance where reserves held by the ceding insurer reflect a statutorily prescribed valuation premium above which reinsurance premium rates would be considered unreasonable, group term life has no such guide. So long as the reinsurer cannot charge premiums in excess of the premium received by the ceding insurer under the provisions of the YRT reinsurance agreement, such provisions would not be considered unreasonable. Any provision in the YRT
reinsurance agreement which allows the reinsurer to charge reinsurance premiums in excess of the proportionate premium received by the ceding insurer would be considered unreasonable.

For Fall 2019 Discussion

NAIC Staff recommends that the Working Group take the following actions regarding the exposed items:

1. **Adopt the exposed SSAP No. 61R disclosures (with paragraph number updates)** reflected below and with an initial effective date of year end 2020 reporting. Proposed effective date language for the disclosures is illustrated below.

   **Fall 2019 Drafting Note:** The disclosure paragraph numbering was updated from 81 – 87 as exposed to be 78 to 84 to reflect that the following disclosures will be inserted before existing paragraph 78. In addition, recommendations for Fall National meeting is illustrated language for Fall 2019 discussion illustrating the proposed December 31, 2020 effective date for the new disclosures.

   78. Disclosures for paragraphs 82-87, which are required to be included with the annual audit report financial statements beginning with the period ended December 31, 201X regarding reinsurance contracts. The disclosures required within paragraphs 82-87 shall be included in accompanying supplemental schedules of the annual audit report beginning in year-end 201X. These disclosures shall be limited to reinsurance contracts entered into, renewed or amended on or after January 1, 1996. This limitation applies to the annual audit report only and does not apply to the statutory annual statement interrogatories and the property and casualty reinsurance summary supplemental filing. *(Drafting Note: From SSAP No. 62R, paragraph 92)*

   79. Disclose any reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) subject to A-791 that includes a provision, which limits the reinsurer’s assumption of significant risks identified as in A-791. Examples of risk limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. If true, indicate the number of reinsurance contracts to which such provisions apply. For contracts subject to A-791, indicate if deposit accounting was applied for all contracts, which limit significant risks. *(Drafting Note: Similar to SSAP No. 62R, paragraph 93, and is also relevant to A-791 evaluations.)*

   80. Disclose any reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) not subject to A-791, for which reinsurance accounting was applied and includes a provision that limits the reinsurer’s assumption of risk. Examples of risk limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. If true, indicate the number of reinsurance contracts to which such provisions apply. If affirmative, indicate if the reinsurance credit was reduced for the risk limiting features. *(Drafting Note: Similar to SSAP No. 62R, paragraph 93.)*

   81. Disclose if any reinsurance contracts which contain features (except reinsurance contracts with a federal or state facility) described below which result in delays in payment in form or in fact:

   c. Provisions which permit the reporting of losses, or settlements are made, less frequently than quarterly or payments due from the reinsurer are not made in cash within ninety (90) days of the settlement date (unless there is no activity during the period). *(Drafting Note: From SSAP No. 62R, paragraph 94.e. and Appendix A-791, paragraph 2.e.)*

   d. Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity. *(Drafting Note: From SSAP No. 62R, paragraph 94.f., also relevant to risk transfer guidance in SSAP No. 61R.)*
82. Disclose if the reporting entity has reflected reinsurance accounting credit for any contracts not subject to Appendix A-791 and not yearly renewable term, which meet the risk transfer requirements of SSAP No. 61R and identify the type of contracts and the reinsurance contracts.
   
   a. Assumption Reinsurance – new for the reporting period.
   
   b. Non-proportional reinsurance, which does not result in significant surplus relief. If yes, indicate if the insured event(s) triggering contract coverage has been recognized.

83. Disclose if the reporting entity ceded any risk which is not subject to A-791 and not yearly renewable term reinsurance, under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either: (Drafting Note: From SSAP No. 62R, paragraph 97)

   a. Accounted for that contract as reinsurance under statutory accounting principles (“SAP”) and as a deposit under generally accepted accounting principles (“GAAP”); or
   
   b. Accounted for that contract as reinsurance under GAAP and as a deposit under SAP.

84. If affirmative disclosure is required for paragraph 86, explain why the contract(s) is treated differently for GAAP and SAP. (Drafting Note: From SSAP No. 62R, paragraph 98)

Effective Date (not previously exposed)

86. The disclosure for compliance with Model #787 or AG 48 shall be effective for reporting periods ending on or after December 31, 2015. The revisions adopted in November 2018 to expand liquidity disclosures are effective year-end 2019, concurrent with the inclusion of data-captured financial statement disclosures. The disclosures captured in paragraphs 78-84 which help to identify certain reinsurance contract features are effective for reporting periods ending on or after December 15, 2020.

2. Adopt the exposed revisions to A-791 question and answer regarding contracts with medical loss ratios.

   New Appendix A-791 question and answer regarding business that has a statutorily required medical loss ratio or similar refund / rebate.

   Q: If a company cedes health insurance business that is subject to a Medical Loss Ratio (MLR), or similar statutorily required refunds / rebates, must the reinsurer participate in the payment of any refunds / rebates?

   A: The reinsurer needs to participate in the payment of its share of any statutorily required MLR or similar refund or rebate based on loss ratio calculations to the extent that the experience of the health business reinsured, during the period that it is reinsured, contributes to the calculation of the refund. Although the payment of such a refund based on the experience of business that is currently reinsured could result in a reduction of surplus on the part of the ceding insurer, if the reduction in surplus of the ceding insurer is entirely attributable to the experience prior to the effective date of the reinsurance, then it is outside of the contract requirements. Accordingly, such a provision should not cause a reinsurance agreement to be out of compliance with Appendix A-791 of the Accounting Practices and Procedure Manual. It is recognized that some refund calculations may involve multiple years.

   Furthermore, just as an experience refund is not considered in the determination as to whether a reinsurance agreement is proportional, the requirement for the payment of a refund to policyholders based on a Medical Loss Ratio requirement should also not be considered.
Note: This Q&A only applies to refunds related to a statutory MLR or similar refund or rebate requirement for health insurance and should not be applied to any other situation.

3. Refer to the informal life and health reinsurance drafting group the exposed revisions to the A-791 question and answer update to clarify the phrase “certain non-proportional contracts” with informal questions received by NAIC staff regarding: 1) the application of the exposed language regarding measurement period and settlement period and, 2) the application of substantially less likely than not. During the interim the informal questions were distributed to the drafting group. Based on informal input from various drafting group members, more discussion is needed regarding this question and answer item and this is an issue that the drafting group can lend some useful expertise.

4. Provide direction on the A-791 question and answer, regarding the paragraph 2c exposed regulator language. As noted in the summary section above, regulator and industry members of the drafting group could not come to agreement. Industry comments received still indicate opposition on the topic of limiting group term life YRT reinsurance contracts to being not greater than the amount of the underlying direct proportionate premium reinsurance premium for the contract to receive reinsurance accounting. If preferred, the Working Group could have further discussion and provide direction at a subsequent meeting as the drafting group has noted that the regulators and the industry members are not in agreement on this topic. In addition, request assistance and input from LATF on evaluation of YRT risk transfer.
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Prepayments to Service and Claims Adjusting Providers

Check (applicable entity):

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

Description of Issue:
This agenda item seeks to address a regulator inquiry regarding prepayments to providers of claims and adjusting services in which the service provider is prepaid by the insurer. While the initial inquiry for this agenda item was a prepaid roadside assistance provider, the accounting issues are relevant to other providers of claims and adjusting services as well.

The prepayments can take a variety of forms and the provider can take on a variety of duties, but in the example provided, the roadside assistance provider was being prepaid a flat fee for a minimum number of vehicles/policies regardless of claims incurred or sales. The provider additionally received a flat fee per vehicle if actual sales exceed the negotiated minimum number of vehicles. The provider, who is not an insurer, was contracted to provide roadside assistance and administer and settle claims using only the prepaid amounts. So, to use a health care analogy, the provider accepts a “capitated” payment to administer and settle claims.

Roadside assistance is a common feature or rider to many automobile insurance policies that has been available for several years. Roadside assistance provides towing and other services such as jumpstarting car batteries, unlocking doors and gas refills for the insured. Discussions with industry representatives indicate that in most cases, roadside assistance providers may have rates that are negotiated, but providers are not typically prepaid. Rather, when the insured calls for assistance negotiated rate providers are dispatched and subsequently paid at negotiated rates as the claims for assistance are incurred. This agenda item is focused on prepayments to providers.

To provide a fictional numeric example, the minimum annual payment to the provider was for 50,000 vehicles at $10 per vehicle, with additional payments per vehicle required if sales exceed the initial fees. The provider in this example, was also responsible for administering claims and dispatching service in exchange for the “capitated” fee. Therefore, the roadside assistance provider would not bill the insurer further when claims are incurred.

The guidance in SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses, paragraphs 4 and 5 (excerpted in the Authoritative Literature section) are relevant to the timing of claims recognition and payment of loss adjustment expenses. The guidance provides that claims are recognized when incurred. The existing guidance indicates that paying a third party in advance to adjust claims in the future does not decrease the claims adjustment liability. The claim adjustment liability is only reduced when the claim has been adjusted, not when it is prepaid. In accordance with SSAP No. 64—Offsetting and Netting of Assets and Liabilities, prepayments to a third party do not meet the right of offset requirements.

The statutory accounting and reporting questions at issue are how the direct writer accounts for and reports the prepaid claims and adjusting expenses initially and subsequently. The existing guidance notes that claim adjusting expenses are not reduced for payments to third parties. The guidance in SSAP No. 55 indicates liabilities shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to managed care providers. The prepaid
expenses under consideration may include a prepayment for claims administration and or a prepayment for the claims.

In reviewing the annual statement instructions for the Underwriting and Expense Exhibit, Part 3, and the related instructions for property and casualty expenses, the initial prepayment to the provider seems be consistent with miscellaneous underwriting expense.

For policies that purchase the coverage and incurred a claim, it seems appropriate to reclassify a proportionate percentage of the initial prepayment to claims incurred and loss adjustment expenses as losses are incurred and adjusted. However, it would be inappropriate to allocate claims expense and claims adjusting expenses to policies that did not purchase the coverage and inappropriate to allocate the costs of the provider to claims or claims adjusting expenses prior to incurring the claims. Therefore, in the event of prepayment to a third-party provider, some of the costs may remain in miscellaneous adjusting expense.

Existing Authoritative Literature:

- **SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses**, paragraphs 4 and 5 includes the following:

**SUMMARY CONCLUSION**

4. Claims, losses, and loss/claim adjustment expenses shall be recognized as expenses when a covered or insured event occurs. In most instances, the covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs. For claims-made type policies, the covered or insured event is the reporting to the entity of the incident that gives rise to a claim. Claim payments and related expense payments are made subsequent to the occurrence of a covered or insured event, and in order to recognize the expense of a covered or insured event that has occurred, it is necessary to establish a liability. Liabilities shall be established for any unpaid claims and unpaid losses (loss reserves), unpaid loss/claim adjustment expenses (loss/claim adjustment expense reserves) and incurred costs, with a corresponding charge to income. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related to extra contractual obligations and bad-faith lawsuits.

5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims adjustment expenses on non-capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third-party administrators, etc. The liability for claims adjustment expenses on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers.

**General**

10. The liability for claim reserves and claim liabilities, unpaid losses, and loss/claim adjustment expenses shall be based upon the estimated ultimate cost of settling the claims (including the effects of inflation and other societal and economic factors), using past experience adjusted for current trends, and any other factors that would modify past experience. These liabilities shall not be discounted unless authorized for specific types of claims by specific SSAPs, including SSAP No. 54R and SSAP No. 65—Property and Casualty Contracts.

The guidance in SSAP No. 55, paragraph 5 was incorporated from **INT 02-21: Accounting for Prepaid Loss Adjustment Expenses and Claim Adjustment Expenses**, which was nullified when the guidance was moved to SSAP No. 55.

© 2019 National Association of Insurance Commissioners 2
SSAP No. 64—Offsetting and Netting of Assets and Liabilities provides the following:

2. Assets and liabilities shall be offset and reported net only when a valid right of setoff exists except as provided for in paragraphs 3 and 4. A right of setoff is a reporting entity’s legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying an amount that the other party owes to the reporting entity against the debt(INT 09-08). A valid right of setoff exists only when all the following conditions are met:

a. Each of the two parties owes the other determinable amounts. An amount shall be considered determinable for purposes of this provision when it is reliably estimable by both parties to the agreement;

b. The reporting party has the right to set off the amount owed with the amount owed by the other party;

c. The reporting party intends to setoff; and

d. The right of setoff is enforceable at law.

Property and Casualty Annual Statement Instructions Underwriting and Investment Exhibit Part 3 – Expenses provides the following:

A company that pays any affiliated entity (including a managing general agent) for the management, administration, or service of all or part of its business or operations shall allocate these costs to the appropriate expense classification items (salaries, rent, postage, etc.) as if these costs had been borne directly by the company. Management, administration, or similar fees should not be reported as a one-line expense. The company may estimate these expense allocations based on a formula or other reasonable basis.

A company that pays any non-affiliated entity (including a managing general agent) for the management, administration, or service of all or part of its business or operations shall allocate these costs to the appropriate expense classification items as follows:

a. Payments for claims handling or adjustment services are allocated to Loss Adjustment Expenses (Column 1) in the Underwriting and Investment Exhibit, Part 3. If the total of such expenses incurred equals or exceeds 10% of the total incurred Loss Adjustment Expenses (Line 25, Column 1), the company shall allocate these costs to the appropriate expense classification items as if these costs had been borne directly by the company. If such expenses are less than 10% of the total, they may be reported on Line 1 of Column 1.

b. Payments for services other than claims handling or adjustment services are allocated to the appropriate expense classification items as if these costs had been borne directly by the company, if the total of such fees paid equals or exceeds 10% of the total incurred Other Underwriting Expenses (Line 25, Column 2). If the total is less than 10%, the payments may be reported on Line 2 if the fees are calculated as a percentage of premiums, or on Line 3 if the fees are not calculated as a percentage of premiums.

The total management and service fees incurred attributable to affiliates and non-affiliates is reported in the footnote to the Underwriting and Investment Exhibit, Part 3 of the annual statement, and the method(s) used for allocation shall be disclosed in the Notes to the Financial Statements. The company shall use the same allocation method(s) on a consistent basis. Refer to SSAP No. 70—Allocation of Expenses for accounting guidance.

Exclude from investment expenses brokerage and other related fees, to the extent they are included in the actual cost of a bond upon acquisition. Refer to SSAP No. 26R—Bonds for accounting guidance.
Include all other internal costs or costs paid to an affiliated company related to origination, purchase or commitment to purchase bonds.

For the purpose of establishing uniformity in classifications of expenses in reporting entities’ statements and reports filed with the Insurance Departments, the company shall observe the instructions contained in the Appendix of these instructions for the Uniform Classification of Expenses.

Activity to Details of Write-ins Aggregated at Line 24 for Miscellaneous Expenses

List separately each category of miscellaneous expenses for which there is no pre-printed line on Underwriting and Investment Exhibit, Part 3.

- *Property and Casualty Annual Statement Instructions Underwriting Appendix Instructions for Uniform Classifications of Expenses of Property and Casualty Insurers* provides the following:

1.1 Direct

Include: The Following Expenses When in Connection with the Investigation and Adjustment of Policy Claims:

- **Independent Adjusters**: Fees and expenses of independent adjusters or settling agents
- **Legal**: Fees and expenses of lawyers for legal services in the defense, trial, or appeal of suits, or for other legal services
- **Bonds**: Premium costs of bonds
- **Appeal Costs and Expenses**: Appeal bond premiums, charges for printing records, charges for printing briefs, court fees and incidental to appeals
- **General Court Costs and Fees**: Entry fees and other court costs, and other fees not includible in Losses (Note: Interest and costs assessed as part of or subsequent to judgment are includible in Losses.)
- **Medical Testimony**: Fees and expenses of medical witnesses of attendance or testimony at trials or hearings (“Medical” includes physicians, surgeons, chiropractors, chiropodists, dentists, osteopaths, veterinarians, and hospital representatives.)
- **Expert Witnesses**: Fees and expenses of expert witnesses for attendance or testimony at trials or hearings
- **Lay Witnesses**: Fees and expenses of lay witnesses for attendance or testimony at trials or hearings
- **Services of Process**: Constables, sheriffs, and other fees and expenses for service of process, including subpoenas
- **Transcripts of Testimony**: Stenographers’ fees and fees for transcripts of testimony
- **Medical Examinations**: Fees for medical examinations, fees for performing autopsies, fees for impartial examination, x-rays, etc., for the purpose of trial and determining questions of liability (This does not include fees for medical examinations, x-rays, etc., made to determine necessary treatment, or made solely to determine the extent or continuation of disability, or first aid charges, as such fees and charges are includible in Losses.)
- **Miscellaneous**: Costs of appraisals, expert examinations, surveys, plans, estimates, photographs, maps, weather reports, detective reports, audits, credit or character reports, watchmen (Charges for hospital records and records of other kinds, notary fees, certified copies of certificates and legal documents, charges for Claim Adjustment Services by underwriting syndicates, pools, and associations)
Exclude: Compensation to employees (see Salaries)

Expenses of salaried employees (see Travel and Travel Items)

Items includible in Allowances to Managers and Agents

Payments to State Industrial Commissions (see Taxes, Licenses, and Fees)

Payments to claim adjusting organizations except where the expense is billed specifically to individual companies (see Boards, Bureaus, and Associations)

Cost of services of medical examiners for underwriting purposes (see Surveys and Underwriting Reports)

Salvage and subrogation recovery expense, rewards, lost and found advertising, expenses for disposal of salvage (Such expenses shall be deducted from salvage.)

Any expenses which by these instructions are includible elsewhere

Separation of Claim Adjustment Services:

The Statistical Plans filed by certain rating bureaus contain definitions of “Allocated Loss Adjustment Expenses” which exclude for rating purposes certain types of claim adjustment services as defined herein. For the lines of business thus affected, companies that are members of such rating bureaus shall maintain records necessary to the reporting of Claim Adjustment Services—Direct, as follows:

a. As defined in Statistical Plans
b. Other than as defined in Statistical Plans

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

Convergence with International Financial Reporting Standards (IFRS): During the development of IFRS 17, Insurance Contracts, the International Accounting Standards Board (IASB) had discussions regarding classification for the revenue which are not on point to roadside assistance prepayments. Similar to the AICPA issue noted above, the issue was whether roadside assistance sold as part of an insurance policy should be included within the scope of insurance contracts or whether it should be accounted for separately as fee for

© 2019 National Association of Insurance Commissioners
service. The IFRS 17 issued in May 2017 notes that some fixed-fee service contracts meet the definition of an insurance contract (for example, automobile roadside assistance) and IFRS 17 provides an option to use IFRS 15, Revenue from Contracts with Customers to account for as fee for service.

Staff Review Completed by:
Robin Marcotte, NAIC Staff - September 2018

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. 55 to provide guidance as follows:

1. The initial prepayment for providers of claims adjusting expense and claim payment is recognized as a miscellaneous underwriting expense.

2. Subsequently, for direct policies that purchased the related insurance coverage which used the claims or adjusting services incur losses which are paid, a proportionate percentage of the initial provider prepayment amounts are reclassified from miscellaneous underwriting expense to claims adjustment expense and or claims expense, as applicable.

3. To the extent that additional amounts are prepaid for direct policies that did not purchase services, the prepaid expenses shall remain in miscellaneous underwriting expenses.

Note that NAIC staff envisions that additional annual statement instruction clarifications may be indicated after the Working Group finalizes guidance.

Proposed revisions to SSAP No. 55 recommended for November 2018 exposure:

4. Claims, losses, and loss/claim adjustment expenses shall be recognized as expenses when a covered or insured event occurs. In most instances, the covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs. For claims-made type policies, the covered or insured event is the reporting to the entity of the incident that gives rise to a claim. Claim payments and related expense payments are made subsequent to the occurrence of a covered or insured event, and in order to recognize the expense of a covered or insured event that has occurred, it is necessary to establish a liability. Liabilities shall be established for any unpaid claims and unpaid losses (loss reserves), unpaid loss/claim adjustment expenses (loss/claim adjustment expense reserves) and incurred costs, with a corresponding charge to income.

   a. **Prepayments to third party administrators, management companies or other entities for unpaid losses/claims, except for capitated payments for manage care contracts, shall not reduce losses/claims and shall be initially reported as miscellaneous underwriting expenses.** When incurred losses/claims are paid, claims prepayments to third party administrators, management companies or other entities (except for capitated payments for manage care contracts) are reclassified proportionately based on the losses/claims cost from miscellaneous underwriting expenses to loss/claim expenses paid. Flat fee minimum prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as miscellaneous underwriting expenses and not reclassified to loss/claim adjusting expenses.

   b. **Claims related extra contractual obligations losses and bad-faith losses shall be included in losses.** See individual business types for the accounting treatment for adjustment expenses related to extra contractual obligations and bad-faith lawsuits.
5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims adjustment expenses on non-capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third-party administrators, etc. The liability for claims adjustment expenses on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers.

   a. Prepayments to third party administrators, management companies or other entities, except for capitated payments for manage care contracts, for unpaid losses/claims adjusting expenses shall be initially reported as miscellaneous underwriting expenses.

   b. When incurred losses/claims adjusting expenses are paid, prepayments to third party administrators, management companies or other entities (except for capitated payments for manage care contracts) are reclassified proportionately based on the adjusting expenses from miscellaneous underwriting expenses to paid loss/claim adjusting expenses. Flat fee minimum prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as miscellaneous underwriting expenses and not reclassified to loss/claim adjusting expenses.

Status:
On November 15, 2018, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses, as shown above, to provide guidance clarifying that prepayments to providers of claims and adjusting services shall be recognized as miscellaneous underwriting expenses, with guidance for reclassification as claims adjustment expense or claims expense, as applicable, as claims are paid. During the November 2018 Working Group discussion, it was highlighted that the proposed treatment is different than recognizing a nonadmitted prepaid asset, as the amounts are not expected to be material. Comments were requested on this difference and if the amounts are expected to be material.

Spring 2019 National Meeting discussion:
NAIC staff recommends re-exposure of modified proposed language which was developed with interested parties input as illustrated below and in the agenda item. The interested parties responded to the request for comments and noted a preference to “nonadmit a prepaid asset” for prepaid loss and LAE, which is consistent with existing guidance, instead of the to the previously exposed “expense and reclassify as amounts are paid” approach. NAIC staff has proposed a modification to the interested parties’ proposed language to exclude the reference to SSAP No. 84—Health Care and Government Insured Plan Receivables which is not currently referenced in SSAP No. 55. In addition, NAIC staff has recommended guidance regarding flat fee bundled payments which indicates nonadmission of prepaid amounts and allocation to expense categories as benefits or services are rendered.

On April 6, 2019, the Statutory Accounting Principles (E) Working Group exposed modified language, developed with interested parties’ input as described above, which requires nonadmittance for prepaid loss and LAE. This guidance is consistent with existing statutory accounting principles and was revised from the previously exposed “expense and reclassify as amounts are paid” approach. In addition, guidance was exposed regarding flat fee bundled payments which indicates nonadmission of prepaid amounts and allocation to expense categories as benefits or services are rendered. The exposed language is illustrated below.

2019 Spring National Meeting exposure:
4. Claims, losses, and loss/claim adjustment expenses shall be recognized as expenses when a covered or insured event occurs. In most instances, the covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs. For claims-made type policies, the covered or insured event is the reporting to the entity of the incident that gives rise to a claim. Claim payments and related expense payments are made subsequent to the occurrence of a covered or insured event, and in order to recognize the expense of a covered or insured event that has occurred, it is necessary to establish a liability. Liabilities shall be established for any unpaid claims and unpaid losses (loss reserves), unpaid loss/claim adjustment expenses (loss/claim adjustment expense reserves) and incurred costs, with a corresponding charge to income.

   a. All prepayments (i.e., variable, fixed or bundled amounts) to third party administrators, management companies or other entities for unpaid claims, losses and losses/claims adjustment expenses, except for capitated payments for managed care contracts, shall not reduce losses/claims and shall be initially reported as a prepaid asset and nonadmitted in accordance with SSAP No. 29—Prepaid Expenses. When the benefit has been provided to the policyholder or claimant, the claims prepayments to third party administrators, management companies or other entities (except for capitated payments for managed care contracts), are reclassified proportionately from the prepaid nonadmitted asset to claims, losses or loss/claim expenses paid based on the amount of losses/claims cost incurred to provide the benefit.

   b. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as miscellaneous underwriting expenses.

   c. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related

5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims adjustment expenses on non-capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third-party administrators, etc. The liability for claims adjustment expenses on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers.

   a. When the prepaid benefit as described in paragraph 4 has been provided to the policyholder or the claimant, the associated prepayments to third party administrators, management companies or other entities (except for capitated payments for managed care contracts) are reclassified proportionately from the prepaid nonadmitted asset to paid loss/claim adjusting expenses based on the amount of losses/claims cost incurred to provide the benefit. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as miscellaneous underwriting expenses.

On August 3, 2019, the Statutory Accounting Principles (E) Working Group exposed revisions to SSAP No. 55, as illustrated below, that emphasize existing guidance that loss and loss adjusting expense liabilities are established regardless of payments to third parties (except for capitated health claim payments). The liabilities are not recognized as paid until the losses are paid to claimants or claims are adjusted. Prepayments to third party administrators, which are not for claims or loss adjusting expense, are “miscellaneous underwriting expenses.” The revisions also add a reference to SSAP No. 84—Health Care and Government Insured Plan Receivables regarding prepayments to providers.
2019 Summer National Meeting exposure:

SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses:

4. Claims, losses, and loss/claim adjustment expenses shall be recognized as expenses when a covered or insured event occurs. In most instances, the covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs. For claims-made type policies, the covered or insured event is the reporting to the entity of the incident that gives rise to a claim. Claim payments and related expense payments are made subsequent to the occurrence of a covered or insured event, and in order to recognize the expense of a covered or insured event that has occurred, it is necessary to establish a liability. Liabilities shall be established for any unpaid claims and unpaid losses (loss reserves), unpaid loss/claim adjustment expenses (loss/claim adjustment expense reserves) and incurred costs, with a corresponding charge to income.

a. The liability for unpaid losses and claims shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims on non-capitated payments under managed care contracts shall be established in an amount necessary to pay the losses/claims irrespective of payments made to third-party administrators, etc. The liability for claims on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers. As loss or claims payments occur, from the third-party administrators, management companies or other entities, to the policyholder or claimant, paid claims, losses or paid loss/paid claim adjusting liabilities are reduced. Note that guidance regarding the admissibility of loans and advances to providers which apply to health insurance and managed care contracts are addressed in SSAP No. 84—Health Care and Government Insured Plan Receivables.

b. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as 1) Aggregate write ins for miscellaneous expenses - Property and Casualty (Underwriting and Investment Exhibit Part 3); 2) Aggregate write ins for expenses - Life/Health (Exhibit 2 – General expenses) or 3) aggregate write ins for expenses (General Administrative Expenses)- health (Underwriting and Investment Exhibit Part 3)

c. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related

5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims adjustment expenses on non-capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third-party administrators, etc. The liability for claims adjustment expenses on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers.

a. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as 1) Aggregate write ins for miscellaneous expenses - Property and Casualty (Underwriting and Investment Exhibit Part 3); 2) Aggregate write ins for expenses - Life/Health (Exhibit 2 – General expenses) or 3) aggregate write ins for expenses (General Administrative Expenses)- health (Underwriting and Investment Exhibit Part 3).
For Fall 2019 National Meeting Discussion:

NAIC Staff recommends that the Working Group expose revisions incorporating the majority of interested parties’ comments as reflected below as tracked changes to SSAP No. 55 (rather than as reflected as changes to the Summer 2019 exposure). Interested parties’ comments primarily delete the exposed guidance and move the same or similar concepts into the broad product guidance for property and casualty, life and health in SSAP No. 55. These revisions are to reinstate annual statement references by entity type and to adjust scoping language and make the SSAP No. 29 prepaid guidance consistent. Note that shading reflects staff proposed variations in wording from the interested parties proposed wording that accomplishes a similar intent.

Unpaid Claims, Losses and Loss Adjustment Expenses SSAP No. 55

SUMMARY CONCLUSION

4. Claims, losses, and loss/claim adjustment expenses shall be recognized as expenses when a covered or insured event occurs. In most instances, the covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs. For claims-made type policies, the covered or insured event is the reporting to the entity of the incident that gives rise to a claim. Until a claim payments and related expense payments are made subsequent to the occurrence of a covered or insured event, and in order to recognize the expense of a covered or insured event that has occurred, it is necessary to establish a liability. Liabilities shall be established for any unpaid claims and unpaid losses (loss reserves), unpaid loss/claim adjustment expenses (loss/claim adjustment expense reserves) and incurred costs, with a corresponding charge to income. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related to extra contractual obligations and bad-faith lawsuits.

5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts for which the liability for claims adjustment expenses on non-capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third-party administrators, etc. The liability for claims adjustment expenses on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers.

Property/Casualty

6. The following are types of future costs relating to property and casualty contracts, as defined in SSAP No. 50, which shall be considered in determining the liabilities for unpaid losses and loss adjustment expenses:

a. Reported Losses: Expected payments for losses relating to insured events that have occurred and have been reported to, but not paid by, the reporting entity as of the statement date;

b. Incurred But Not Reported Losses (IBNR): Expected payments for losses relating to insured events that have occurred but have not been reported to the reporting entity as of the statement date. As a practical matter, IBNR may include losses that have been reported to the reporting entity but have not yet been entered to the claims system or bulk provisions. Bulk provisions are reserves included with other IBNR reserves to reflect deficiencies in known case reserves;

c. Loss Adjustment Expenses: Expected payments for costs to be incurred in connection with the adjustment and recording of losses defined in paragraphs 6.a. and 6.b. Examples of expenses incurred in these activities are estimating the amounts of
losses, disbursing loss payments, maintaining records, general clerical, secretarial, office maintenance, occupancy costs, utilities, computer maintenance, supervisory and executive duties, supplies, and postage. Loss adjustment expenses can be classified into two broad categories: Defense and Cost Containment (DCC) and Adjusting and Other (AO):

i. DCC include defense\(^1\), litigation, and medical cost containment expenses, whether internal or external. DCC include, but are not limited to, the following items:

(a) Surveillance expenses;
(b) Fixed amounts for medical cost containment expenses;
(c) Litigation management expenses;
(d) Loss adjustment expenses for participation in voluntary and involuntary market pools if reported by accident year;
(e) Fees or salaries for appraisers, private investigators, hearing representatives, reinspectors and fraud investigators, if working in defense of a claim, and fees or salaries for rehabilitation nurses, if such cost is not included in losses;
(f) Attorney fees incurred owing to a duty to defend, even when other coverage does not exist; and
(g) The cost of engaging experts;

ii. AO are those expenses other than DCC as defined in (i) above assigned to the expense group “Loss Adjustment Expense.” AO include, but are not limited to, the following items:

(a) Fees and expenses of adjusters and settling agents;
(b) Loss adjustment expenses for participation in voluntary and involuntary market pools if reported by calendar year;
(c) Attorney fees incurred in the determination of coverage, including litigation between the reporting entity and the policyholder;

\(^1\) Legal defense costs incurred under the definition of covered damages or losses as the only insured peril would be accounted for as losses, while legal defense costs incurred under a duty to defend would be accounted for as Defense and Cost Containment (DCC). For policies where legal costs are the only insured peril, the insurer would record the legal costs that reimburse the policyholder as loss and, to the extent the insurer participated in the defense, would record its legal costs as DCC. This is not intended to change the classifications of legal expenses for existing long tailed lines of liability coverage, such as medical malpractice and workers’ compensation insurance.
(c) Adjustment expenses arising from claims related lawsuits such as extra contractual obligations and bad faith lawsuits.

d. The contractual terms for arrangements (i.e., variable, fixed or bundled amounts) to third party administrators, management companies, or other entities for unpaid claims, losses and losses/claims adjustment expenses, shall be evaluated to determine if the arrangement meets the criteria to be reported as a prepaid asset and nonadmitted in accordance with SSAP No. 29—Prepaid Expenses. These payments shall not be offset against any amounts required to be reported in accordance with paragraphs 4 or 5 within this guidance. Only when loss/claim and related adjusting expense payments which are made by the third-party administrators, management companies or other entities, to the policyholder or claimant, shall the insurer’s liability (loss/claim or loss/claim adjustment expense reserves) be reduced.

e. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as aggregate write-in for miscellaneous underwriting benefits in the Underwriting and Investment exhibit Part 3.

Life, Accident and Health

7. The following future costs relating to life and accident and health indemnity contracts, as defined in SSAP No. 50, shall be considered in determining the liability for unpaid claims and claim adjustment expenses:

a. Accident and Health Claim Reserves: Reserves for claims that involve a continuing loss. This reserve is a measure of the future benefits or amounts not yet due as of the statement date which are expected to arise under claims which have been incurred as of the statement date. This shall include the amount of claim payments that are not yet due such as those amounts commonly referred to as disabled life reserves for accident and health claims. The methodology used to establish claim reserves is discussed in SSAP No. 54R.

b. Claim Liabilities for Life/Accident and Health Contracts:

i. Due and Unpaid Claims: Claims for which payments are due as of the statement date;

ii. Resisted Claims in Course of Settlement: Liability for claims that are in dispute and are unresolved on the statement date. The liability either may be the full amount of the submitted claim or a percentage of the claim based on the reporting entity’s past experience with similar resisted claims;

iii. Other Claims in the Course of Settlement: Liability for claims that have been reported but the reporting entity has not received all of the required information or processing has not otherwise been completed as of the statement date;

iv. Incurred But Not Reported Claims: Liability for which a covered event has occurred (such as death, accident, or illness) but has not been reported to the reporting entity as of the statement date.

c. Claim Adjustment Expenses for Accident and Health Reporting Entities are those costs expected to be incurred in connection with the adjustment and recording of accident and health claims defined in paragraphs 7.a. and 7.b. Certain claim adjustment expenses reduce the number or cost of health services thereby resulting in lower
premiums or lower premium increases. These claim adjustment expenses shall be classified as cost containment expenses.

d. Claim Adjustment Expenses for Life Reporting Entities: Costs expected to be incurred (including legal and investigation) in connection with the adjustment and recording of life claims defined in paragraph 7.b. This would include adjustment expenses arising from claims-related lawsuits such as extra contractual obligations and bad-faith lawsuits.

c. In cases where insurers advance funds to third-party administrators, management companies or other entities prior to the occurrence of the claim who then, on behalf of the insurer, adjudicate the claim and make payments to insureds or other claimants, the guidance in paragraph 9 applies.

**Managed Care**

8. The following costs relating to managed care contracts as defined in SSAP No. 50 shall be considered in determining the claims unpaid and claims adjustment expenses:

a. Claims unpaid for Managed Care Reporting Entities:
   
i. Unpaid amounts for costs incurred in providing care to a subscriber, member or policyholder including inpatient claims, physician claims, referral claims, other medical claims, resisted claims in the course of settlement and other claims in the course of settlement;
   
ii. Incurred But Not Reported Claims: Liability for which a covered event has occurred (such as an accident, illness or other service) but has not been reported to the reporting entity as of the statement date;
   
iii. Additional unpaid medical costs resulting from failed contractors under capitation contracts and provision for losses incurred by contractors deemed to be related parties for which it is probable that the reporting entity will be required to provide funding;

b. Claim Adjustment Expenses for Managed Care Reporting Entities are those costs expected to be incurred in connection with the adjustment and recording of managed care claims defined in paragraph 8.a. Certain claim adjustment expenses reduce the number or cost of health services thereby resulting in lower premiums or lower premium increases. These claim adjustment expenses shall be classified as cost containment expenses.

c. Liabilities for percentage withholds (“withholds”) from payments made to contracted providers;

d. Liabilities for accrued medical incentives under contractual arrangements with providers and other risk-sharing arrangements whereby the health entity agrees to share savings with contracted providers.

e. In cases where insurers advance funds to third-party administrators, management companies or other entities prior to the occurrence of the claim who then, on behalf of the insurer, adjudicate the claim and make payments to insureds or other claimants, the guidance in paragraph 9 applies.

**Managed Care and Accident and Health**

© 2019 National Association of Insurance Commissioners 13
Drafting Note: New guidance is issued within par. 9, which is underlined. Existing par 9 is renumbered to par. 10, and all other pars within existing guidance (i.e., pars. 10 – 23, will be renumbered to 11 – 24, respectively.

9. In some instances, insurers advance funds to third-party administrators, management companies or other entities prior to the occurrence of the claim who then, on behalf of the insurer, adjudicate the claim and make payments to insureds or other claimants. In such cases the following guidance applies:

   a. For capitated payments under managed care contracts, the liability for claims and claim adjusting expenses shall be established in an amount necessary to adjudicate and pay all unpaid claims irrespective of payments to third-party administrators, management companies or other entities, and is reported net of capitated payments to providers.

   b. For non-capitated advance payments, the liability for unpaid losses/claims and related adjustment expenses shall be established regardless of any payments made to third-party administrators, management companies or other entities, and such payments shall be reported by the insurer as prepayments. All prepayments (i.e., variable, fixed or bundled amounts) to third party administrators, management companies, or other entities for unpaid claims, losses and losses/claims adjustment expenses, shall be initially reported as a prepaid asset and nonadmitted in accordance with SSAP No. 29—Prepaid Expenses. These payments shall not be offset against any amounts required to be reported in accordance with paragraphs 4 or 5 within this guidance. Only when loss/claim and related adjusting expense payments which are made by the third-party administrators, management companies or other entities, to the policyholder or claimant, shall the insurer’s liability (loss/claim or loss/claim adjustment expense reserves) be reduced.

   c. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as (1) Aggregate write ins for expenses - Life/ Health (Exhibit 2 – General expenses) or (2) Aggregate write ins for expenses (General Administrative Expenses) - Health (Underwriting and Investment Exhibit Part 3)

Note that this guidance in paragraph 9 does not alter existing guidance regarding the admissibility of loans and advances to providers which apply to health insurance and managed care contracts which is addressed in SSAP No. 84—Health Care and Government Insured Plan Receivables.
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: ASU 2014-17, Business Combinations – Pushdown Accounting, a Consensus of the FASB Emerging Issues Task Force

Check (applicable entity):

- Modification of existing SSAP
- New Issue or SSAP
- Interpretation

Check box for applicable entity:

- P/C
- Life
- Health

Description of Issue:

ASU 2014-17, Business Combinations – Pushdown Accounting, a Consensus of the FASB Emerging Issues Task Force (ASU 2014-17) was issued to provide guidance on whether and at what threshold an acquired entity that is a business or nonprofit activity can apply pushdown accounting in its separate financial statements. Prior to the issuance of this ASU, pushdown accounting was only required under U.S. GAAP for SEC registrants. Pursuant to the provisions in the ASU, acquirees now have the option to apply pushdown accounting. Pushdown accounting is a convention of accounting for the purchase of a subsidiary at the purchase cost rather than its historical basis. In effect, the acquiree’s assets and liabilities are written up (or down) to reflect the purchase price and, to the extent that the purchase price exceeds fair value, to recognize the excess as goodwill. In short, the total amount that is paid to purchase the subsidiary becomes the subsidiary’s new book value on its financial statements.

To illustrate the difference in applying pushdown accounting:

- Acquiree’s Book Value of Assets = $100 and Liabilities = $50.
- Acquiree’s Fair Value of Assets = $120 and Liabilities = $30.

If the purchase price was $90:

- “Normal” Purchase Accounting = Recognize SCA at $50 with the parent recognizing goodwill of $40.
- “Pushdown” Purchase Accounting = Recognize SCA at $90 with no goodwill recognized by the parent.

Under U.S. GAAP, goodwill is calculated as the purchase price of the acquiree less the market value of the acquiree. Any gains and losses associated with the new book value are “pushed down” from the acquiree’s income statement and balance sheet to the acquired company’s income statement and balance sheet. ASU 2014-17 states that an acquired entity may elect the option to apply pushdown accounting in the reporting period in which the change-in-control event occurs, but it also has the option to apply pushdown accounting in a reporting period subsequent to its most recent change-in-control event. If pushdown accounting is applied in a subsequent reporting period, it will be considered a change in accounting principle.

Under statutory accounting, a business combination is accounted for as either a statutory purchase or a statutory merger. A business combination in which one entity is acquired by another, and a parent-subsidiary relationship is created, is accounted for as a statutory purchase. The acquirer reports its investment at cost, which 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. For acquired subsidiary, controlled and affiliated (SCA) entities valued under an equity method of accounting, goodwill is defined as the difference between the cost of acquiring the SCA and the reporting entity’s share of the book value of the SCA. For U.S. insurance SCAs, the historical basis of the
SCA will continue to be used in preparing its statutory financial statements. As such, pushdown accounting is not permitted for this equity method of accounting.

While statutory accounting utilizes the framework that was established by U.S. GAAP, statutory accounting focuses on the balance sheet, as opposed to the income statement, and places additional emphasis on the concepts of consistency and conservatism due to this difference in reporting objectives. The use of pushdown accounting as an accounting method under statutory accounting is problematic for the reasons listed below.

- A change in the ownership of an entity should not result in a new basis of accounting for that entity in its separate financial statements as transactions affecting an entity’s stock should not affect the entity’s accounting.

- If the acquiree has entered into third-party agreements with terms related to financial statements presented on the existing basis of accounting, restatement under pushdown accounting could pose problems in determining or maintaining compliance with those requirements.

- In the event there are still minority ownership interests in the acquired entity, utilization of pushdown accounting would result in a different set of financial statements and these owners would not have a meaningful set of comparative financial statements.

- There isn’t a reasonable way to determine which owner’s transactions should qualify for pushdown accounting, in a scenario in which there are multiple owners who are deemed to control the acquiree (10%+ ownership of outstanding stock measured at the holding company level).

- Goodwill restrictions under statutory accounting, such as the admissibility of goodwill limited to 10% of the reporting entity’s surplus and amortization over a ten-year span, would essentially be eluded.

**Example of U.S. GAAP with and without Pushdown Accounting versus Statutory Accounting**

Entity A purchases 100% of Entity Z (which has a fair value of 200 and is on the books for $100, Assets = $200 and Liabilities = $100) for $500.

**Entity Z’s Accounting on Standalone Financials:**

<table>
<thead>
<tr>
<th></th>
<th>U.S. GAAP without Pushdown</th>
<th>U.S. GAAP with Pushdown</th>
<th>Statutory Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td>300</td>
<td>500</td>
<td>200</td>
</tr>
<tr>
<td>Liabilities</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Equity</td>
<td>200</td>
<td>400</td>
<td>100</td>
</tr>
<tr>
<td>Goodwill</td>
<td>300</td>
<td>0</td>
<td>400</td>
</tr>
</tbody>
</table>

**Result:** Pushdown accounting increases the basis of the acquired entity from $100 under statutory accounting to $400 under U.S. GAAP. It also circumvents the goodwill restrictions under statutory accounting by increasing the basis of the acquired entity on its standalone financial statements.

**Actual SCA Filing**

NAIC Staff also refer to an actual SCA Sub 2 filing that was submitted during 2018 under the 8.b.iii valuation method (Non-Insurance SCA Entity under GAAP Basis). This acquisition was completed under the pushdown accounting method for U.S. GAAP. Since the existing guidance in SSAP No. 97 values 8.b.iii entities on the audited “U.S. GAAP equity of the investee,” the existing guidance does not allow for modifications/adjustments to remove the “pushdown accounting” impact. This allowed the parent reporting entity to avoid reporting goodwill for the acquired SCA. *(Entity names and values have been changed.*)
ABC purchased 50% of G for $500. G’s book value was $105 (Assets = $205 and Liabilities = $100) and fair value was $290.

Entity G’s Accounting on Standalone Financials:

<table>
<thead>
<tr>
<th></th>
<th>U.S. GAAP without Pushdown</th>
<th>U.S. GAAP with Pushdown</th>
<th>Statutory Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td>390</td>
<td>600</td>
<td>205</td>
</tr>
<tr>
<td>Liabilities</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Equity</td>
<td>290</td>
<td>500</td>
<td>105</td>
</tr>
<tr>
<td>Goodwill</td>
<td>210</td>
<td>0</td>
<td>395</td>
</tr>
</tbody>
</table>

The insurance reporting entity’s investment in G was increased due to the goodwill that was paid as part of the acquisition of G. This results in a value of G that vastly differs between U.S. GAAP where pushdown accounting is used and statutory accounting, which is much more conservative.

Existing Authoritative Literature:

SSAP No. 68—Business Combinations and Goodwill

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.

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 with 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, 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. 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.\(^1\)

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

**Valuation of Investments in Downstream Holding Companies**

22. SSAP No. 48 requires the financial statements of joint ventures, partnerships, and/or limited liability companies in which the downstream noninsurance holding company has a minor ownership interest or otherwise lacks control, i.e., ownership interest is less than 10% (hereinafter referred to as “non SCA SSAP No. 48 entities”), to be valued using U.S. GAAP basis financial statements. Valuation of a downstream holding company, including its investments in SCA entities, depends upon the nature of the SCA entities and non SCA SSAP No. 48 entities it holds in accordance with paragraph 8 of this statement. All liabilities, commitments, contingencies, guarantees or obligations of the downstream noninsurance holding company, which are required to be recorded under applicable statutory accounting guidance, shall be reflected in the parent insurance reporting entity’s determination of the carrying value of the investment in the downstream noninsurance holding company, if not already recorded in the financial statements of the downstream noninsurance holding company. If an SCA investment of the downstream holding company does not meet the provisions of paragraph 8.a. or if it elects not to use the guidance in paragraph 8.a., and instead uses the guidance in paragraph 8.b., the downstream holding company would be valued as the sum of the following (if applicable):

a. Investments by a downstream holding company in U.S. insurance SCA entities are recorded based upon the guidance in paragraph 8.b.i.;

b. Investments by a downstream holding company in noninsurance SCA entities that are engaged in transactions or activities described in paragraph 8.b.ii., are recorded based upon the guidance in paragraph 8.b.ii.;

c. Investments by a downstream holding company in noninsurance SCA entities that do not qualify under paragraph 21.b. shall be recorded based upon the guidance in paragraph 8.b.iii.;

2 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.

3 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.
e. Any other assets and/or liabilities of the downstream holding company (not addressed in paragraphs 21.a. through 21.d.) shall be valued in accordance with the applicable SSAP.

For purposes of applying paragraphs 21-26 of this statement, a downstream holding company shall be considered to be the parent reporting entity’s investment in a SCA entity. See paragraphs 25 and 26 for a limited exception to the audited financial statements requirement for downstream noninsurance holding companies which meet specified conditions.

Admissibility Requirements of Investments in Downstream Holding Companies

23. To meet the admissibility requirements of this statement, unless the limited exception to the audited financial statements requirement discussed in paragraphs 25 and 26 applies, an annual audit of the financial statements of SCA entities, including the downstream holding company valued under paragraphs 8.b.i through 8.b.iv. must be obtained. The requirement for audited financial statements may be met by utilizing any one of the following methods:

a. Audited US GAAP financial statements of the downstream SCA holding company. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA’s domiciliary state.) The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities and non-SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet shall then be adjusted for GAAP to SAP differences for paragraph 8.b.i., 8.b.ii. and 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or

b. Audited foreign GAAP-basis financial statements of the downstream SCA holding company. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA’s domiciliary state.) The audited foreign GAAP basis financial statements shall include an audited footnote disclosure within the financial statements that reconciles each consolidated entity’s net income and equity on a foreign basis of accounting to a U.S. GAAP basis. The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities non SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet shall then be adjusted for GAAP to SAP differences of the insurance entities and paragraph 8.b.ii., and 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or

c. Individual audits of the downstream holding company and the downstream holding company’s investments in individual SCA entities.
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): During the 2019 Summer National Meeting, the Working Group received information on the history of pushdown and information from discussions with AICPA and interested party representatives. This information has been captured in the agenda item for future reference:

Comparison of SAP / GAAP Goodwill Guidance, including GAAP Pushdown:

<table>
<thead>
<tr>
<th>SCA Acquisition</th>
<th>Purchase Price: $300</th>
<th>Asset Book Value: $90</th>
<th>Asset Fair Value: $150</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard SAP Accounting:</td>
<td>Investment in SCA: $90 Goodwill: $210</td>
<td>The combined $300 is reported as the investment in SCA, but the goodwill is separately reported and is subject to the SSAP No. 68 admittance restrictions and the 10-year amortization.</td>
<td></td>
</tr>
<tr>
<td>U.S. GAAP Standard:</td>
<td>Investment in SCA: $150 Goodwill: $150</td>
<td>When pushdown is not elected, under U.S. GAAP, goodwill is calculated on the difference between fair value and the purchase price. This is different than SAP where goodwill is calculated based on the difference between book value and the purchase price.</td>
<td></td>
</tr>
<tr>
<td>U.S. GAAP Pushdown:</td>
<td>Parent Reporting: Investment in SCA: $300</td>
<td>With pushdown, the reported value at the reporting entity level simply reflects the purchase price.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>SCA Reporting: Assets: $150 Goodwill: $150</td>
<td>With pushdown, the acquired SCA increases the book value of their assets to fair value, and reports goodwill on their F/S for any remaining difference.</td>
<td></td>
</tr>
</tbody>
</table>

Preliminary information from discussions with AICPA and Industry representations

- Insurance reporting entities that were SEC filers have historically used pushdown when acquiring SCAs. This is because pushdown accounting was required for SEC filers and US GAAP allowed pushdown to prevent differences between the SEC and US GAAP.

- With ASU 2014-17, the US GAAP guidance became an election for all reporting entities. As such, more entities may have elected to use pushdown, but no information is known as to the extent pushdown accounting has been applied.

- For the SEC registrants that used pushdown, the U.S. GAAP guidance was followed. As such, at acquisition the assets and liabilities of the SCA were adjusted to fair value, and the goodwill calculated was the difference between the purchase price and the fair value of the SCA. (This is different from the goodwill calculation required under SSAP No. 68.) The goodwill was then recognized as an asset on the SCA books (and not at the insurance reporting entity level). This goodwill was subject to the U.S. GAAP impairment calculation, which requires annual testing of impairment, but was not subject to the admittance or amortization requirements of SSAP No. 68.

- For non-SEC registrants that have elected pushdown under the new GAAP provisions, it is uncertain how goodwill was calculated prior to the pushdown. (Whether it was calculated under the guidance in SSAP No. 68 or under U.S. GAAP.)
Although U.S. GAAP now permits pushdown beyond SEC filers, pushdown is prohibited under IFRS.

Per the discussion with interested parties’ representatives, the acquisition of a new SCA from a non-related party is considered to be an economic transaction under SSAP No. 25. However, if the acquisition of an SCA was from a related party, the it would not be considered an economic transaction. With classification as an economic transaction, the interested parties noted that increase of the SCA to represent fair value is consistent under SSAP No. 25.

**Historical SAP Guidance:**

The original Issue Paper No. 68 noted that pushdown should be prohibited in all SCA acquisitions. Issue Papers are not authoritative, and this guidance was not what was adopted in the original SSAP No. 68. There is no discussion in the original Issue Paper on the expansion that permitted pushdown for the “7.b.iii” entities in the issued SSAP No. 46. The expansion on the use of pushdown to all SCA entities except insurance SCA entities “8.b.i” was then reflected as a modification to SSAP No. 68 from the 2004 adoption of SSAP No. 88—Investments in Subsidiary, Controlled and Affiliated Entities, A Replacement of SSAP No. 46. (This revision expanded the ability to use pushdown accounting to noninsurance entities that engage in insurance “activities” and meet the revenue test under 8.b.ii.) There was no discussion in the corresponding Issue Paper (No. 118) regarding the expansion to all entities except insurance SCAs. NAIC staff suspects that as pushdown was limited to only SEC registrants under U.S. GAAP, the expansion to all entities that could use audited U.S. GAAP was not concerning as it would be applied only in the SEC-qualifying situations. This aspect of SSAP No. 68 has not been modified since the adoption of SSAP No. 88.

**Original Codification of AP&P Manual – Effective Jan. 1, 2001:**

**Issue Paper No. 68—Business Combinations and Goodwill:**

8. Under the statutory purchase method the historical bases of the acquired entity shall continue to be used in preparing its statutory financial statements except in those instances provided for in paragraph 8.b of Issue Paper No. 46. Therefore, pushdown accounting is not permitted.

**Issue Paper No. 46—Accounting for Investments in Subsidiary, Controlled or Affiliated Entities:**

8b. If a SCA investment does not meet the requirements for the market valuation approach in paragraph 7.a. or, if the requirements are met, but a reporting entity elects not to use that approach, investments in SCAs shall be recorded as follows:

i. Investments in insurance SCA entities shall be recorded based on the underlying statutory equity of the respective entity's financial statements, adjusted for unamortized goodwill as provided for in Issue Paper No. 68—Business Combinations and Goodwill (Issue Paper No. 68);

ii. Investments in noninsurance SCA entities that have no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, shall be recorded based on the underlying equity of the respective entity's financial statements adjusted to a statutory basis of accounting and the resultant proportionate share of the subsidiary's adjusted surplus, adjusted for unamortized goodwill as provided for in Issue Paper No. 68. Examples include but are not limited to: 1) an insurer and a SCA entity that leases autos, furniture, office equipment, or computer equipment to the insurer, 2) an insurer and a SCA entity that owns real estate property that is leased to the insurer for office space, and 3) an insurer and an SCA entity which holds investments which an insurer could acquire directly (i.e., "look through" investment subsidiary);

iii. Investments in noninsurance SCA entities that have significant ongoing operations beyond the holding of assets that are primarily for the direct or indirect benefit or use of the reporting entity...
or its affiliates, shall be recorded based on the audited GAAP equity of the investee. Examples include but are not limited to: 1) a property-casualty or life insurer and a SCA entity that is an oil and gas venture, and 2) a property-casualty or life insurer and a SCA manufacturer.

SSAP No. 68—Business Combinations and Goodwill

8. Under the statutory purchase method the historical bases of the acquired entity shall continue to be used in preparing its statutory financial statements except in those instances provided for in paragraph 7.b.iii of SSAP No. 46. Therefore, pushdown accounting is not permitted.

SSAP No. 46—Investments in Subsidiary, Controlled and Affiliated Entities:

7.b.iii. Investments in noninsurance SCA entities that have significant ongoing operations beyond the holding of assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, shall be recorded based on the audited GAAP equity of the investee. Examples include but are not limited to: (i) a property-casualty or life insurer and a SCA entity that is an oil and gas venture, and (ii) a property-casualty or life insurer and a SCA manufacturer.

AP&P Manual – As of March 2005:

SSAP No. 88—Investments in Subsidiary, Controlled and Affiliated Entities, A Replacement of SSAP No. 46 detailed the amendments adopted to SSAP No. 68:

26. This statement supersedes paragraphs 4-6 of SSAP No. 68—Business Combinations and Goodwill as follows:

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. 88, 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. 88 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. Business combinations accounted for under the statutory purchase method and in which the acquired entity is valued in accordance with, 8 b. i. SSAP No. 88 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.ii., 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.**

**Information or issues (included in Description of Issue) not previously contemplated by the Working Group:**

None

**Convergence with International Financial Reporting Standards (IFRS):**

Currently, there is no guidance in IFRS on pushdown accounting as this is not a method of accounting that is accepted under IFRS.
Staff Recommendation:
Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose the proposed revisions to SSAP No. 68—Business Combinations and Goodwill and SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities to reject ASU 2014-17, Business Combinations – Pushdown Accounting for statutory accounting. This agenda item also explicitly prohibits use of pushdown accounting under the statutory accounting basis, which includes all entities accounting for under SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies and SSAP No. 97. These revisions will explicitly prohibit insurance reporting entities that hold SCAs valued on the basis of U.S. GAAP (8.b.ii or 8.b.iii) to utilize a value for the SCA that reflects the impact of pushdown accounting. Insurance reporting entities that hold SCAs that utilized pushdown accounting for U.S. GAAP will be required to adjust their U.S. GAAP financial statements to remove the effect of pushdown accounting, and provide audited support of their modification. The insurance reporting entity shall recognize the difference between the purchase price and the net book value of the entity (prior to pushdown accounting) as goodwill in accordance with SSAP No. 68. This goodwill shall be admitted and amortized in accordance with the limitations and provisions of SSAP No. 68. The effective date of these revisions shall be Jan. 1, 2020.

Staff Note: Staff has considered that it will be more difficult to maintain separate sets of accounting records if multiple entities are acquired, especially with the complex nature of insurance company reporting structures. Staff also notes that the election to apply pushdown accounting under U.S. GAAP is irrevocable; as such, a grandfather provision will allow any SCAs acquired prior to December 31, 2019 to continue to use pushdown accounting in its financial statements.

Staff Review Completed by:
Fatima Sediqzad - NAIC Staff
March 2019

Proposed Revisions:

SSAP No. 68—Business Combinations and Goodwill

Business Combinations
2. A business combination shall be accounted for as either a statutory purchase or a statutory merger. Business combinations that create a parent-subsidiary relationship shall be accounted for as a statutory purchase. Business combinations where equity of one entity is issued in exchange for the equity of another entity, which is then canceled, and prospectively only one entity exists, shall be accounted for as a statutory merger.

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. Pushdown accounting is not a permitted convention of accounting under statutory accounting, including the acquisition of an entity that follows U.S. GAAP as its basis of accounting.

6. For those acquired SCA entities accounted for using the equity method in accordance with paragraph 8.b.i. of SSAP No. 97 under the statutory purchase method, the historical basis of the acquired entity shall continue to be used in preparing its statutory financial statements. Therefore, pushdown accounting is not permitted, as noted in paragraph 20.
20. This statement rejects ASU 2017-04, Simplifying the Test for Goodwill Impairment, ASU 2016-03, Intangibles—Goodwill and Other, Business Combinations, Consolidation, Derivatives and Hedging; ASU 2014-17, Business Combinations – Pushdown Accounting, a Consensus of the FASB Emerging Issues Task Force; ASU 2014-02, Accounting for Goodwill (a consensus of the Private Company Council), ASU 2012-02, Testing Indefinite-Lived Intangible Assets for Impairment, ASU 2011-08, Testing Goodwill for Impairment and ASU 2010-28, When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts; Accounting Principles Board Opinion No. 16, Business Combinations; FASB Statement No. 38, Accounting for Preacquisition Contingencies of Purchased Enterprises, an amendment of APB Opinion No. 16; Accounting Principles Board Opinion No. 17, Intangible Assets; FASB Statement No. 79, Elimination of Certain Disclosures for Business Combinations by Nonpublic Enterprises; FASB Statement No. 141, Business Combinations; and FASB Statement No. 142, Goodwill and Other Intangible Assets. The following related interpretative pronouncements are also rejected:

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

Applying the Market Valuation, Audited Statutory Equity and Audited GAAP Equity Methods

8. The admitted investments in SCA entities shall be valued using either the market valuation approach (as described in paragraph 8.a.), or one of the equity methods (as described in paragraph 8.b.) adjusted as appropriate in accordance with the guidance in SSAP No. 25—Affiliates and Other Related Parties (SSAP No. 25), paragraph 16.d.

   a. In order to use the market valuation approach for SCA entities, the following requirements apply:

   b. If a SCA investment does not meet the requirements for the market valuation approach in paragraph 8.a. or, if the requirements are met, but a reporting entity elects not to use that approach, the reporting entity’s proportionate share of its investments in SCAs shall be recorded as follows:

      i. Investments in U.S. insurance SCA entities shall be recorded based on either 1) the underlying audited statutory equity of the respective entity’s financial statements, adjusted for any unamortized goodwill as provided for in SSAP No. 68—Business Combinations and Goodwill (SSAP No. 68) or 2) the underlying audited statutory equity of the respective entity’s financial statements, adjusted for any unamortized goodwill, modified to remove the impact of any permitted or prescribed accounting practices that depart from the NAIC Accounting Practices and Procedures Manual. Reporting entities shall record investments in U.S. insurance SCA entities on at least a quarterly basis, and shall base the investment value on the most recent quarterly information available from the SCA. Entities may recognize their investment in U.S. insurance SCA entities based on the unaudited statutory equity in the SCAs year-end Annual Statement if the annual SCA audited financial statements are not complete as of the filing deadline. The recorded statutory equity shall be adjusted for audit adjustments, if any, as soon as the annual audited financial statements have been completed. Annual consolidated or combined audits are allowed if completed in accordance with the Model Regulation Requiring Annual Audited Financial Reports as adopted by the SCA’s domiciliary state;

3 If the insurance SCA employs accounting practices that depart from the NAIC accounting practices and procedures, and the reporting insurance entity has not adjusted the valuation of the insurance SCA to be consistent with the NAIC accounting practices and procedures, (i.e., retains the effect of the permitted or prescribed practice in its valuation), disclosure about those accounting practices that affect the insurance SCA’s net income and surplus shall be made pursuant to paragraph 36. If the reporting entity has adjusted the investment in the insurance SCA with the resulting valuation being consistent with the accounting principles of the AP&P Manual, the disclosures in paragraph 36 are not required.
ii. Investments in both U.S. and foreign noninsurance SCA entities that are engaged in the following transactions or activities:

(a) Collection of balances as described in SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers

(b) Sale/lease or rental of EDP Equipment and Software as described in SSAP No. 16R—Electronic Data Processing Equipment and Software

(c) Sale/lease or rental of furniture, fixtures, equipment or leasehold improvements as described in SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements

(d) Loans to employees, agents, brokers, representatives of the reporting entity or SCA as described in SSAP No. 20—Nonadmitted Assets

(e) Sale/lease or rental of automobiles, airplanes and other vehicles as described in SSAP No. 20—Nonadmitted Assets

(f) Providing insurance services on behalf of the reporting entity including but not limited to accounting, actuarial, auditing, data processing, underwriting, collection of premiums, payment of claims and benefits, policyowner services

(g) Acting as an insurance or administrative agent or an agent for a government instrumentality performing an insurance function (e.g. processing of state workers compensations plans, managing assigned risk plans, Medicaid processing etc).

(h) Purchase or securitization of acquisition costs

and if 20% or more of the SCA’s revenue is generated from the reporting entity and its affiliates, then the underlying equity of the respective entity’s audited U.S. Generally Accepted Accounting Principles (GAAP) financial statements shall be adjusted to a limited statutory basis of accounting in accordance with paragraphs 9 and 20FN. For purposes of this section, revenue means GAAP revenue reported in the audited U.S. GAAP financial statements excluding realized and unrealized capital gains/losses. Foreign SCA entities are defined as those entities incorporated or otherwise legally formed under the laws of a foreign country. Paragraphs 232-287 provide guidance for investments in holding companies;

New Footnote – If the audited U.S. GAAP financial statements reflect the pushdown method of accounting, the financial statements must first be modified to eliminate the effects of the pushdown accounting before applying the statutory basis adjustments.

iii. Investments in both U.S. and foreign noninsurance SCA entities that do not qualify under paragraph 8.b.ii., shall be recorded based on the audited U.S. GAAP equity of the investee, adjusted in accordance with paragraph 20. Foreign SCA entities are defined as those entities incorporated or otherwise legally formed under the laws of a foreign country. Additional guidance on investments in downstream holding companies is included in paragraphs 232-287. Additional guidance on the use of audited foreign GAAP basis financial statements for the U.S. GAAP equity valuation amount is included in paragraph 243.b.

iv. Investments in foreign insurance SCA entities shall be recorded based on the underlying U.S. GAAP equity from the audited U.S. GAAP basis financial
Pushdown Accounting

20. Pushdown accounting is a convention of accounting for the purchase of a subsidiary at the purchase cost rather than its historical cost. Under pushdown accounting, the acquiree’s assets and liabilities are written up (or down) to reflect the purchase price and, to the extent that the purchase price exceeds fair value, to recognize the excess as goodwill. As such, the total amount that is paid to purchase the subsidiary becomes the subsidiary’s new book value on its financial statements. Pushdown accounting is not permitted under statutory accounting, therefore all SCAs that utilize audited U.S. GAAP financial statements to determine the valuation method under this statement (SCAs valued in accordance with paragraphs 8.b.ii and 8.b.iii) that reflect pushdown accounting must be adjusted, in accordance with an audited reconciliation, to eliminate the effects of pushdown accounting. In addition to adjusting the equity basis of the SCA to eliminate pushdown accounting, the insurance reporting entity shall separately recognize goodwill, as appropriate based on the purchase price and net book value of the entity at acquisition (without pushdown accounting) and report the goodwill in accordance with the provisions of SSAP No. 68. Reporting entities that do not have audited support to eliminate the impact of pushdown accounting shall consider the SCA nonadmitted for statutory reporting purposes. Historical acquisitions of SCAs that have involved pushdown accounting shall continue admittance of the SCA with approval of the domiciliary commissioner. On a prospective basis for newly acquired SCAs, and for historical SCA acquisitions in which domiciliary commissioner approval is not received, reporting entities that do not have audited support to eliminate the impact of pushdown accounting shall report the SCA as a nonadmitted asset for statutory reporting purposes.

Valuation of Investments in Downstream Holding Companies

22. SSAP No. 48 requires the financial statements of joint ventures, partnerships, and/or limited liability companies in which the downstream noninsurance holding company has a minor ownership interest or otherwise lacks control, i.e., ownership interest is less than 10% (hereinafter referred to as “non SCA SSAP No. 48 entities”), to be valued using U.S. GAAP basis financial statements. Valuation of a downstream holding company, including its investments in SCA entities, depends upon the nature of the SCA entities and non SCA SSAP No. 48 entities it holds in accordance with paragraph 8 of this statement. All liabilities, commitments, contingencies, guarantees or obligations of the downstream noninsurance holding company, which are required to be recorded under applicable statutory accounting guidance, shall be reflected in the parent insurance reporting entity’s determination of the carrying value of the investment in the downstream noninsurance holding company, if not already recorded in the financial statements of the downstream noninsurance holding company. The historical basis of the acquired entity shall continue to be used in preparing its financial statements. If an SCA investment of the downstream holding company does not meet the provisions of paragraph 8.a. or if it elects not to use the guidance in paragraph 8.a., and instead uses the guidance in paragraph 8.b., the downstream holding company would be valued as the sum of the following (if applicable):

Admissibility Requirements of Investments in Downstream Holding Companies

23. To meet the admissibility requirements of this statement, unless the limited exception to the audited financial statements requirement discussed in paragraphs 26 and 27 applies, an annual audit of the financial statements of SCA entities, including the downstream holding company valued under paragraphs
8.b.i through 8.b.iv. must be obtained. The requirement for audited financial statements may be met by utilizing any one of the following methods:

a. Audited US GAAP financial statements of the downstream SCA holding company, where the historical basis of the SCA has been used to prepare its financial statements. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA’s domiciliary state.) The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities and non-SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet schedule shall then be adjusted for GAAP to SAP differences for paragraph 8.b.i., 8.b.ii. and 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or

b. Audited foreign GAAP-basis financial statements of the downstream SCA holding company. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA’s domiciliary state.) The audited foreign GAAP basis financial statements shall include an audited footnote disclosure within the financial statements that reconciles each consolidated entity’s net income and equity on a foreign basis of accounting to a U.S. GAAP basis. The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities non SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet shall then be adjusted for GAAP to SAP differences of the insurance entities and paragraph 8.b.ii., and 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or

c. Individual audits of the downstream holding company and the downstream holding company’s investments in individual SCA entities.

48. This statement rejects ASU 2014-17, Business Combinations – Pushdown Accounting, a Consensus of the FASB Emerging Issues Task Force, ASU 2011-10, Derecognition of in Substance Real Estate, APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock, AICPA Accounting Interpretations APB 18, The Equity Method of Accounting for Investments in Common Stock: Accounting Interpretations of APB Opinion No. 18, FASB Technical Bulletin No. 79-19, Investor’s Accounting for Unrealized Losses on Marketable Securities Owned by an Equity Method Investee, FASB Emerging Issues Task Force No. 87-21, Change of Accounting Basis in Master Limited Partnership Transactions, FASB Emerging Issues Task Force No. 96-16, Investor’s Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights, FASB Emerging Issues Task Force No. 98-2: Accounting by a Subsidiary or Joint Venture for an Investment in the stock of Its Parent Company or Joint Venture Partner and FASB Staff Position No. APB 18-1, Accounting by an Investor for Its Proportionate Share of Accumulated Other Comprehensive Income of an Investee Accounted for under the Equity Method in Accordance with APB Opinion No. 18 upon a Loss of Significant Influence.
Status:
On April 6, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No 68—Business Combinations and Goodwill and SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities to reject ASU 2014-17, Business Combinations – Pushdown Accounting for statutory accounting as well as explicitly prohibit the use of pushdown accounting under statutory accounting, which includes all entities accounted for under SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies and SSAP No. 97.

On August 3, 2019, the Statutory Accounting Principles (E) Working Group exposed this agenda item with a request for comments on the three options listed below. Additionally, to ensure that goodwill resulting from an insurance reporting entity’s acquisition of an SCA when pushdown is applied is captured within the goodwill admittance limitation, the exposure includes limited revisions to reference this goodwill in SSAP No. 68—Business Combinations and Goodwill, paragraph 9. (Note: Information provided during the Summer National Meeting on the history of pushdown and information from AICPA and industry representatives has been captured within this agenda item under the “Activity to Date” section.)

The options for Working Group consideration include:

1) **Complete rejection of pushdown accounting.** As pushdown is now an election for SEC / U.S. GAAP filers, reporting entities can avoid use of pushdown if prohibited for statutory accounting. (NAIC staff would propose a prospective effective date if electing this option to avoid restatement of those entities that have previously elected pushdown.)

2) **Permission to use pushdown for all non-insurance entities.** This option would increase optionality into the statutory financial statements. If permitted, this approach would result in different SCA values and goodwill calculations for those that follow the guidance in SSAP No. 68 and those that utilize pushdown. Under SSAP No. 68, acquired SCAs do not write-up their assets or liabilities to fair value and goodwill is calculated as the difference between purchase price and book value. Under U.S. GAAP pushdown, acquired SCAs write-up their assets and liabilities to fair value, and goodwill is calculated as the difference between the purchase price and the fair value of the acquired entity. With pushdown, the goodwill is reported at the SCA level. As such, goodwill will be an indefinite asset unless it is identified as impaired. (Under U.S. GAAP, private entities and not-for-profit entities can elect to amortize goodwill over a 10-year period, but this is not an election for public entities.) If this option is supported, NAIC staff would recommend that the goodwill admittance limitation capture goodwill from an insurance entity’s acquisition of an SCA that is reported on the SCA financial statements. (This option would not permit pushdown for insurance SCAs (8.b.i entities).)

(If this option is considered, NAIC staff would propose restrictions on the use of pushdown that differ from U.S. GAAP. For example, under U.S. GAAP, a reporting entity could subsequent elect pushdown accounting in any reporting period after original acquisition. If pushdown was permitted, NAIC staff would propose to require the election at original acquisition and not allow subsequent elections.)

3) **Permit pushdown if elected by SEC Registrants, excluding non-insurance entities.** Although this option would introduce different accounting by type of reporting entity, it is consistent with when pushdown would have been applied under prior statutory accounting guidance. (Under the old SEC provisions, pushdown was only permitted when meeting certain SEC requirements.) This would seemingly allow the companies that have historically utilized pushdown under the SEC rules to continue acquisitions under that prior approach. If this option is supported, NAIC staff would recommend that the goodwill admittance limitation capture goodwill from the acquisition of an SCA that is reported on the SCA financial statements. (Also, NAIC staff would propose restrictions to the provisions to ensure the election is made at the time of original acquisition.) (This option would not permit pushdown for insurance SCAs (8.b.i entities).)
Exposed Edits to SSAP No. 68—Business Combinations and Goodwill:

8. 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.

9. Positive goodwill recorded under the statutory purchase method of accounting shall be admitted subject to the following limitation: Positive goodwill from all sources, including life, accident and health, and deposit-type assumption reinsurance and goodwill resulting from the acquisition of an SCA by the insurance reporting entity that is reported on the SCA’s financial statements (resulting from the application of pushdown accounting), is limited in the aggregate to 10% of the acquiring 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. 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.\[NT 01-18\]

\[^4\] 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.

\[^5\] 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 20 of SSAP No. 97.
This page intentionally left blank.
Statutory Accounting Principles (E) Working Group  
Maintenance Agenda Submission Form  
Form A

Issue: Attribution of Goodwill

Check (applicable entity):

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

Description of Issue:
This agenda item was drafted to expand the statutory guidance regarding the attribution of purchase price and goodwill from an acquisition and to add explicit language regarding the accounting treatment for these scenarios; specifically, for situations in which an insurance company acquires a holding company that owns multiple companies. There has not been consistency in the application of these scenarios in the SCA filings.

NAIC Staff has illustrated an actual SCA filing in the example below. The names of the companies and the amounts used in the example have been changed.

ABC Insurance Company purchased 100% of Holding Company D for $200 million, which resulted in goodwill of $150 million. Holding Company D owns 100% of three subsidiaries: Company X, Company Y and Company Z. Company X and Company Z are both non-insurance entities, while Company Y is a U.S. insurance entity. The attribution of purchase price and goodwill are necessary for the reasons listed below.

- **Standalone financials** - If Companies X, Y and Z present standalone financials, the purchase price and goodwill will need to be allocated down from the acquisition of Holding Company D. Company Y will present its financial statements separately in the Annual Statement it is required to file.

- **Look-through** - If Holding Company D is not audited, the goodwill from the acquisition of Holding Company D may not be admitted as part of Holding Company D’s value, but a look-through can be performed to one and/or all of the companies that D owns. With the look-through, the purchase price and goodwill would need to be allocated to each subsidiary that Holding Company D owns at the time of its
acquisition and each subsidiary’s equity could be admitted, along with the goodwill from the acquisition, subject to goodwill limitations.

- **Taxes** - The purchase price and goodwill would also need to be allocated down to each entity that Holding Company D owns for tax purposes. SSAP No. 101—*Income Taxes* permits an entity to admit its adjusted gross deferred tax assets (DTAs) against its own deferred tax liabilities (DTLs) but not against gross DTLs of other members of the affiliated or consolidated group. This must be done on an entity-by-entity basis.

- **Sale of entity** - If the insurance reporting entity subsequently sells one or more of the entities that Holding Company D owns, it would need the allocated purchase price and goodwill amount to calculate any gain or loss resulting from the sale.

Existing Authoritative Literature:

**Bold and underlined guidance is for emphasis.**

**SSAP No. 68—Business Combinations and Goodwill**

**Statutory Purchases of SCA Investments**

2. 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.

3. 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.

4. 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.

5. 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, 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. 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.

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

11. For investments in entities recorded on an equity method (paragraph 8.b.i. through 8.b.iv.) after the date of acquisition, the investment amount shall be 1) adjusted for the amortization of statutory goodwill as defined in SSAP No. 68, and 2) adjusted, with a corresponding unrealized gain or loss, for the reporting entity’s share of undistributed earnings and losses of the investee (net of dividends declared). (This results in a reduction of the investment amount when dividends declared are in excess of the undistributed accumulated earnings attributable to the investee.)

Admissibility Requirements of Investments in Downstream Holding Companies

22. To meet the admissibility requirements of this statement, unless the limited exception to the audited financial statements requirement discussed in paragraphs 25 and 26 applies, an annual audit of the financial statements of SCA entities, including the downstream holding company valued under paragraphs 8.b.i through 8.b.iv. must be obtained. The requirement for audited financial statements may be met by utilizing any one of the following methods:

a. Audited US GAAP financial statements of the downstream SCA holding company. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA’s domiciliary state.) The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities and non-SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet shall then be adjusted for GAAP to SAP differences for paragraph 8.b.i., 8.b.ii. and 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or

b. Audited foreign GAAP-basis financial statements of the downstream SCA holding company. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance

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 20 of SSAP No. 97.

3 Dividends are recognized in investment income when declared.

© 2019 National Association of Insurance Commissioners
entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA’s domiciliary state.) The audited foreign GAAP basis financial statements shall include an audited footnote disclosure within the financial statements that reconciles each consolidated entity’s net income and equity on a foreign basis of accounting to a U.S. GAAP basis. The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities non SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet schedule shall then be adjusted for GAAP to SAP differences of the insurance entities and paragraph 8.b.ii., and 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or

c. Individual audits of the downstream holding company and the downstream holding company’s investments in individual SCA entities.

23. If the downstream noninsurance holding company does not meet the requirements of paragraph 25, audited GAAP financial statements, as described in paragraph 22, are required for the downstream noninsurance holding company and its SCA and non SCA investments in order for the investment in the downstream noninsurance holding company to be classified as an admitted asset.

24. A purchased downstream holding company is valued in accordance with the provisions of paragraphs 21-24 and the provisions of SSAP No. 68.

SSAP No. 101—Income Taxes

Exhibit A – Implementation Questions and Answers

8.9 Parent Company P files a consolidated federal income tax return with its insurance subsidiaries, R, S and T. Assume consolidated taxes that could be recovered through loss carryback total $450. However, in the prior carryback years $200 was paid by each of the subsidiaries, R, S and T. The difference between the amount paid by the subsidiaries ($600) and the amount available through loss carryback ($150) is attributable to interest expense incurred by Company P. Pursuant to the group’s written income tax allocation agreement, in the case of loss carrybacks, taxes recoverable are limited to the consolidated taxes paid in the carryback years.

8.10 Because the adjusted gross DTA admitted under paragraph 11.a. for each reporting entity cannot exceed what each entity paid and could reasonably be expected to be refunded by P, no more than $450 in total may be admitted by the subsidiaries (under paragraph 11.a.). If the adjusted gross DTA associated with the subsidiaries’ temporary differences that reverse in the 11.a. period exceed the $450 of taxes recoverable through loss carryback on a consolidated basis, the adjusted gross DTA admitted by the insurance subsidiaries under paragraph 11.a. should be allocated among the subsidiaries, consistent with the principles of its written income tax allocation agreement. This allocation would, in most instances, be based on each subsidiary’s share of reversing temporary differences.

8.11 Under paragraph 11.c., an entity may admit its adjusted gross DTAs, after application of paragraphs 11.a. and 11.b., based upon offset against its own existing gross DTLs and not against gross DTLs of other members of the affiliated or consolidated group.

Limited Exceptions to the Audit Requirements for Downstream Noninsurance Holding Companies

25. This statement requires that investments in SCA entities be recorded using one of the valuation methods described in paragraph 8 in order to be admitted assets. Each of the paragraph 8.b. valuation methods require the financial statements of SCA entities, including downstream noninsurance holding companies, to be audited in order for the investments in SCA entities to be admitted assets. Likewise, SSAP No. 48 requires the financial statements of joint ventures, partnerships, and/or limited liability companies in which the downstream noninsurance holding
company has a minor ownership interest or otherwise lacks control, i.e., ownership interest is less than 10% to be audited (U.S. GAAP) in order to be admitted assets. There is a limited exception to the requirement to have audited financial statements of a downstream noninsurance holding company, provided that the entities owned by the downstream noninsurance holding company (paragraph 8.b.iii entity) have audited financial statements as described in paragraphs 25 and 26.

26. The process of admitting audited investments in entities owned by an unaudited downstream noninsurance holding company SCA entity will be known as a “look through.” In order to admit the investments in audited SCAs or the audited non SCA SSAP No. 48 entities owned by an unaudited downstream noninsurance holding company, a reporting entity may apply the look through approach, provided all of the following conditions are met:

a. The downstream noninsurance holding company is an 8.b.iii entity, and

b. The downstream noninsurance holding company does not own any other assets which are material to the downstream holding company other than the audited SCA entities and/or audited non SCA SSAP No. 48 entities, and

c. The downstream noninsurance holding company is not subject to liabilities, commitments, contingencies, guarantees or obligations which are material to the downstream noninsurance holding company.

If an investment in a downstream noninsurance holding company meets the requirements set forth above, the reporting entity can admit the individual audited SCA entities and/or audited non SCA SSAP No. 48 entities; however, unaudited immaterial assets of the downstream noninsurance holding company are to be carried at the lesser of the paragraph 8 valuation or nonadmitted (e.g. some equity method investments are required to be carried at a negative value due to either statutory adjustments or to parental obligations to keep funding the subsidiary).

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

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

Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation:
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 expand statutory accounting guidance to explicitly state that the attribution of purchase price and goodwill are required for a holding company’s subsidiaries upon acquisition of said holding company. The goodwill shall still be reported on the purchasing entity’s financial statements but may be required to be nonadmitted due to the stipulations of this agenda item.

Staff Review Completed by:
Fatima Sediqzad - NAIC Staff
March 2019

Proposed Revisions:
SSAP No. 68—Business Combinations and Goodwill

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 with paragraphs 8.b.ii. or 8.b.iv. of SSAP No. 97. If the acquired entity is a holding company, the purchase price and goodwill shall be calculated to determine the amount of goodwill that should be attributed to the downstream entities that were acquired as part of the holding company acquisition. (This is required because a reporting entity that subsequently qualifies and elects to look-through the holding company pursuant to SSAP No. 97, paragraphs 25-26 is only permitted to admit the goodwill attributed to the downstream entities that are admitted through the SSAP No. 97 look-through approach.) 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.

Status:
On April 6, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 68—Business Combinations and Goodwill and SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, as shown above, to explicitly state that the acquisition of a holding company requires the purchase price and goodwill amount to be attributed downstream to the entities that the holding company directly owns.

On August 3, 2019, the Statutory Accounting Principles (E) Working Group exposed revisions to SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, as illustrated below, to clarify that the “assignment” of goodwill is a disclosure element, with revisions to the disclosure requirements for downstream holding companies. The revisions also reflect a change in terminology from “allocation” to “assignment.”

Proposed Revisions to SSAP No. 97:

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 with paragraphs 8.b.ii. or 8.b.iv. of SSAP No. 97. If the acquired entity is a holding company, the purchase price and goodwill shall be calculated to determine the amount of goodwill that should be assigned to the downstream entities that were acquired as part of the holding company acquisition. This is required because a reporting entity that subsequently qualifies and elects to look-through the holding company pursuant to SSAP No. 97, paragraphs 25-26 is only permitted to admit the goodwill attributed to
the downstream entities that are admitted through the SSAP No. 97 look-through approach. Information on the assigned goodwill shall be captured in the initial Sub 1 filing to the NAIC for all holding company acquisitions and disclosed in accordance with paragraph 42 if the reporting entity utilizes the look-through approach. 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.

41. If a reporting entity holds an investment in a downstream noninsurance holding company, the reporting entity may look-through the downstream noninsurance holding company to the value of (i) SCA entities having audited financial statements and/or (ii) joint ventures, partnerships, and/or limited liability companies having audited financial statements in which the downstream noninsurance holding company has a minor ownership interest or otherwise lacks control, i.e., ownership interest is less than 10% in lieu of obtaining an audit of the financial statements of the downstream noninsurance holding company (provided the limited exception to the audited financial statements requirement contained in paragraphs 26-27 applies).

42. If a reporting entity utilizes the look-through approach for the valuation of the downstream noninsurance holding company instead of obtaining audited financial statements of the downstream noninsurance holding company, the financial statements of the reporting entity shall include the following disclosures for each noninsurance holding company in which the look-through approach is utilized:

   d. Information that details the name of the downstream noninsurance holding company (including whether the reporting entity has looked-through more-than-one holding companies) along with details on the carrying value, goodwill and admitted value of the holding company.

   d-e. Information on the entities held by the noninsurance holding company that includes their carrying value, assignment of goodwill (and how this assignment was determined), whether audited financial statements were obtained, and the ultimate admitted value;

   e. The carrying value of the investment in the downstream non insurance holding company;

   f. The fact that the financial statements of the downstream noninsurance company are not audited;

   g. The fact that the reporting entity has limited the value of its investment in the downstream noninsurance holding company to the value contained in the audited financial statements, including adjustments required by this statement, of SCA entities and/or non-SCA SSAP No. 48 entities owned by the downstream noninsurance holding company and valued in accordance with paragraphs 22-25;

   h. The fact that all liabilities, commitments, contingencies, guarantees or obligations of the downstream noninsurance holding company, which are required to be recorded as liabilities, commitments, contingencies, guarantees or obligations under applicable accounting guidance, are reflected in the reporting entity's determination of the carrying value of the investment in the downstream noninsurance holding company, if not already recorded in the financial statements of the downstream noninsurance holding company.

Example Disclosure for Inclusion in the A/S Illustrations:
(NAIC staff is not proposing to data-capture this information.)

For the year-end 2018 financial statements, the reporting entity reported the value of a downstream holding company using the look-through approach permitted in SSAP No. 97 as the downstream holding company was not supported by audited financial statements. Pursuant to the provisions in SSAP No. 97, the look-through approach is only permitted when the downstream noninsurance entity is an 8.b.iii entity, and the downstream holding company does not own any other assets which are material to the downstream holding company other than the audited/non-audited entities.
held by the downstream holding company. Additionally, the downstream noninsurance holding company is not subject to liabilities, commitments, contingencies, guarantees or obligations which are materials to the downstream holding company.

In accordance with the provisions of SSAP No. 97, the investment of the downstream holding company has been limited to the value contained in the audited financial statements, including adjustments required by SSAP No. 97, of the SCA entities (and SSAP No. 48 entities) owned by the downstream noninsurance holding company pursuant to the valuation requirements detailed in SSAP No. 97, paragraphs 22-25. Detail of how the reported investment of the downstream holding company was determined using the look-through approach is shown below:

<table>
<thead>
<tr>
<th>Downstream Holding Company Look-Through</th>
<th>Carrying Value</th>
<th>Goodwill</th>
<th>Total Admitted Value</th>
<th>SSAP No. 97 Adjustments</th>
<th>Total Nonadmitted</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABC Downstream**</td>
<td>$3,000,000</td>
<td>$250,000</td>
<td>$2,712,500</td>
<td>$0</td>
<td>$287,500</td>
</tr>
<tr>
<td>Name of Look-Through Entity</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>XYZ Entity</td>
<td>Yes</td>
<td>2,500,000</td>
<td>85%</td>
<td>$212,500</td>
<td>$2,712,500</td>
</tr>
<tr>
<td>QRS Entity</td>
<td>No</td>
<td>400,000</td>
<td>10%</td>
<td>$25,000</td>
<td>$0</td>
</tr>
<tr>
<td>MNO Entity</td>
<td>No</td>
<td>100,000</td>
<td>5%</td>
<td>$12,500</td>
<td>$0</td>
</tr>
<tr>
<td>Total</td>
<td>$3,000,000</td>
<td>100%</td>
<td>$250,000</td>
<td>$0</td>
<td>2,712,500</td>
</tr>
</tbody>
</table>

* Goodwill assignment occurred at original acquisition of the downstream holding company on the basis of the percentage of the carrying value of each look-through entity to the total carrying value.  

** ABC Downstream holding company is owned by DEF nonaudited downstream holding company. The reporting entity has conducted a "more-than-one" holding company look-through as both downstream companies qualify for look-through under SSAP No. 97 as they are 8.b.iii entities holding no materials assets or liabilities in accordance with SSAP No. 97, paragraphs 26-27.

Exhibit A – SCA Reporting Process:

Initial Reporting of SCA Investments

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

54. The purpose of a Sub 1 filing is to determine whether the value claimed is reasonable. If the NAIC determines that the reported transaction meets the tests specified, it will complete the filing in the VISION database. If the NAIC determines that the transaction does not meet the tests specified, it shall not complete the filing in the VISION database and instead notifies the reporting insurance company and the state of domicile in writing of its determination.
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Rolling Short-Term Investments

Check (applicable entity):

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

Description of Issue:
This agenda item has been drafted to consider statutory accounting guidance for short-term investment structures that are being purposely designed to mature at or around 364 days (often with affiliates), with the full expectation that the investment structure would be renewed (rolled) continuously for subsequent years. This agenda item also addresses investments reported as cash equivalents, with the same dynamic, but structured to comply with the cash equivalent timeframes. It is believed these structures occur because reporting as short-term investments (or cash equivalents) results with the following benefits:

1) More-desirable risk-based capital (RBC) charge.
2) To avoid filing with either the SVO or to avoid obtaining a rating from a credit rating provider.
3) Limited affiliate reporting.

Although there are investments (e.g., repurchase and reverse repurchase) transactions that are often expected to renew, it is not appropriate to purposely structure investments to qualify for short-term or cash equivalent reporting, with an anticipation that the investment will continuously roll forward, potentially for many years and avoid filing the security for an NAIC designation and/or reporting on the schedule with more appropriate RBC charges as a long-term investment. In order to avoid unintended consequences for desirable short-term investments, the provisions of this agenda item have been structured to specifically apply to the following:

- All affiliated SSAP No. 26R investments.
- All SSAP No. 43R investments.
- All investments that would be reported on Schedule BA if they did not qualify for cash equivalent or short-term reporting. (This includes both affiliated and non-affiliated investments.)

With these restrictions, any non-affiliated investment that would qualify within SSAP No. 26R—Bonds as a long-term investment would be exempt from the proposed new concepts in determining cash equivalent / short-term investment reporting. This scope of the revisions intend to prevent inadvertent application to Treasury-bills, commercial paper, certificates of deposit, etc., where a reporting entity may continuously reacquire the same, or substantially similar short-term investment immediately after maturity of a prior short-term investment. However, any affiliated SSAP No. 26R and any investment (affiliated or non-affiliated) that would be in scope of SSAP No. 43R—Loan-backed and Structured Securities, or that would be reported as an “other invested asset” on Schedule BA is proposed to be subject to the additional concepts for reporting as a cash equivalent / short-term investment. (Repurchase and reverse repurchase transactions are also specifically excluded if they are admitted in accordance with SSAP No. 103R collateral requirements.)

Proposed additional concepts for Cash Equivalents and Short-Term Investments Captured in Scope:
• An overall principle that investments are permitted for short-term and cash equivalent reporting only if the reporting entity reasonably expects the investment duration to be realized (e.g., terminate / mature) on the designated maturity date. If the reporting entity does not expect that the investment will terminate or mature on the designated date but will be renewed / rolled beyond the cash equivalent / short-term maturity deadlines, then the investment shall not be classified within scope of SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments. Such investments shall be reported as long-term investments on the applicable reporting schedule and shall follow the provisions (including NAIC designations and RBC calculations) for a long-term investment. (Although SAP and U.S. GAAP have different definitions for “short-term” / “current asset” reporting, the concept that the duration is “reasonably expected to be realized” is consistent with the “current asset” definition under U.S. GAAP.)

• Provisions that a cash equivalent / short-term investment (unless specifically exempted) is only permitted to be reported within those classifications for one applicable reporting period. As such, if an investment is reported as a short-term investment as of Dec. 31, 2018, and the investment does not mature on the original scheduled maturity date, the reporting entity shall not be permitted to report the investment as a short-term investment on Dec. 31, 2019. (A cash equivalent would only be permitted to be reported with that distinction for one quarter, before moving to a long-term investment schedule.) For these situations, if a security is held after the initial maturity timeframes have passed, the reporting entity shall report the investment as a long-term investment on the applicable schedule and follow all provisions (including NAIC designations and RBC calculations as required) for a long-term investment. (By default, this provision incorporates a quarter (90-day) grace period, because if the security is sold in the quarter following the initial reporting date, it will not subsequently be reported as an invested asset.)

• The sale or maturity of an investment, with a reacquisition of the same or substantially similar security within a 1-year timeframe shall preclude the reporting entity from reporting the currently held security as a cash equivalent or short-term investment regardless of the maturity date. (This one-year timeframe prevents reporting of recurring “re-acquisitions” as cash equivalents or short-term investments.)

• Although wash sales, which are sales and reacquisitions within a 30-day timeframe, of cash-equivalents and short-term investments with credit assessments of NAIC 1-2 are currently excluded from the wash-sale disclosure, modifications have been proposed to require disclosure of all wash sales, regardless of NAIC designation, if the investment or transaction involves an affiliate.

RBC Assessment of Proposed Revisions:

Life Reporting Entities: For life reporting entities, if the investment is a bond, RBC is similar between all reporting schedules in accordance with NAIC designations. If the investment is not a bond, and does not have an NAIC 1 designation, and/or is not permitted to be reported as an “underlying fixed income security” pursuant to the requirements of Schedule BA, a reporting entity receives an RBC benefit by reporting the investment as a cash equivalent or short-term investment rather than as a BA investment. Also, if a reporting entity reports a “credit assessment” for short-term or cash equivalent bonds that is a better assessment than would be received if they had received an NAIC designation, a reporting entity would receive an RBC benefit by reporting the investment as a cash equivalent or short-term investment.

<table>
<thead>
<tr>
<th>Life RBC</th>
<th>Schedule E2 Cash Equivalent*</th>
<th>Schedule DA Short-Term*</th>
<th>Schedule D1 Bond</th>
<th>Schedule BA Fixed Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bond Investment</td>
<td>.0039</td>
<td>.0039</td>
<td>.0039</td>
<td>.0039</td>
</tr>
<tr>
<td>NAIC 1</td>
<td>.0126</td>
<td>.0126</td>
<td>.0126</td>
<td>.0126</td>
</tr>
<tr>
<td>NAIC 2</td>
<td>.0446</td>
<td>.0446</td>
<td>.0446</td>
<td>.0446</td>
</tr>
<tr>
<td>NAIC 4</td>
<td>.0970</td>
<td>.0970</td>
<td>.0970</td>
<td>.0970</td>
</tr>
<tr>
<td>NAIC 5</td>
<td>.2231</td>
<td>.2231</td>
<td>.2231</td>
<td>.2231</td>
</tr>
</tbody>
</table>
Bonds that are reported as cash equivalents or short-term investments receive RBC charges based on the “credit assessment” assigned in Schedule D-Part 1A. Although NAIC designations are not required for these investments, reporting entities are required to report them based on their own credit assessment. If a bond was reported with a higher credit assessment than what it would receive based on NAIC designation (which is required for long-term investments), then a movement from cash equivalent / short-term reporting to a long-term schedule (Schedule D-1 or Schedule BA) would have an RBC impact.

**Property / Casualty and Health Reporting Entities:** For property/casualty and health reporting entities, if the investment is a bond, RBC is similar between all reporting schedules in accordance with NAIC designations. If the investment is not a bond, a reporting entity receives an RBC benefit by reporting the investment as a cash equivalent or short-term investment rather than a BA investment. (P/C entities do not have the ability to report NAIC designations on Schedule BA investments for RBC purposes.) Also, if a reporting entity reports a “credit assessment” for short-term or cash equivalent bonds that is a better assessment than would be received if they had reported an NAIC designation, a reporting entity would receive an RBC benefit by reporting the investment as a cash equivalent or short-term investment.

<table>
<thead>
<tr>
<th>P/C &amp; Health RBC</th>
<th>Schedule E2 Cash Equivalent*</th>
<th>Schedule DA Short-Term*</th>
<th>Schedule D1 Bond</th>
<th>Schedule BA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bond Investment</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NAIC 1</td>
<td>.003</td>
<td>.003</td>
<td>.003</td>
<td>.200</td>
</tr>
<tr>
<td>NAIC 2</td>
<td>.010</td>
<td>.010</td>
<td>.010</td>
<td>.200</td>
</tr>
<tr>
<td>NAIC 3</td>
<td>.020</td>
<td>.020</td>
<td>.020</td>
<td>.200</td>
</tr>
<tr>
<td>NAIC 4</td>
<td>.045</td>
<td>.045</td>
<td>.045</td>
<td>.200</td>
</tr>
<tr>
<td>NAIC 5</td>
<td>.100</td>
<td>.100</td>
<td>.100</td>
<td>.200</td>
</tr>
<tr>
<td>NAIC 6</td>
<td>.3000</td>
<td>.3000</td>
<td>.3000</td>
<td>.200</td>
</tr>
<tr>
<td>Non-Bond Investment</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NAIC 1</td>
<td>.003</td>
<td>.003</td>
<td>XXXX</td>
<td>.200</td>
</tr>
<tr>
<td>NAIC 2</td>
<td>.003</td>
<td>.003</td>
<td>XXXX</td>
<td>.200</td>
</tr>
<tr>
<td>NAIC 3</td>
<td>.003</td>
<td>.003</td>
<td>XXXX</td>
<td>.200</td>
</tr>
<tr>
<td>NAIC 4</td>
<td>.003</td>
<td>.003</td>
<td>XXXX</td>
<td>.200</td>
</tr>
<tr>
<td>NAIC 5</td>
<td>.003</td>
<td>.003</td>
<td>XXXX</td>
<td>.200</td>
</tr>
<tr>
<td>NAIC 6</td>
<td>.003</td>
<td>.003</td>
<td>XXXX</td>
<td>.200</td>
</tr>
<tr>
<td>No Designation</td>
<td>.003</td>
<td>.003</td>
<td>XXXX</td>
<td>.200</td>
</tr>
</tbody>
</table>
(which is required for long-term investments), then a movement from cash equivalent / short-term reporting to a long-term schedule (Schedule D-1 or Schedule BA) would have an RBC impact.

Existing Authoritative Literature:

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

**Cash Equivalents**

6. Cash equivalents are short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash, and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Only investments with original maturities of three months or less qualify under this definition, with the exception of money market mutual funds, as detailed in paragraph 7. Regardless of maturity date, derivative instruments shall not be reported as cash equivalents and shall be reported as derivatives on Schedule DB. Securities with terms that are reset at predefined dates (e.g., an auction-rate security that has a long-term maturity and an interest rate that is regularly reset through a Dutch auction) or have other features an investor may believe results in a different term than the related contractual maturity shall be accounted for based on the contractual maturity at the date of acquisition, except where other specific rules within the statutory accounting framework currently exist.

7. Money market mutual funds registered under the Investment Company Act of 1940 and regulated under rule 2a-7 of the Act shall be accounted for and reported as cash equivalents for statutory accounting. Investments in money market mutual funds shall be valued at fair value or net asset value (NAV) as a practical expedient. For reporting entities required to maintain an asset valuation reserve (AVR), the accounting for unrealized capital gains and losses shall be in accordance with **SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve** (SSAP No. 7). For reporting entities not required to maintain an AVR, unrealized capital gains and losses shall be recorded as a direct credit or charge to surplus. Sales/reinvestments in money market mutual funds are excluded from the wash sale disclosure in SSAP No. 103R.

*Footnote 1: Original maturity means original maturity to the entity holding the investment. For example, both a three-month U.S. Treasury bill and a three-year Treasury note purchased three months from maturity qualify as cash equivalents. However, a Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months.*

**Short-Term Investments**

12. All investments with remaining maturities (or repurchase dates under repurchase agreements) of one year or less at the time of acquisition (excluding derivatives and those investments classified as cash equivalents as defined in this statement) shall be considered short-term investments. Short-term investments include, but are not limited to, bonds, commercial paper, repurchase agreements, and collateral and mortgage loans which meet the noted criteria. Short-term investments shall not include certificates of deposit. Regardless of maturity date, derivative instruments shall not be reported as short-term investments and shall be reported as derivatives on Schedule DB.

13. All short-term investments shall be accounted for in the same manner as similar long-term investments.

14. Short-term investments meet the definition of assets as defined in SSAP No. 4 and are admitted assets to the extent they conform to the requirements of this statement.

**SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities** (bolding and underlining added for emphasis)

28.I. A reporting entity shall disclose the following information for wash sales, as defined in paragraph 12, involving transactions for securities with an NAIC designation of 3 or below, or that do not have an
NAIC designation (excluding all cash equivalents, derivative instruments as well as short-term investments with credit assessments equivalent to an NAIC 1-2 designation). This disclosure shall be included in the financial statements for when the investment was initially sold. For example, if the investment was sold December 20, 2017, and reacquired on January 10, 2018, the transaction shall be captured in the wash sale disclosure included in the year-end 2017 financial statements:

i. A description of the reporting entity’s objectives regarding these transactions;

ii. An aggregation of transactions by NAIC designation 3 or below, or that do not have an NAIC designation;

iii. The number of transactions involved during the reporting period;

iv. The book value of securities sold;

v. The cost of securities repurchased; and

vi. The realized gains/losses associated with the securities involved.

U.S. GAAP – FASB Codification

Master Glossary of “Current Assets”

Current assets is used to designate cash and other assets or resources commonly identified as those that are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business.

Activity to Date (issues previously addressed by the 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) and U.S. GAAP:
Not Applicable – NAIC staff highlights that the distinction of “short-term” under SAP is distinctly different from U.S. GAAP. Under U.S. GAAP, a “current asset” is one that is reasonably expected to be realized in case or sold or consumed during the normal operating cycle of a business. As such, under U.S. GAAP investments move from a non-current (long-term) to current (short-term) classification. This does not occur under SAP, as the distinction of short-term is based on the maturity timeframe at the time of acquisition.

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments to incorporate additional principle concepts in classifying investments as cash equivalents or short-term investments.

As detailed within this agenda item, the proposed revisions will restrict classification as a cash equivalent or short-term investment for all affiliated SSAP No. 26R—Bond investments, all affiliated and nonaffiliated investments in scope of SSAP No. 43R—Loan-backed and Structured Securities and all affiliated and non-affiliated investments that would be reported on Schedule BA in accordance with the following provisions:

- The reporting entity does not reasonably expect that the investment will actually terminate or mature within the timeframe permitted for cash equivalent or short-term investment classification.
• The investment was previously reported as a cash equivalent / short-term investment and the initial maturity timeframes have passed. For example, if an investment was reported as a short-term investment as of Dec. 31, 2018, and the investment was rolled / renewed, the reporting entity will not be permitted to report the investment as a short-term investment on Dec. 31, 2019. (A cash equivalent would only be permitted to be reported for one quarter, before moving to a long-term investment schedule.) For these situations, if a security is held after the initial maturity timeframes have passed, the reporting entity shall report the investment as a long-term investment on the applicable schedule and follow all provisions (including NAIC designations and RBC calculations as required) for a long-term investment.

• The sale or maturity of an investment, with a reacquisition of the same or substantially similar security within a 1-year timeframe would preclude the reporting entity from reporting the currently held security as a cash equivalent or short-term investment regardless of the maturity date. (This one-year timeframe prevents reporting of recurring “re-acquisitions” as cash equivalents or short-term investments.) (This provision is similar to the one regarding “rolled” securities but clarifies that the “settlement” of a security with a reacquisition does not prevent application of the new concepts in determining cash equivalent or short-term reporting. (NAIC staff highlights that this restriction is necessary particularly with the use of “net settlement” structures with affiliates in which no cash is exchanged.)

• Wash sales, regardless of NAIC designation, that involve affiliated investments shall be disclosed.

The proposed revisions in this agenda item have been drafted to focus on affiliated bond investments (SSAP No. 26R), all loan-backed and structured security investments (SSAP No. 43R) and all investments that would be captured on Schedule BA. This approach has been used to exclude a variety of cash equivalent / short-term investments that are often purposely rolled / reacquired to ensure a continuous balance of available short-term liquidity (e.g., Treasury-bills, commercial paper, certificates of deposit, etc.) By excluding all non-affiliated “bonds” from the new guidance, the “normal” recurring short-term / cash equivalent investments are not expected to be impacted. The revisions capture both affiliated and nonaffiliated Schedule BA items, as the short-term structuring is more of an RBC focus. (NAIC staff does not believe there are many SSAP No. 43R securities that qualify as cash equivalents or short-term investments, but they have been specifically identified to prevent such classifications if the noted conditions are met.)

As a key item to note, the proposed revisions permit reporting entities that acquire short-term investments (based on maturity date) that are captured in scope and that they expect to roll (such as an affiliated short-term bond), to report the security as a long-term investment at acquisition. (With this approach, the investment would not have to change reporting schedules once it is rolled after initial acquisition.)

Proposed Revisions to SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments:

**Cash Equivalents**

Cash equivalents are short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash, and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Only investments with original maturities of three months or less can qualify under this definition, with the exception of money market mutual funds, as detailed in paragraph 78. Regardless of maturity date, derivative instruments shall not be reported as cash equivalents and shall be reported as derivatives on Schedule DB. Securities with terms that are reset at predefined dates (e.g., an auction-rate security that has a long-term maturity and an interest rate that is regularly reset through a Dutch auction) or have other features an investor may believe results in a

---

1 Original maturity means original maturity to the entity holding the investment. For example, both a three-month U.S. Treasury bill and a three-year Treasury note purchased three months from maturity qualify as cash equivalents. However, a Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months.
different term than the related contractual maturity shall be accounted for based on the contractual maturity at the date of acquisition, except where other specific rules within the statutory accounting framework currently exist.

7. Regardless of maturity date, affiliated investments that would be in scope of SSAP No. 26R—Bonds and all investments that would be in scope of SSAP No. 43R—Loan-backed and Structured Securities or that would be reported as “Other Invested Assets” shall be reported as long-term investments if any of the following conditions apply:

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

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

   c. The reporting entity reacquired the investment (or a substantially similar investment) within 1 year after the original security matured or was terminated. These reacquired securities shall be reported as long-term investments. (These securities are also not permitted to be reported as short-term investments regardless of the maturity date of the reacquired investment.)

New Footnote 1: Repurchase and reverse repurchase transactions are excluded from these provisions if admitted in accordance with collateral requirements pursuant to SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. Cash equivalents subject to the provisions of paragraph 7 are not permitted to be subsequently reported as short-term investments, even if the updated / reacquired maturity date is within 1 year. These investments shall be reported as long-term investments. To avoid changes in reporting schedules, reporting entities are permitted to report securities as long-term investments at initial acquisition regardless of the initial maturity date.

Short-Term Investments

12. Short-term All investments are investments that do not qualify as cash equivalents with remaining maturities (or repurchase dates under repurchase agreements) of one year or less at the time of acquisition. (excluding derivatives and those investments classified as cash equivalents as defined in this statement) shall be considered short-term investments. Short-term investments can include, but are not limited to, bonds, commercial paper, repurchase agreements, and collateral and mortgage loans. which meet the noted criteria. Short-term investments shall not include certificates of deposit. Regardless of maturity date, derivative instruments shall not be reported as short-term investments and shall be reported as derivatives on Schedule DB.

13. Regardless of maturity date, affiliated investments in scope of SSAP No. 26R—Bonds and all investments that would be in scope of SSAP No. 43R—Loan-backed and Structured Securities or that would be reported as “Other Invested Assets” shall be reported as long-term investments if any of the following conditions apply:

   a. The reporting entity does not reasonably expect the investment to terminate on the maturity date. This provision includes investments that are expected to be renewed (or rolled) with a maturity date that ends subsequent to the initial “less than one year” timeframe.
b. The investment was previously reported as a short-term investment and the initial maturity timeframe has passed. If an investment is reported as a short-term investment and it is unexpectedly renewed / rolled, the reporting entity is not permitted to continue to report the held security as a short-term investment (or as a cash equivalent) regardless of the updated maturity date and shall report the security as a long-term investment. An investment is only permitted to be reported as a short-term investment for one annual reporting period. Meaning, if an investment was reported as a short-term investment as of December 31, 2018, it is not permitted to be reported as short-term investment as of December 31, 2019.

c. The reporting entity reacquired the investment (or a substantially similar investment) within 1 year after the original security matured or was terminated. These reacquired securities shall be reported as long-term investments. (These securities are also not permitted to be reported as cash equivalent investments regardless of the maturity date of the reacquired investment.)

New Footnote 1: Repurchase and reverse repurchase transactions are excluded from these provisions if admitted in accordance with collateral requirements pursuant to SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. Short-term investments subject to the provisions of paragraph 13 are not permitted to be subsequently reported as cash equivalents, even if the updated / reacquired maturity date is within 90-days. These investments shall be reported as long-term investments. To avoid changes in reporting schedules, reporting entities are permitted to report securities as long-term investments at initial acquisition regardless of the initial maturity date.

12.14._ All short-term investments shall be accounted for in the same manner as similar long-term investments.

13.15._ Short-term investments meet the definition of assets as defined in SSAP No. 4 and are admitted assets to the extent they conform to the requirements of this statement.

Proposed Revisions to SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities:

28.l. A reporting entity shall disclose the following information for wash sales, as defined in paragraph 12, for all affiliated investment transactions (including items originally classified as cash equivalents and short-term investments) and for non-affiliated involving investment transactions for securities with an NAIC designation of 3 or below, or that do not have an NAIC designation. (For non-affiliated investments, excluding all cash equivalents, derivative instruments as well as and short-term investments with credit assessments equivalent to an NAIC 1-2 designation, are excluded from this disclosure.) This disclosure shall be included in the financial statements for when the investment was initially sold. For example, if the investment was sold December 20, 2017, and reacquired on January 10, 2018, the transaction shall be captured in the wash sale disclosure included in the year-end 2017 financial statements:

i. A description of the reporting entity’s objectives regarding these transactions;

ii. An aggregation of transactions by NAIC designation 3 or below, or that do not have an NAIC designation;

iii. The number of transactions involved during the reporting period;

iv. The book value of securities sold;

v. The cost of securities repurchased; and

vi. The realized gains/losses associated with the securities involved.

Staff Review Completed by: Julie Gann – May 2019
Status:
On August 3, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 2R—Cash, Drafts and Short-term Investments and SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, as illustrated above, to incorporate additional principle concepts in classifying investments as cash equivalents or short-term investments.

NAIC staff recommends exposure of proposed revisions to SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments, which incorporate additional principle concepts in classifying investments as cash equivalents or short-term investments. Items from the original August 3, 2019 exposure are highlighted below and exclude certain qualified cash pooling arrangements (as proposed in agenda item 2019-42) from the restricted cash equivalent reporting detailed in this agenda item. Note: both agenda items (2019-20 and 2019-42) are concurrently exposed and if adopted in their current form, must be adopted simultaneously. Additionally, paragraph 8 as referenced below for cash pooling reflects the modifications proposed in agenda item 2019-42.

Proposed Revisions for Fall 2019 Discussion: to SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments:

Cash Equivalents

6. Cash equivalents are short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash, and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Only investments with original maturities of three months or less can qualify under this definition, with the exception of money market mutual funds, as detailed in paragraph 7B, and cash pooling, as detailed in paragraph 8. Regardless of maturity date, derivative instruments shall not be reported as cash equivalents and shall be reported as derivatives on Schedule DB. Securities with terms that are reset at predefined dates (e.g., an auction-rate security that has a long-term maturity and an interest rate that is regularly reset through a Dutch auction) or have other features an investor may believe results in a different term than the related contractual maturity shall be accounted for based on the contractual maturity at the date of acquisition, except where other specific rules within the statutory accounting framework currently exist.

7. Regardless of maturity date, affiliated investments that would be in scope of SSAP No. 26R—Bonds and all investments that would be in scope of SSAP No. 43R—Loan-backed and Structured Securities or that would be reported as “Other Invested Assets” shall be reported as long-term investments if any of the following conditions applyFN:

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

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

2 Original maturity means original maturity to the entity holding the investment. For example, both a three-month U.S. Treasury bill and a three-year Treasury note purchased three months from maturity qualify as cash equivalents. However, a Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months.
was reported as a cash equivalent in the first quarter, it is not permitted to be reported as a cash equivalent in the second quarter.

c. The reporting entity reacquired the investment (or a substantially similar investment) within 1 year after the original security matured or was terminated. These reacquired securities shall be reported as long-term investments. (These securities are also not permitted to be reported as short-term investments regardless of the maturity date of the reacquired investment.)

New Footnote 1: Repurchase and reverse repurchase transactions are excluded from these provisions if admitted in accordance with collateral requirements pursuant to SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. Additional exclusions include cash pooling arrangements permitted under paragraph 8. Cash equivalents subject to the provisions of paragraph 7 are not permitted to be subsequently reported as short-term investments, even if the updated / reacquired maturity date is within 1 year. These investments shall be reported as long-term investments. To avoid changes in reporting schedules, reporting entities are permitted to report securities as long-term investments at initial acquisition regardless of the initial maturity date.

Short-Term Investments

12. Short-term All investments are investments that do not qualify as cash equivalents with remaining maturities (or repurchase dates under repurchase agreements) of one year or less at the time of acquisition. (excluding derivatives and those investments classified as cash equivalents as defined in this statement) shall be considered short-term investments. Short-term investments can include, but are not limited to, bonds, commercial paper, repurchase agreements, and collateral and mortgage loans which meet the noted criteria. Short-term investments shall not include certificates of deposit. Regardless of maturity date, derivative instruments shall not be reported as short-term investments and shall be reported as derivatives on Schedule DB.

13. Regardless of maturity date, affiliated investments in scope of SSAP No. 26R—Bonds and all investments that would be in scope of SSAP No. 43R—Loan-backed and Structured Securities or that would be reported as "Other Invested Assets" shall be reported as long-term investments if any of the following conditions apply:\n
   a. The reporting entity does not reasonably expect the investment to terminate on the maturity date. This provision includes investments that are expected to be renewed (or rolled) with a maturity date that ends subsequent to the initial "less than one year" timeframe.

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

   c. The reporting entity reacquired the investment (or a substantially similar investment) within 1 year after the original security matured or was terminated. These reacquired securities shall be reported as long-term investments. (These securities are also not permitted to be reported as cash equivalent investments regardless of the maturity date of the reacquired investment.)

New Footnote 1: Repurchase and reverse repurchase transactions are excluded from these provisions if admitted in accordance with collateral requirements pursuant to SSAP No. 103R—Transfers and...
Servicing of Financial Assets and Extinguishments of Liabilities. Short-term investments subject to the provisions of paragraph 13 are not permitted to be subsequently reported as cash equivalents, even if the updated / reacquired maturity date is within 90-days. These investments shall be reported as long-term investments. To avoid changes in reporting schedules, reporting entities are permitted to report securities as long-term investments at initial acquisition regardless of the initial maturity date.

12.14. All short-term investments shall be accounted for in the same manner as similar long-term investments.

13.15. Short-term investments meet the definition of assets as defined in SSAP No. 4 and are admitted assets to the extent they conform to the requirements of this statement.

Proposed Revisions to SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities:

28.l. A reporting entity shall disclose the following information for wash sales, as defined in paragraph 12, for all affiliated investment transactions (including items originally classified as cash equivalents and short-term investments) and for non-affiliated involving investment transactions for securities with an NAIC designation of 3 or below, or that do not have an NAIC designation. (For non-affiliated investments, excluding all cash equivalents, derivative instruments as well as and short-term investments with credit assessments equivalent to an NAIC 1-2 designation are excluded from this disclosure.) This disclosure shall be included in the financial statements for when the investment was initially sold. For example, if the investment was sold December 20, 2017, and reacquired on January 10, 2018, the transaction shall be captured in the wash sale disclosure included in the year-end 2017 financial statements:

i. A description of the reporting entity’s objectives regarding these transactions;

ii. An aggregation of transactions by NAIC designation 3 or below, or that do not have an NAIC designation;

iii. The number of transactions involved during the reporting period;

iv. The book value of securities sold;

v. The cost of securities repurchased; and

vi. The realized gains/losses associated with the securities involved.
This page intentionally left blank.
Issue: Levelized and Persistency Commission

Check (applicable entity):

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

Description of Issue:
NAIC staff has received regulator inquiries on the application of the levelized commissions guidance in SSAP No. 71—Policy Acquisition Costs and Commissions. This agenda item is to recommend clarifications to the existing levelized commissions guidance and provide additional guidance regarding commission that is based on policy persistency. SSAP No. 71 describes that levelized commissions occur in situations in which a third party pays agents non-levelized commissions and the reporting entity pays a third party by levelized payments. The statement notes that it is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid to the third party from the reporting entity. SSAP No. 71 identifies such arrangements as funding agreements between the reporting entity and the third party. SSAP No. 71 then identifies that the use of a commission arrangement where commission payments are not linked to traditional elements (such as premium payments and policy persistency) requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions is required.

The questions received by NAIC staff relate to the use of levelized commission arrangements and when the liability for commission based on annual persistency is required to be recorded as a liability in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.

Levelized Commission

For the example in question, a third party is paying agent commissions and receiving periodic payments. Consistent with the guidance in SSAP No. 71, paragraph 4, the third party (funding agent) is paying the agents on behalf of the reporting entity and receiving levelized payments from the reporting entity which include additional fees or interest in excess of the commissions. The agreement between the reporting entity and the funding agent specifies that the funding agent will not be reimbursed by the reporting entity if the policies that generate the commission are cancelled prior to the policy anniversary date. The regulator noted that the reporting entity was not accruing the liability to the third-party funding agent, asserting that the payments to the funding agent were theoretically avoidable until the policy had passed the anniversary year-end date.

The accounting issue is whether levelized commission arrangements that are linked to traditional elements (such as premium payments and policy persistency) requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions.

Persistency Commission

Also, in the noted example, the reporting entity was also asserting that the levelized commission obligations related to policy persistency commission were not required to be accrued until the policy anniversary year end had been passed. The reporting entity asserts that the liability is not required until the persistency commission was fully earned by the agent and therefore unavoidable.
The accounting issue is if the persistency commission expense should be accrued proportionately over the policy period to which the commission relates, or if it is accrued only when fully earned and unavoidable.

Existing Authoritative Literature:

*Preamble* provides the following (**bolding added for emphasis**):

37. Liabilities require recognition as they are incurred. Certain statutorily mandated liabilities may also be required to arrive at conservative estimates of liabilities and probable loss contingencies (e.g., interest maintenance reserves, asset valuation reserves, and others).

38. Revenue should be recognized only as the earnings process of the underlying underwriting or investment business is completed. **Accounting treatments which tend to defer expense recognition do not generally represent acceptable SAP treatment.**

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

**Liabilities**

2. A liability is defined as certain or probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).

3. A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity’s financial statements when incurred.

4. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies.

**Loss Contingencies or Impairments of Assets**

6. For purposes of implementing the statutory accounting principles of loss contingency or impairment of an asset described below, the following additional definitions shall apply:
   - a. **Probable**—The future event or events are likely to occur;
   - b. **Reasonably Possible**—The chance of the future event or events occurring is more than remote but less than probable;
   - c. **Remote**—The chance of the future event or events occurring is slight.

7. A loss contingency or impairment of an asset is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an enterprise that will ultimately be resolved when one or more future event(s) occur or fail to occur (e.g., collection of receivables).

8. An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations if both of the following conditions are met:
   - a. Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the statutory financial statements. It is implicit in this condition that it is probable
that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and
b. The amount of loss can be reasonably estimated.

SSAP No. 71—Policy Acquisition Costs and Commissions provides the following (bolding added for emphasis):

**SUMMARY CONCLUSION**

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

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. **Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported.**

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

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

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

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

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

Staff Review Completed by:
Robin Marcotte, NAIC Staff – July 2019
Staff Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 71 as illustrated below. NAIC Staff recommends that revisions to the guidance clarify the following:

1. A levelized commission arrangement (whether linked to traditional or nontraditional elements) require the establishment of a liability for the full amount of the unpaid principal and accrued interest payable to a third party at the time the policy is issued.

2. The persistency commission is accrued proportionately over the policy period in which the commission relates to and is not deferred until fully earned.

These recommendations are consistent with the original intent of SSAP No. 71 as well as the Statutory Statement of Concepts focusing on Recognition (excerpts from Preamble, paragraphs 37 and 38):

- Liabilities require recognition as they are incurred.
- Accounting treatments which tend to defer expense recognition do not generally represent acceptable SAP treatment.

Proposed Revisions to SSAP No. 71:

SUMMARY CONCLUSION

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets. The recognition of commission expense for new and renewal insurance contracts meets the definition of a liability under SSAP No. 5R when the policy is issued or renewed. The issuance of the policy is the obligating event under SSAP No. 5R.

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

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

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

New Footnote – The guidance in this paragraph does not imply that levelized commissions that are linked to traditional elements do not require establishment of a liability. Rather, such levelized commissions are captured in paragraphs 3-4.

Status:
On August 3, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 71—Policy Acquisition Costs and Commissions, as illustrated above, to clarify levelized commissions guidance and provide additional direction regarding commissions that are based on policy persistency. The revisions also clarify that the recognition of commission expense is based on experience to date.

For Fall 2019 Discussion NAIC staff has proposed updates for exposure.

Paragraph 2 - Removed previously exposed revisions as unneeded.
Paragraph 3 - Added clarifying phrases regarding persistency commission accrual. The concept is that normal persistency commission is accrued for the period it relates to unless the policy is cancelled.
Paragraph 4 - Added two clarifying phrases to assist with identifying levelized commission funding agreements.
Paragraph 5 - Added clarifying phrases regarding funding agreements.
Footnote 1 - Redrafted to remove double negative wording.

SSAP No. 71:

SUMMARY CONCLUSION

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

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

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

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

\textbf{New Footnote} – The guidance in this paragraph notes that that levelized commissions which use a third party to pay agents that are linked to traditional elements require establishment of a liability for the amounts that have been paid to the agents and any interest accumulated to date.
<table>
<thead>
<tr>
<th>COMMENTER / DOCUMENT</th>
<th>PAGE REFERENCE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Comment Letters Received for Items Exposed for the 2019 Fall National Meeting</td>
<td>1-17</td>
</tr>
<tr>
<td>Interested Parties – October 11, 2019</td>
<td></td>
</tr>
<tr>
<td>o Ref #2017-28: Reinsurance Credit</td>
<td></td>
</tr>
<tr>
<td>o Ref #2018-26: SCA Loss Tracking – Accounting Guidance</td>
<td></td>
</tr>
<tr>
<td>o Ref #2019-04: SSAP No. 32 – Investment Classification Project</td>
<td></td>
</tr>
<tr>
<td>o Ref #2019-08: Reporting Deposit Type Contracts</td>
<td></td>
</tr>
<tr>
<td>o Ref #2019-12: ASU 2014-17, Business Combinations, Pushdown Accounting</td>
<td></td>
</tr>
<tr>
<td>o Ref #2019-14: Allocation of Goodwill</td>
<td></td>
</tr>
<tr>
<td>o Ref #2019-18: Other Derivatives</td>
<td></td>
</tr>
<tr>
<td>o Ref #2019-19: SIRI – Equity Interests</td>
<td></td>
</tr>
<tr>
<td>o Ref #2019-22: Wash Sale Disclosure</td>
<td></td>
</tr>
<tr>
<td>o Ref #2019-23: Going Concern</td>
<td></td>
</tr>
<tr>
<td>o Ref #2019-24: Commission</td>
<td></td>
</tr>
<tr>
<td>o Ref #2019-26: Appendix A-785 Updates for Covered Agreements</td>
<td></td>
</tr>
<tr>
<td>o Ref #2019-27EP: Editorial and Maintenance Update</td>
<td></td>
</tr>
<tr>
<td>o Ref #2019-28: ASU 2019-05, Targeted Transition Relief</td>
<td></td>
</tr>
<tr>
<td>o Ref #2019-29: ASU 2019-06, Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities</td>
<td></td>
</tr>
<tr>
<td>o Ref #2019-30: ASU 2019-03, Updating the Definition of Collections</td>
<td></td>
</tr>
<tr>
<td>o Ref #2019-31: ASU 2018-08, Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made</td>
<td></td>
</tr>
<tr>
<td>Interested Parties – October 25, 2019</td>
<td>18-23</td>
</tr>
<tr>
<td>o Ref #2018-38: Prepaid Providers</td>
<td></td>
</tr>
<tr>
<td>Acadia Capital Solutions, Inc. – October 11, 2019</td>
<td>24</td>
</tr>
<tr>
<td>o Ref #2019-24: Commission</td>
<td></td>
</tr>
<tr>
<td>Informal Comments AICPA/NAIC Task Force – October 11, 2019</td>
<td>25</td>
</tr>
<tr>
<td>o Ref #2019-12: ASU 2014-17, Business Combinations, Pushdown Accounting</td>
<td></td>
</tr>
<tr>
<td>GreenbergTraurig – October 10, 2019</td>
<td>26-28</td>
</tr>
<tr>
<td>o Ref #2019-24: Commission</td>
<td></td>
</tr>
<tr>
<td>Security Benefit – October 11, 2019</td>
<td>29-30</td>
</tr>
<tr>
<td>o Ref #2019-20: Rolling Short-Term Investments</td>
<td></td>
</tr>
<tr>
<td>Teachers Insurance and Annuity Association of America – October 11, 2019</td>
<td>31-36</td>
</tr>
<tr>
<td>o Ref #2019-12: ASU 2014-17, Business Combinations, Pushdown Accounting</td>
<td></td>
</tr>
</tbody>
</table>
This page intentionally left blank.
October 11, 2019

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: Exposure Drafts Released for Comment During NAIC National Meeting with Comments due October 11

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the exposure drafts released for comment by the Statutory Accounting Principles (E) Working Group (the “Working Group”), during the NAIC Summer National Meeting in New York. We offer the following comments:

Ref #2017-28: Reinsurance Credit

The Working Group adopted, as final, Issue Paper No. 162—Property and Casualty to document for historical purposes the revisions related to SSAP No. 62R—Property and Casualty Reinsurance, which was adopted at the 2018 Fall National Meeting.

In addition to the issue paper adoption, on August 3, 2019, the Working Group also exposed for comment the following items applicable to SSAP No. 61R – Life, Deposit-Type and Accident and Health Reinsurance (SSAP No. 61R) and Appendix A-791 – Life and Health Reinsurance Agreements (A-791):

1. Disclosures, (previously exposed) and concurrent with the exposure, directed notification to the Financial Analysis (E) Working Group of the exposure as the disclosures were originally developed at their request.
2. The two A-791 QA items related to certain nonproportional reinsurance contracts” covered under the A-791 and medical loss ratios (previously exposed – the drafting group reviewed the comments).

3. Regulator proposed revisions to add A-791 QA under paragraph 2c regarding group term life YRT reinsurance contracts.

Interested parties appreciate the outreach the NAIC has made to the industry through the informal SSAP No. 61R Life and Health reinsurance drafting group. We believe the drafting group has allowed us to better understand the issues raised by regulators.

In summary, we do not have any concerns with the re-exposed disclosures and the two Q&A’s regarding short-duration health reinsurance treaties and offer the following comments.

With respect to the group term life YRT exposure, in general interested parties believe this draft exposure language addresses the concerns expressed by regulators in the drafting group and in prior exposures, and we would support this Q&A being added to 2.c in Appendix A-791, as long as the guidance does not impact contracts that do not raise such concerns as described below.

The proposed Q&A would deny risk transfer for specific group term life YRT reinsurance transactions if the reinsurer has the right to charge reinsurance premiums higher than the premiums received by the ceding company on the business reinsured. However, SSAP 61R and Appendix A-791 specifically exempt YRT reinsurance arrangements from paragraph 2.e of Appendix A-791, which denies risk transfer if the reinsurance agreement charges reinsurance premiums greater than the direct premiums collected by the ceding company.

There are specific circumstances where YRT reinsurance agreements do have reinsurance premiums greater than direct premiums, yet reinsurance accounting is appropriate, and this 2.e exemption has allowed those circumstances to meet risk transfer regulations. Examples of such reinsurance agreements include:

1. High level excess YRT agreements. High amount policies have higher volatility in claims. It is reasonable and appropriate for a reinsurer to charge a higher amount to cover these claims.
2. Level term premiums, where a true one-year risk premium in later years is likely to exceed the level premium.
3. In force business, where a ceding company has realized they are not charging sufficient premiums for the true risk. The ceding company may have to accept higher reinsurance premiums than they charge to appropriately discharge the risk going forward.
4. YRT for universal life. YRT premiums often will not have a direct or proportional relationship to either the premiums or cost of insurance rates charged by the ceding company.

The concerns about group term life YRT reinsurance raised by regulators are focused on reinsurance agreements with risk limiting features. As the exposure is phrased, the guidance
here would be limited to group term life YRT reinsurance agreements where future experience refunds can be offset against current and prior year losses. Reinsurance agreements such as those in the examples above are unlikely to have such a loss carryforward provision, and thus should not be impacted by this guidance.

Additionally, we would like to comment on the implementation/timing of the proposed exposure, when it is finalized. We believe that there are reinsurance transactions in place today which meet current regulations for risk transfer that would not meet risk transfer under this new guidance. This new Q&A may impact some company’s financial statements. Consideration should be given to grandfathering these transactions, or to establishing a prospective effective date that would provide enough time for these companies to make appropriate changes to their reinsurance agreements or to otherwise prepare for this impact. If a prospective effective date is the approach chosen, we recommend an effective date of 1/1/2021.

Ref #2018-26: SCA Loss Tracking – Accounting Guidance

The Working Group exposed revisions to SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, to revise the existing reporting requirements for when a reporting entity has a negative value in an SCA investment when the reporting entity has provided a financial commitment or guarantee. The illustration from the existing INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses has also been moved to SSAP No. 97, in its entirety, as a new exhibit. This INT provides examples of how losses in an SCA shall be applied to other investments once the SCA equity investment has been halted at zero.

On August 3, 2019, the Working Group re-exposed revisions to SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets and SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, to require a financial commitment or guarantee for a subsidiary, controlled, or affiliated (SCA) entity to be recognized as a non-contingent guarantee liability. These proposed revisions differ from the prior exposure as they would capture the entire financial guaranty or commitment for an SCA within scope of SSAP No. 5R and report a zero value for SCAs with a negative equity value.

Interested parties believe that additional clarifications are necessary regarding the proposed revisions to paragraphs 18 and 24 of SSAP No. 5R. Regarding paragraph 18, we believe a parent’s guarantee on behalf of an SCA entity with negative equity could result in the recognition of either an initial guarantee liability or a liability subsequent to the initial recognition. Therefore, we propose more general wording to the end of paragraph 18 as follows:

18. The following types of guarantees are exempted from the initial liability recognition in paragraphs 20-25, but are subject to the disclosure requirements in paragraphs 29-32. For the guarantees addressed in paragraphs 18f and 18g, recognition of a contingent guarantee may be required subsequent to initial recognition in accordance with paragraph 24a.
a. Guarantee that is accounted for as a derivative instrument, other than credit derivatives within SSAP No. 86;
b. Guarantee for which the underlying is related to the performance of nonfinancial assets that are owned by the guaranteed party, including product warranties;
c. Guarantee issued in a business combination that represents contingent consideration;
d. Guarantee in which the guarantor’s obligation would be reported as an equity item;
e. Guarantee by an original lessee that has become secondarily liable under a new lease that relieved the original lessee from being the primary obligator;
f. Guarantees (as defined in paragraph 16) made to/or on behalf of directly or indirectly wholly-owned insurance or non-insurance subsidiaries; and
g. Intercompany and related party guarantees that are considered “unlimited” (e.g., typically in response to a rating agency’s requirement to provide a commitment to support).

The exemptions for items f and g above do not apply in situations in which a reporting entity has provided a financial guarantee or commitment to support a subsidiary, controlled or affiliated entity (SCA), and the SCA’s equity is negative (see paragraph 24).

We find the new paragraph 24 wording confusing in that it tells the preparer in the first sentence to recognize the greater of the guarantee liability or the negative equity of the SCA. However, the third sentence clarifies that the guarantee liability shall not exceed the maximum amount of the guarantee. We propose condensing these items into one sentence in our recommended revisions below, and also clarifying that the “greater” term actually refers to the greater negative impact to the reporting entity’s financial statements. We also recommend that the new proposed paragraph be a stand-alone paragraph (i.e., new paragraph 25, with re-numbering of all subsequent paragraphs):

“In situations in which a reporting entity has provided a financial guarantee or commitment to support a subsidiary, controlled or affiliated entity (SCA), and the reporting entity’s share of losses in the SCA exceed the equity method carrying amount of the SCA (resulting in a negative equity value in the SCA), the reporting entity shall adjust the initially recognized guarantee obligation to reflect the greater impact of (i) the then-current fair value liability for the guarantee or (ii) the negative equity position, limited to the maximum amount of the financial guarantee or commitment provided by the reporting entity. (For This guidance requires the recognition of a guarantee liability for guarantees captured in paragraphs 18f and 18g this guidance requires recognition of a contingent guaranty when negative equity exists in an SCA.) The recognized guarantee liability shall not exceed the maximum amount of the financial guarantee or commitment provided by the reporting entity. The guidance in paragraphs 24 and 25 through 26 shall be followed for the recognition of recognizing a contingent liability and subsequent re-recognition of a noncontingent liability, as applicable.”
Ref #2019-04: SSAP No. 32 – Investment Classification Project

The Working Group exposed for comment Issue Paper No. 1XX—Preferred Stock to revise the definitions, measurement guidance and impairment guidance for preferred stock pursuant to the investment classification project.

Interested parties substantially agree with the objectives of the proposal to:

a. Improve preferred stock definitions, with inclusion of information from U.S. generally accepted accounting principles (GAAP) for classifying preferred stock as redeemable or perpetual. The revisions also incorporate a new exhibit to capture various terms prevalent in preferred stock.
b. Revise the measurement guidance to ensure appropriate, consistent measurement based on the type of preferred stock held and the terms of the preferred stock. The revisions also incorporate guidance for mandatory convertible preferred stock.
c. Incorporate revisions to clarify impairment guidance as well as guidance for dividend recognition and redemption of preferred stock with the issuer.

Interested parties have the following comments related to the issue paper:

Overall:

The issue paper refers to preferred stock throughout the document, at times the paper references the instruments as securities. For purposes of definitional clarity we do not believe the use of the term security is interchangeable as it pertains to preferred stock. As such, we recommend that all references to security be changed to interest or directly reference the type of stock under discussion.

Scope:

Interested parties note that the scope retains, albeit edited, the guidance that preferred stock of subsidiary, controlled and affiliated entities is included and therefore accounted for under the guidance for preferred stock regardless of their SCA character. Interested parties also note that preferred stock in SCAs other than preferred stock issued by domestic insurance entities is required to be filed with the NAIC pursuant to paragraph 50 of SSAP No. 97 Exhibit A – SCA Reporting Process. For the avoidance of doubt, interested parties suggest a clarifying sentence in double underline below. The existing wording in SSAP No. 32 and the exposed language for SSAP No. 32 is below with interested parties suggested clarifying sentence (underlined).

Existing language in SSAP No. 32

SCOPE OF STATEMENT
1. This statement establishes statutory accounting principles for preferred stock.
2. Investments in preferred stock of subsidiaries, controlled or affiliated entities, including preferred stock interests of certified capital companies (CAPCO) per INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO) are included within the scope of this statement.

Exposed language in SSAP No. 32 and interested parties suggested clarifying sentence in underline

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for preferred stock.
2. Investments in preferred stock of entities captured in SSAP No. 97—Investments in subsidiaries, controlled or affiliated entities or SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies, as well as preferred stock interests of certified capital companies per INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO) are included within the scope of this statement. The requirement to file investments in preferred stock of certain subsidiaries, controlled or affiliated entities with the NAIC pursuant to SSAP No. 97 does not affect the application of the accounting under this statement.

Definitions:

The proposed definitional guidance could potentially change the scope of what is considered redeemable preferred stock vs perpetual preferred stock and create an inconsistency as to how the preferred stock would be treated. Under the previous guidance, redeemable preferred stock included stock that was mandatorily redeemable or redeemable at the option of the holder. This definition was consistent with how GAAP distinguishes between debt and equity security classification under ASC 321, Investments—Equity Securities. We believe the intention of the Staff was to align the definitions with the treatment under GAAP. However, using the language from ASC 480, which addresses the accounting from the issuer’s perspective, does not align with how the investor in the security accounts for the asset under GAAP. As such we propose the following revisions (indicated with edit marks) to the definitions:

3. Preferred stock shall include:

   a. Redeemable preferred stock, which is preferred stock subject to mandatory redemption requirements or whose redemption is outside the control of the issuer. Redeemable preferred stock is any stock which 1) the issuer undertakes to redeem at a fixed or determinable price on the fixed or determinable date or dates, whether by operation of a sinking fund or otherwise; 2) is redeemable at the option of the holders; or 3) has conditions for redemption which are not solely within the control of the issuer, such as stock which must be redeemed out of future earnings. Preferred stock which meet one or more both of these three criteria would be classified as redeemable preferred stock regardless of other attributes such as voting rights or dividend rights. (Staff Note – this definition comes from FASB ASC 480-10-S99, modified to eliminate reference to conversion features as mandatory convertible preferred stock has special treatment under this SSAP.) ; and to be consistent with the description of redeemable preferred stock for a holder in the ASC Master Glossary definition of debt security.);

   b. Perpetual preferred stock, which is preferred stocks which are not redeemable or are redeemable other than solely at the option of the issuer (non-redeemable preferred stock). Perpetual preferred stock is any preferred stock which does not meet the criteria to
be classified as redeemable preferred stock pursuant to paragraph 3.a. Staff Note – this definition comes from FASB ASC 480-10-S99 modified to be made consistent with the description of redeemable preferred stock for a holder in the ASC Master Glossary definition of debt security.)

**Fair Value Cap for Callable Perpetual Preferred Stock:**

The issue paper broadly requires fair value measurement for redeemable preferred stock, perpetual preferred stock, mandatory convertible preferred stock and dividends (paras 16.a-d, para 18), depending on the quality rating expressed as an NAIC designation. Interested parties note that these assets may not have readily determinable fair values, and as such, fair value techniques using the cost approach, Level 3 inputs and practical expedients may be prevalent and necessary for these assets.

The issue paper discusses carrying perpetual preferred at fair value capped by any call price. However, it did not provide guidance on timing for application of the cap. Because the call may not be effective for a period of time, we propose the language be modified to state that “the measurement for these preferred stocks reflects fair value, not to exceed any currently effective buy back rates (call prices) that the issuer can utilize to redeem the stock.” These provisions would ensure that purchases of perpetual preferred stock could still be carried at values greater than par (assuming market values remain above par).

**Other Than Temporary Impairment (OTTI):**

For perpetual preferred stock, if the intent of the clarification is to provide OTTI guidance when the asset is already recorded at fair value then we would suggest OTTI language consistent with SSAP No. 30R, revised for preferred stock as follows:

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

**Ref #2019-08: Reporting Deposit-Type Contracts**

The Working Group exposed this agenda item with the inclusion of the items and questions that were noted, with a request for additional comments from industry and state insurance regulators, and directed notifications of the exposure with a request for comments to the Financial Stability (EX) Task Force and the Life Actuarial (A) Task Force on the reporting of insurance contracts that do not have a mortality or morbidity risk.
This agenda item was initially drafted in response to questions identified by the Financial Stability Task Force (“FSTF”) in developing liquidity disclosure changes to the 2019 life blank. An agenda item was exposed with a request for comments on why guaranteed investment contracts (“GICs”), or other deposit-type contracts, are reported in Exhibit 5 – Life Contracts or Exhibit 6 – Accident and Health Contracts, instead of Exhibit 7 – Deposit Type Contracts.

On August 3, 2019, this agenda item was re-exposed with the inclusion of the items and questions noted below, with a request for additional comments from industry and state insurance regulators, and directed notifications of the exposure with a request for comments to the FSTF and the Life Actuarial Task Force on the reporting of insurance contracts that do not have a mortality or morbidity risk.

Before responding to the questions raised, interested parties note that the comments from the FSTF anticipates a classification system based on degree of risk. This is entirely new. The current classification is based strictly on mortality guarantees (Exhibit 5), morbidity guarantees (Exhibit 6), or neither (Exhibit 7). There is no concept of degree of risk in the current statutory classification. If the benefits of such fundamental changes to Exhibits 5, 6, and 7 were demonstrated to outweigh the costs, this would be a significant undertaking and companies would need significant lead time to implement systems changes. Please see the questions and interested parties (IP) responses below:

1. **Classification at Issuance** – The interested parties noted that because a contract was life-contingent at issue, it is reported in Exhibit 5, and then it remains in Exhibit 5 after the death of the annuitant.

   **Question** – Is it appropriate to classify products based on original issuance when the original risks are no longer present in the contract? Is this simply past industry practice, or is there direction that prevents reclassification to the category that most appropriately reflects the risk? Preliminary information received from the Financial Stability (EX) Task Force (FSTF) staff has noted that this practice will make it more difficult to properly aggregate and assess deposit-type contracts, and that this assessment is important as the payouts for deposit-type contracts are significantly different than payouts generated by an insured event. The Task Force has identified that information on liabilities, particularly those that can be called quickly with little or no surrender penalty, is of critical importance to liquidity assessments.

   **IP Response** - Tradition and SSAP No. 50 generally classify contracts with any life contingencies as life contracts. In practice, this “any life contingencies” is interpreted as those that are guaranteed.

SSAP No. 50, Paragraph 5, includes the statement, “Such classification shall be made at the inception of the contract and shall not change.” In practice, if there is a new contract, such as a supplementary contract to a life insurance benefit, the contract is re-evaluated as to whether it contains life contingency guarantees. For policyholder election of a payout benefit from a deferred annuity contract, re-evaluation varies depending on the
Company’s valuation and risk policies. (For example, two-tiered policies are priced for annuitization, and the election of an annuitization option may be treated as a continuing contract and may not create a re-evaluation.)

For payout contracts issued as life contingent with a minimum guaranteed certain period, death of the original annuitant does not cause a change in contract. It is a change in payee for the remainder of the guaranteed certain period.

2. **State Approval** – The interested parties noted that state insurance departments have the discretion to approve or require a contract to be classified as a life or A/H insurance contract.

**Question** – If a state directs reporting differently than what is stipulated in the AP&P Manual, is that being captured as a permitted or prescribed practice? (The provisions in SSAP No. 1 require permitted / prescribed practice reporting when it results in different statutory reporting. Examples included in SSAP No. 1 include gross or net presentation, financial statement reporting lines, etc.)

**IP Response** - In our observation and experience, discretion exercised by state insurance departments on product classification is rare. When it happens, it is generally in the product filing process, generally applies to group products (e.g., association group), and where there is judgement as to whether the benefits should be classified as Exhibit 5 or Exhibit 6.

3. **Annuity Guidance** – The interested parties cited existing annuity guidance in paragraph 20 of SSAP No. 50 - Classifications of Insurance or Managed Care Contracts. Per this guidance, contracts containing well-defined class-based (e.g., age / gender) annuity purchase rates used in defining either a specific or maximum purchase rate guarantee would constitute an annuity contract containing a life contingency that would require it to be classified as a life contract.

**Question** – NAIC staff agrees with the citation from interested parties on annuities in paragraph 20 of SSAP No. 50 - Classifications of Insurance or Managed Care Contracts. However, with the intent to have more explicit product breakouts to allow for better assessment, is it time to clarify / revise this guidance to result with the appropriate breakouts created by FSTF? It was noted that the current concepts were established a long time ago and there is a focus on non-traditional insurance liabilities (which includes funding agreements) for liquidity risk assessment as they can have higher run risk.

**IP Response** – We believe the current guidance supports the classification of life annuity contracts within Exhibit 5 regardless of payout status. While we acknowledge the conceptual distinction noted by NAIC Staff with respect to a single life annuity contract for which the life status has changed, we do not believe this represents a significant change in the risk profile of a given block of annuity contracts, for which the majority may not reach term-certain status.
We would also highlight the administrative burden of the proposed changes. As a practical matter, it would be necessary to convert life annuity contracts to new plan codes on the death of the annuitant in order to capture the appropriate information in the Summary of Operations by Line of Business. This change must be implemented at the policy administration system level and would require significant time and effort on the part of industry. We do not believe the perceived benefits of this change justify the cost, particularly given recent significant annual statement changes for product reporting. Rather than implementing additional product granularity at this time, we suggest that regulators and staff work with industry to review the new Note 32 and Note 33 disclosures, which are specifically designed to communicate liquidity risk. We believe these disclosures will fulfill the regulatory objective in a more cost-efficient manner.

4. Materiality of Issue – Although the interested parties cite a “common” scenario, without information in the financial statements, there is no current ability to identify the extent contracts with no remaining mortality or morbidity risk are reflected as life contracts.

Question – To what extent are deposit-type contracts captured in an exhibit other than Exhibit 7? Is it possible to receive information from companies regarding this population for assessment purposes?

IP Response - We contend that by the guidance identified in SSAP No. 50, paragraph 20, a certain and life annuity, or a refund annuity, that continues payments to a surviving beneficiary after the death of the primary annuitant is not re-classified as a deposit-type contract. It is a life annuity contract where additional information on the life-status of the annuitant has become known.

Many deferred annuities contemplated by SSAP No. 50, paragraph 20a, are ultimately surrendered rather than electing a guaranteed lifetime income. These annuities are treated as investment contracts under US GAAP and re-evaluated at the time of election to annuitize. On the other hand, it is becoming more common for deferred annuities to include guaranteed minimum income benefits, minimum death benefits, or similar benefits (collectively GMxBs). A policyholder no longer has to annuitize for the contract to be subject to life contingent risks.

Ref #2019-12: ASU 2014-17, Business Combinations – Pushdown Accounting, a Consensus of the FASB Emerging Issues Task Force

Ref #2019-14: Attribution of Goodwill

The Working Group re-exposed Ref #2019-12 with a request for comments on whether pushdown accounting should be prohibited, permitted for noninsurance entities, or permitted only for U.S. Securities and Exchange Commission (SEC) registrants. The exposure also clarifies that goodwill resulting from an insurance reporting entity’s acquisition of an SCA when pushdown is applied shall be included in the reporting entity’s goodwill admittance limitation of 10% of surplus.
The Working Group re-exposed Ref #2019-14 to consider revisions to SSAP No. 97 – *Investments in Subsidiary, Controlled and Affiliated Entities* to require disclosure, upon acquisition of a holding company with downstream subsidiaries, of the carrying value, goodwill and admitted value of the acquired holding company as well as how the assignment of goodwill to the downstream entities was determined.

Interested parties reviewed the options exposed by the Working Group for consideration regarding pushdown accounting in Ref #2019-12. We do not recommend option 1 (“complete rejection of pushdown accounting”). With regard to the second and third options exposed for Working Group consideration, interested parties need additional time to evaluate whether these options are feasible. In our discussions, it was apparent that the proposed changes involve significant changes to insurers’ reporting and the complexities of the reporting mechanics of the annual statement will need to be addressed in applying the 10% goodwill admittance limitation and pushdown accounting. These complexities include the application of an aggregate 10% admittance limitation when multiple SCA entities carry GAAP goodwill on their individual balance sheets, as well as application to an acquired SCA holding company with subsidiaries (or layers of subsidiaries). Because annual statement reporting and disclosure includes considerable details on each investment in an SCA entity, specific guidance will likely be needed to address reporting issues such as presentation on the annual statement balance sheet and the related investment schedules, as well as interpretation related to current disclosures (including the proposed disclosures in Ref #2018-14). We believe these operational complexities need to be addressed before any proposal is considered for adoption by the Working Group.

Interested parties request additional time to evaluate various approaches for allowing pushdown accounting and working though the operational mechanics of a goodwill admittance limitation as well as evaluating the impact on insurers’ capital and surplus. Our goal is to present a recommendation for Ref # 2019-12 to the Working Group during the 2020 Spring National NAIC Meeting that addresses these complexities. Because the proposed disclosures in Ref #2019-14 includes specific SCA entity goodwill and admitted value amounts, interested parties would include those proposed disclosures in our evaluation and recommendation and, therefore, also request additional time to respond to that agenda item.

Given the need to work out clear examples that address the reporting complexities and the need for transition guidance, interested parties do not believe the proposed changes in Ref #2019-12 and Ref # 2019-14 are non-substantive nor do we believe these proposed changes can be applicable to year end 2019 reporting.

**Ref #2019-18: Accounting for “Other” Derivatives**

The Working Group re-exposed revisions to SSAP No. 86—*Derivatives*, to clarify that “other” derivatives not used in hedging, income generation or replication shall be reported at fair value and do not qualify as admitted assets.
Interested parties are still concerned about potential unintended consequences of the cliff effect (potential non-admission of a bond with a trivial embedded derivative) as capital markets develop. If and when problems develop, interested parties may re-examine this issue.

**Ref #2019-19: SIRI – Equity Interests**

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions that clarify what should be captured in SIRI *Line 13: 10 Largest Equity Interests*, noting that a look-through should only occur for non-diversified funds. The revisions also exclude Securities Valuation Office (SVO)-Identified Bond Exchange-Traded Funds (ETFs) and SVO-Identified investments with underlying characteristics of fixed-income investments from this equity interrogatory. With exposure, a referral was directed to the Capital Adequacy (E) Task Force with a request for clarification on the impact, if any, these changes may have to risk-based capital.

Interested parties have no comment on this item.

**Ref #2019-20: Rolling Short-Term Investments**

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 2R—Cash, Drafts and Short-term Investments* and *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, to incorporate additional principle concepts in classifying investments as cash equivalents or short-term investments.

Interested parties have concerns about the proposal to prohibit the reporting of certain short-term investments and cash equivalents as such. Certain short-term / cash equivalent investment structures have been identified by industry that are utilized in order to facilitate efficiencies and gain economies of scale and we believe they should continue to be reported as short-term or cash equivalents. While these investments may be regularly renewed, the risk profile continues to be commensurate with that of short-term investments or cash equivalents. Interested parties disagree with the broad-based language of the current exposure and believe there are more direct approaches to addressing concerns about inappropriate investment classification. We welcome the opportunity to discuss alternative approaches with staff.

**Short-Term Cash Pooling Arrangements:**

Many entities maintain short-term cash pooling arrangements. These arrangements have been instituted at insurance entities in order to more effectively invest enterprise cash, gain economies of scale, and reduce transaction costs; they have not been instituted in order to circumvent reporting requirements. Through the use of these arrangements, entities are able to generate higher returns for subsidiaries while reducing cost and personnel time required for investing on a short-term basis for all affiliated companies in an organization. These arrangements are often held within separate legal entities in which each participant invests or withdraws funds as needed on a short-term basis (sometimes daily), with their ownership interest in the arrangement.
fluctuating accordingly. However, participants maintain some level of interest in the pool for an extended period of time. These cash pooling arrangements have been permitted by model investment law; in addition, many insurers have received guidance from state regulators to report these investments as either short-term investments or cash equivalents depending upon the character of the underlying investments in the pool. We believe, although an insurer may own interest in the pools for longer than 3 months or a year, their investments in the short-term pools should continue to be reported as either short-term or cash equivalents, depending on the maturity dates of the underlying assets in the pool, because the risk of repayment is commensurate with the risk of repayment for the underlying assets.

In addition to the specific structures noted above, interested parties are concerned that the exposed guidance would result in misclassified assets on the balance sheet (e.g., BA asset for short-term pool arrangements instead of a cash equivalent), which would distort the level of cash, impacting liquidity ratios, RBC charges and presentation of cash flows. Thus, for these reasons, interested parties believe that short-term investment / cash equivalent reporting should continue for investments made at fair market terms with contractual maturities within the applicable time periods.

Short-Term Lending:

Regarding short-term lending, interested parties believes that the reporting of the investment should continue to follow the form of the legal agreement, including the contractual maturity. These loans are structured for several important business reasons and have contractual maturities of less than one-year, often with the ability to renew. Upon initial evaluation, lender considerations include borrower repayment ability, value of any collateral provided, current market conditions and the presence of subordinated capital. Diligent underwriting and structuring are performed, with the completed loan agreement representing a binding contract with an unconditional obligation to repay upon contractual maturity (<12 months). Neither lender nor borrower has an obligation to extend the loan; however, at maturity, both lender and borrower have the ability to re-evaluate the transaction. If either or both parties wish to extend, the lender re-evaluates the financial position of the borrower, current value of existing collateral, and terms of the loan. If the lender decides to renew the loan, the terms are reviewed and renegotiated/re-underwritten with new terms reflecting then current market rates, consistent with the provisions of SSAP 25. Therefore, any extension should be considered a new loan transaction with a new maturity date. If extension is not mutually agreed upon, repayment to the lender is contractually required. Further, for short-term lending with affiliates over certain thresholds, prior regulatory approval may be required, providing additional opportunity for regulatory oversight. Thus, as long as these short-term loans have been made at fair market rates and with fair market conditions (which is required for loan admittance in accordance with SSAP No. 25 paragraph 9, if applicable), the economics and risk of the investment is commensurate with short-term investment reporting.

Interested parties recommend that the scope of the issue be identified prior to proposing any changes to the SSAPs. This should include identification of specific problematic investment structures, under which the economics of the transaction are not commensurate with the current
classification. Once the scope and magnitude are identified, a decision can be made whether the targeted issue is widespread or limited to a few companies and whether a more direct approach may also have the desired result.

**Ref #2019-22: Wash Sale Disclosure**

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, to clarify that only investments that meet the definition of a wash sale in accordance with SSAP No. 103R that cross reporting period-end dates would be subject to the wash sale disclosure.

Interested parties support the proposed revisions.

**Ref #2019-23: Going Concern**

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, to clarify that if an unalleviated going concern is noted in audited financial statements or audit opinion, the SCA shall be nonadmitted.

Interested parties have no comment on this item.

**Ref #2019-24: Levelized and Persistency Commission**

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 71—Policy Acquisition Costs and Commissions, to clarify levelized commissions guidance and provide additional direction regarding commissions that are based on policy persistency. The revisions also clarify that the recognition of commission expense is based on experience to date.

The proposal as written will be a substantive change to the current guidance and to our industry, despite being categorized as nonsubstantive. The proposed changes do not merely clarify the current SSAP 71 regarding commissions, but substantially change a key point regarding persistency. During the SAP formulation process, there were two Issue Papers issued in 1996 (January and final paper in September 1996), the latter of which introduced the last sentence of paragraph 5 of the current SSAP 71. The addition of this sentence in the final issue paper from 1996 makes a distinction between the levelized commissions described as funding agreements and those which are based on persistency and other traditional elements. The effect of removing that distinction is substantive and requires the protocol of a substantive change. Additional comments and details are as follows:

1. The proposal makes substantive changes to the accounting paradigm for levelized commissions. As written, the proposed changes may have serious unintended consequences to statutory accounting. The nature of the exposed substantive changes separates the issue of “persistency” as a key element of the levelized commission
payment mode of operation. This practice is engaged in by several insurers, specifically companies issuing variable life and annuity products. For example, per the exposed language, a liability for trail commissions over possibly decades would be required at policy issuance although not formally due. Persistency is a critical insurance risk. (See proposed language that the only obligating event is initial sale of a policy.) Ignoring persistency runs directly counter to various other principles of statutory accounting, most notably the definition of principle risks for reinsurance consideration in A-791.

2. The newly installed Principles-Based Reserving ("PBR") methodology allowed by regulators now includes the commission element. The effects of the proposal on PBR have not been reviewed or analyzed to determine if there are any unintended consequences, possibly double-counting, that inure to the proposal.

3. The effects of the proposal relative to reinsurance transactions have not been reviewed and analyzed inasmuch as reinsurance transactions must transfer risk, including persistency risk. (See note above regarding A-791.)

4. The issuance of a policy or contract is not the sole triggering event of a commission liability under a levelized commission mode of operation. Persistency requirements under the actual terms of the contract between the payor (the insurer) and the payee (the agent or broker receiving the levelized commission) is a key determinant as to when a liability is incurred. If a policy is issued but the persistency requirement is not met, then no commission liability is due.

5. The current accounting mode is standard in the industry, preceding the formulation of current SAP (reference the Accounting Practices and Procedures Manual-Life which was in force prior to the effective date of current SAP and which includes the same wording as current SSAP No. 71).

6. The proposal does not address policy fees, which can possibly be interpreted in a similar vein as commissions.

7. The proposal’s paradigm could possibly be applied to other items reflecting estimated predictable expenses that have yet to be incurred or for which benefits have not been received.

8. The proposal seems to be at odds with GAAP accounting rules as to the establishment of liabilities, specifically how GAAP treats commissions tied to persistency. Required persistency is deemed a “future” event negating the need for recording a current liability. This is differentiated where payments are merely extended (payment due solely based on passage of time) versus payments requiring ongoing commitments, persistency.

**Conclusion**

The proposal set forth is certainly substantial and requires additional in-depth analysis. Further, due to the substantive amendment currently proposed has broad and unintended implications, we ask the SAPWG to further consider and deliberate the issues.

**Ref #2019-26: Appendix A-785 Revisions from U.S./EU and U.S./UK Covered Agreements**
The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to Appendix A-785, Credit for Reinsurance, related to the “Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance And Reinsurance” (Covered Agreement) adopted to the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786).

Interested parties note that on page 17 of the exposure, paragraph 13.b refers to “paragraph 12.g” and should be “paragraph 13.g”


The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed editorial revisions to SSAP No. 62R—Property and Casualty Reinsurance, SSAP No. 86—Derivatives, and SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities.

Interested parties have no comment on this item.

**Ref #2019-28: ASU 2019-05, Targeted Transition Relief**

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 100R—Fair Value, to reject ASU 2019-05, Targeted Transition Relief for statutory accounting.

Interested parties support the conclusion reached.

**Ref #2019-29: ASU 2019-06, Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities**

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 68—Business Combinations and Goodwill and SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, to reject ASU 2019-06, Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities for statutory accounting.

Interested parties support the proposed revisions.

**Ref #2019-30: ASU 2019-03, Updating the Definition of Collections**

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2019-03, Updating the Definition of Collections as not applicable to statutory accounting.

Interested parties have no comment on this item.
Ref #2019-31: ASU 2018-08, Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2018-08, Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made as not applicable to statutory accounting.

Interested parties have no comment on this item.

* * *

Thank you for considering interested parties’ comments. If you have any questions in the interim, please do not hesitate to contact us.

Sincerely,

D. Keith Bell           Rose Albrizio
October 25, 2019

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: Exposure Draft Ref #2018-38: Prepayments to Service and Claims Adjusting Providers for Comment During NAIC National Meeting with Comments due October 11

Dear Mr. Bruggeman:

This item was initially exposed for comment in November 2018 in response to a regulator inquiry regarding prepayments to providers of claims and adjusting services for which the service provider is prepaid by the insurer. Interested parties provided comments to the original exposure draft, specifically regarding the treatment of the prepaid expenses as not being consistent with the classification of such amounts as miscellaneous underwriting expenses if the prepaid expense is for a covered peril in accordance with the underlying insurance contract.

During the 2019 Spring National Meeting, the Working Group incorporated these changes into the exposure draft and re-exposed this item for comment. The proposed accounting treatment would require prepayments for loss and loss adjustment expenses to be classified as a prepaid asset, and nonadmitted in accordance with SSAP No. 29, Prepaid Expenses. Upon payment of the claim to the policyholder, the prepaid asset would be reclassified as a loss or loss adjustment expense, in accordance with the terms of the contract.

As described in the issue summary, NAIC staff noted that this guidance is consistent with existing guidance instead of the approach to “expense and reclassify as amounts are paid” contained in the previous exposure draft. The more recent exposure draft retained the exclusion of this guidance to contracts subject to SSAP No. 84, Health Care and Government Insured Plan Receivables.

The Working Group made additional revisions to the exposure draft during the Summer National Meeting to “emphasize existing guidance that loss and loss adjusting expense liabilities are established regardless of payments to third parties. The liabilities are not recognized as
paid until the losses are paid to claimants or claims are adjusted. Payments to third party administrators, which are not for claims or loss adjusting expense, are ‘miscellaneous underwriting expenses.’” As noted in the 2019 Summer National Meeting minutes, these additional revisions were made in conjunction with comments primarily from the health insurance industry as the previous exposure draft was not consistent with current accounting requirements.

Interested parties note that there are differences in the treatment of loss and loss adjusting expenses by different sectors of the industry. However, the current exposure removes important clarification from the 2019 Spring National Meeting exposure draft. To address these noted concerns, interested parties proposes the following changes which are highlighted in yellow to the 2019 Summer National Meeting exposure draft – these changes incorporate industry specific guidance to address the differences in accounting by industry. Interested parties also propose moving exposed item 4.c. back to the last sentence of paragraph 4, along with proposed wording for the treatment of prepaid loss and loss adjusting expenses by specific sector of the industry. As reflected in the drafting note, there is already existing guidance which will remain unchanged; the additional clarifying guidance is proposed to be added to existing guidance.

2019 Summer National Meeting exposure:

SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses:

4. Claims, losses, and loss/claim adjustment expenses shall be recognized as expenses when a covered or insured event occurs. In most instances, the covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs. For claims-made type policies, the covered or insured event is the reporting to the entity of the incident that gives rise to a claim. Until claim payments and related expense payments are made subsequent to the occurrence of a covered or insured event, and in order to recognize the expense of a covered or insured event that has occurred, it is necessary to establish a liability. Liabilities shall be established for any unpaid claims and unpaid losses (loss reserves), unpaid loss/claim adjustment expenses (loss/claim adjustment expense reserves) and incurred costs, with a corresponding charge to income. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related to extra contractual obligations and bad-faith lawsuits, as well as the accounting treatment for prepaid expenses as it relates to specific industries.

a. The liability for unpaid losses and claims shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims on non-capitated payments under managed care contracts shall be established in an amount necessary to pay the losses/claims irrespective of payments made to third-party administrators, etc. The liability for claims on capitated payments under managed care contracts shall be established in an amount necessary to
adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers. As loss or claims payments occur, from the third-party administrators, management companies or other entities, to the policyholder or claimant, (except for capitated payments for managed care contracts) paid claims, losses or paid loss/paid claim adjusting liabilities are reduced. Note that guidance regarding the admissibility of loans and advances to providers which apply to health insurance and managed care contracts are addressed in SSAP No. 84—Health Care and Government Insured Plan Receivables.

b. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as 1) Aggregate write ins for miscellaneous expenses—Property and Casualty (Underwriting and Investment Exhibit Part 3); 2) Aggregate write ins for expenses—Life/Health (Exhibit 2—General expenses) or 3) aggregate write ins for expenses (General Administrative Expenses)—health (Underwriting and Investment Exhibit Part 3).

c. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related

5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts for which the liability shall be reported net of capitated payments to providers. The liability for claims adjustment expenses on non-capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third-party administrators, etc. The liability for claims adjustment expenses on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers.

a. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as 1) Aggregate write ins for miscellaneous expenses—Property and Casualty (Underwriting and Investment Exhibit Part 3); 2) Aggregate write ins for expenses—Life/Health (Exhibit 2—General expenses) or 3) aggregate write ins for expenses (General Administrative Expenses)—health (Underwriting and Investment Exhibit Part 3).
**Property/Casualty**

**Drafting Note: the following is within existing guidance. There are no proposed changes to the guidance in pars. 6.a., 6.b., and 6.c. However, there is new guidance proposed in 6.d. and 6.e. that was in pars. 4.a., 4.b., and 5.a. of the previous exposure draft. This wording is underlined.**

6. The following are types of future costs related to property and casualty contracts, as defined in SSAP No. 50, which shall be considered in determining the liabilities for unpaid losses and loss adjustment expenses.

   d. All prepayments (i.e., variable, fixed or bundled amounts) to third party administrators, management companies, or other entities for unpaid claims, losses and losses/claims adjustment expenses, shall be initially reported as a prepaid asset and nonadmitted in accordance with SSAP No. 29 – Prepaid Expenses. These payments shall not be offset against any amounts required to be reported in accordance with paragraphs 4 or 5 within this guidance.

   Consistent with the recognition criteria in paragraph 4, when the covered or insured events occurs the associated prepayments to third party administrators, management companies or other entities are reclassified proportionately from the prepaid nonadmitted asset to claims, losses or loss/claim adjustment expenses based on the amount of losses/claims or loss/claims adjustment expenses incurred to provide the benefit.

   e. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as miscellaneous underwriting benefits and are not included within the scope of SSAP No. 55.

**Life, Accident and Health**

**Drafting Note: the following is within existing guidance. There are no proposed changes to the guidance in pars. 7.a., 7.b., 7.c. and 7.d. However, there is new guidance proposed in 7.e. that was in pars. 4.a., 4.b., and 5.a. of the previous exposure draft. This wording is underlined.**

7. The following future costs relating to life and accident and health indemnity contracts, as defined in SSAP No. 50, shall be considered in determining the liability for unpaid claims and claim adjustment expenses:

   e. In cases where insurers advance funds to third-party administrators, management companies or other entities prior to the occurrence of the claim who then, on behalf of the insurer, adjudicate the claim and make
payments to insureds or other claimants, the guidance in paragraph 9 applies.

Managed Care

Drafting Note: the following is within existing guidance. There are no proposed changes to the guidance in pars. 8.a., 8.b., 8.c. and 8.d. However, there is new guidance proposed in 8.e. that was in pars. 4.a., 4.b., and 5.a. of the previous exposure draft. This wording is underlined.

8. The following costs relating to managed care contracts as defined in SSAP No. 50 shall be considered in determining the claims unpaid and claims adjustment expenses:

   e. In cases where insurers advance funds to third-party administrators, management companies or other entities prior to the occurrence of the claim who then, on behalf of the insurer, adjudicate the claim and make payments to insureds or other claimants, the guidance in paragraph 9 applies.

Managed Care and Accident and Health

Drafting Note: New guidance is issued within par. 9, which is underlined. Existing par 9 is renumbered to par. 10, and all other pars within existing guidance (i.e., pars. 10 – 23, will be renumbered to 11 – 24, respectively.

9. In some instances, insurers advance funds to third-party administrators, management companies or other entities prior to the occurrence of the claim who then, on behalf of the insurer, adjudicate the claim and make payments to insureds or other claimants. In such cases the following guidance applies:

   a. For capitated payments under managed care contracts, the liability for claims and claim adjusting expenses shall be established in an amount necessary to adjudicate and pay all unpaid claims irrespective of payments to third-party administrators, management companies or other entities, and is reported net of capitated payments to providers.

   b. For non-capitated advance payments, the liability for unpaid losses/claims and related adjustment expenses shall be established regardless of any payments made to third-party administrators, management companies or other entities, and such payments shall be reported by the insurer as prepayments. Only when loss/claim and related adjusting expense payments are made by the third-party administrators, management companies or other entities, to the policyholder or claimant, shall the insurer’s liability (loss/claim or loss/claim adjustment expense reserves)
be reduced. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as (1) Aggregate write ins for expenses - Life/Health (Exhibit 2 – General expenses) or (2) Aggregate write ins for expenses (General Administrative Expenses) - Health (Underwriting and Investment Exhibit Part 3).

Note that this guidance in paragraph 9 does not alter existing guidance regarding the admissibility of loans and advances to providers which apply to health insurance and managed care contracts which is addressed in SSAP No. 84—Health Care and Government Insured Plan Receivables.

*  *  *

Thank you for considering interested parties’ comments. If you have any questions in the interim, please do not hesitate to contact us.

Sincerely,

D. Keith Bell  Rose Albrizio
We have reviewed the proposed changes to SSAP No. 71 – Policy Acquisition Costs and Commissions as outlined in Ref. #2019-24. We question several elements of the proposal and strongly object to the revisions for the following reasons:

1. This is very much a substantive change to existing policy, contrary to the characterization in the published exposure draft.

2. The proposal dramatically alters the fundamental premise of statutory accounting by creating a situation in which certain historically period expenses, trail commission payments, are to be treated differently from other period expenses by way of an accrual methodology. This leads to:
   a. A hybrid of statutory, GAAP and tax accounting.
   b. Fundamentally and permanently different economics for products designed with trail commission payments, leading to the need for significant effort at primary writers to redesign and/or reprice such products, presumably at a cost to the consumer.
   c. Guaranteed renewable products, like Long Term Care Insurance, could be exposed to further rate increases if the fundamental profit dynamics of the products change as a result of the new reserving practices.
   d. New uncertainty within the statutory accounting framework as to which other period expenses should also be accrued or might be targeted for similar treatment.
   e. A situation whereby trail commission expenses have a greater impact on statutory capital than other, similar expenses.
   f. A disincentive for primary writers to align the interests of the writer, broker/agent and policyholder through trail commissions because of the unique treatment and resulting capital implications.

3. Should the proposed changes be adopted, primary writers will be exposed to new and substantial accounting and actuarial workload relating to the determination of accrual methodologies for each effected product and the related periodic ‘true-up’ required to adjust the new statutory reserves for actual performance. All this with no apparent benefit for the consumer, primary writer, investment community, or regulatory bodies.

cc: Julie Gann (jgann@naic.org), Robin Marcotte (rmarcotte@naic.org), Jim Pinegar (jpinegar@naic.org), Fatima Sediqzad (fsediqzad@naic.org), Jake Stultz (jstultz@naic.org)
The members of the AICPA NAIC Task Force (Task Force, which is a task force of the AICPA) would like to informally request clarifications on the following exposed Statutory Accounting Principles Working Group documents:

**Ref No. 2019-12: ASU 2014-17, Business Combinations - Pushdown Accounting, a Consensus of the FASB EITF**

Consistent with our comments submitted June 14 on the draft exposed at the 2019 Spring National Meeting, the Task Force believes the proposed revisions could be a significant change to current SAP and requests clarification as to what is meant by "audited reconciliation" and "audited support" in the proposed new paragraph 20 of SSAP 97. Would this be similar to adjustments made to the audited U.S. GAAP carrying value for par. 8.b.ii and 8.b.iv entities? For these adjustments, there is no "audited reconciliation" included in any financial statements. An insurance entity prepares a schedule to determine the required adjustments for purposes of its carrying value of the SCA, which is subject to audit procedures in relation to the insurer’s financial statements taken as a whole, but there is no reconciliation included in the audited financial statements of the SCA.

In the re-exposed document we note that the working group clarified, for companies that receive approval from their domiciliary commissioner to continue to admit the existing goodwill that has been pushed down on or before December 31 2019, that this goodwill would be subject to the 10% of surplus limitation. We suggest that specific transition guidance be provided for companies that have not previously included this goodwill in the goodwill limitation calculation. We also suggest that the working group clarify whether this GAAP goodwill is subject to amortization under SSAP 68 (as it is not amortized under U.S. GAAP). We also request that specific transition guidance be added for companies that do not obtain approval from their domiciliary regulator to continue to admit goodwill pushed down from acquisitions prior to January 1, 2020. Given the proximity of these discussions to year-end 2019, the SAP Working Group may also want to consider whether it is too near year-end to adopt any changes for 2019, since a December 2019 adoption would likely not provide adequate time for capital planning for affected companies.
October 10, 2019

Dale Bruggeman, Chair
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street
Kansas City, MO 64106

Re: SSAP No. 71—Policy Acquisition Costs and Commissions

Dear Mr. Bruggeman:

Thank you for the opportunity to provide comments on Proposal 2019-24 from the Statutory Accounting Principles Working Group regarding Policy Acquisition Costs and Commissions. The Working Group voted to expose revisions to SSAP 71 – Policy Acquisition Costs and Commissions - for comment at the NAIC Summer Meeting on August 3, 2019, categorized as non-substantive, to clarify levelized commission guidance and to provide additional direction regarding certain commission obligations. I offer comments on behalf of our client, DRB Insurance Solutions, LLC, a licensed insurance producer (“DRB”).

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

The accounting issue is whether levelized commission arrangements that are linked to traditional elements (such as premium payments and policy persistency) should require the establishment of a liability for the full amount of the unpaid principal and accrued interest which may be paid to a third-party in the future based upon the occurrence of defined events outside the control of the parties involved. However, the persistency commission expense should be accrued proportionately over the policy period to which the commission relates and it should accrue only
when fully earned and unavoidable, specifically since the payments to the funding agent are theoretically avoidable until the policy passes the anniversary year-end date.

NAIC Staff indicates that this proposal is to recommend clarifications to the existing levelized commissions guidance and provide additional guidance regarding commission obligations that are based on policy persistency. Questions received by NAIC staff relate to the use of levelized commission arrangements and when the liability for a commission structure that is based on annual persistency is required to be recorded as a liability in accordance with SSAP No. 5R-Liabilities, Contingencies and Impairments of Assets. Staff made the following recommendations:

1. A levelized commission arrangement (whether linked to traditional or nontraditional elements) require the establishment of a liability for the full amount of the unpaid principal and accrued interest payable to a third-party at the time the policy is issued.

2. The persistency commission is accrued proportionately over the policy period in which the commission relates to and is not deferred until fully earned.

However, we respectfully suggest that requiring the expensing at policy issuance of future levelized commission payments that are contingent upon policy persistency will likely establish a dangerous precedent requiring the accrual of liabilities for other predictable future expense payments for services or other benefits that are not yet payable. Examples may include payroll costs, commissions and expense allowances on reinsurance assumed, non-vested postemployment benefits and compensated absences and/or lease obligations.

Further, in accordance with SSAP No. 5R, key characteristics of a liability include: (1) a present duty or responsibility that entails settlement by probable future transfer of assets, (2) with little or no discretion to avoid the future sacrifice, and (3) the obligating event has already occurred. With respect to recognition of commission expense, the proposed revisions to SSAP No. 71 include the justifying statement that “The issuance of the policy is the obligating event under SSAP No. 5R.” However, this statement is factually inaccurate. The insurance company is not contractually obligated to pay future levelized commissions if the policy does not persist. No subsequent levelized commission ever becomes due unless the policy remains in-force through each subsequent anniversary date. Until the policy reaches each anniversary date, the insurance company is not obligated and has no present duty or responsibility to pay the commission.

Statutory Accounting and Principle-Based Reserving

The fundamental objective of statutory accounting is to measure solvency, as expressed in the Preamble to the Accounting Practices and Procedures Manual. Statutory Accounting Principles require expensing current amounts that are no longer available to pay policyholder claims in the future or that will have no value in liquidation. However, probable future levelized commission payments are payments that have not yet been made. Accordingly, the insurance company still has the cash or other assets that will ultimately be used to make those payments should the policies persist. Therefore, required accrual of levelized commissions appears inconsistent with the fundamental objective of measuring solvency.
Principle-Based Reserving (PBR) is a new shift in reserving approach and is expected to include consideration of commission payments within policy reserves. The addition of an accrual for levelized commissions would duplicate expenses on the Statement of Operations and again, function inconsistently with the assumptions contained in PBR.

Non-Substantive Change
Levelized commission programs began over thirty years ago, before the 1998 publication of Statutory Issue Paper No. 71 and the January 1, 2001 codification of Statutory Accounting Principles. The primary objectives of a levelized commission structure include aligning the interests of the customer, the agent, and the company and improved persistency from providing ongoing customer service. There is a duty to act in the best interests of the policyholder, as well as a compensation incentive, to make sure policies are well serviced so they stay in-force.

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

In conclusion, the proposed revision to SSAP 71 is clearly not “non-substantive” and would have substantial unintended consequences only some of which I have mentioned here. Accordingly, the proposal requires further substantive and policy analysis prior to consideration by the Working Group. Additionally, the expansive effect of this policy decision should be subject to open deliberation and public comment as the Working Group considers further action. Thank you for the opportunity to comment.

Very truly yours
GREENBERG TRAURIG, P.A.

Julie Mix McPeak
October 11, 2019

Submitted electronically to jgann@naic.org; rmarcotte@naic.org; jpinegar@naic.org; fsediqzad@naic.org; and, jstultz@naic.org.

Mr. Dale Bruggeman
Chair of the Statutory Accounting Principles Working Group
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Dear Mr. Bruggeman,

We appreciate the opportunity to comment on the Statutory Accounting Principles Working Group (the “SAPWG”) exposure regarding NAIC’s Ref #2019-20 - Rolling Short-Term Investments (the “exposure”).

We agree that SSAP No. 2R – *Cash, Cash Equivalents, Drafts and Short-Term Investments* should not be utilized to mischaracterize long-term investments as short-term investments. We thus support revisions to exclude from SSAP No. 2R short-term investment structures purposely designed to mature at or around 364 days (often with affiliates) with full expectation that the investment structure will be renewed (rolled). We propose modest modifications to the recommendation, however, that we believe will support eliminating abuses of SSAP No. 2R while also ensuring that legitimate short-term investment activity continues under SSAP No. 2R.

The exposure sets forth “an overall principle that investments are permitted for short-term and cash equivalent reporting only if the reporting entity reasonably expects the investment duration to be realized (e.g., terminate / mature) on the designated maturity date” (the “overall principle”). We fully support the overall principle and believe it is essential that it be preserved. We believe, however, that certain elements of the exposure are not fully consistent with the overall principle – namely, commentary and scoping around 1) all affiliated SSAP No. 26R - Bonds investments and 2) the reacquisition of the same or substantially similar short-term investment immediately after maturity of a prior short-term investment. We address each of these items in greater detail below.

**Item 1 - all affiliated SSAP No. 26 investments**

The exposure states that: “by excluding all non-affiliated ‘bonds’ from the new guidance, the ‘normal’ recurring short-term / cash equivalent investments are not expected to be impacted.” This implies that “normal” recurring short-term / cash equivalent investments can only occur between unaffiliated entities. We disagree; we believe that the overall principle should apply to all investments, not just those that are affiliated. We also believe the concern that including unaffiliated investments would inadvertently scope in U.S. Treasury-bills, commercial paper, certificates of deposit, etc., where a reporting entity may continuously reacquire the same or a substantially similar short-term investment of such nature immediately after maturity of such a prior short-term investment, can and should be addressed otherwise (see below).
**Item 2 - the reacquisition of the same or substantially similar short-term investment immediately after maturity of a prior short-term investment**

The exposure states that “the sale or maturity of an investment, with a reacquisition of the same or substantially similar security within a 1-year timeframe, would preclude the reporting entity from reporting the currently held security as a cash equivalent or short-term investment regardless of the maturity date. (This one-year timeframe prevents reporting of recurring ‘re-acquisitions’ as cash equivalents or short-term investments.) (This provision is similar to the one regarding ‘rolled’ securities but clarifies that the ‘settlement’ of a security with a reacquisition does not prevent application of the new concepts in determining cash equivalent or short-term reporting.) (NAIC staff highlights that this restriction is necessary particularly with the use of “net settlement” structures with affiliates in which no cash is exchanged.)

The reacquisition of the same or a substantially similar short-term investment immediately after the maturity of a prior short-term investment should be permitted as long as the following proposed conditions are met that substantiate and evidence that the overall principle has been factually satisfied:

1. The prior short-term investment / cash equivalent has been fully, contractually settled in cash on or prior to a maximum original maturity date of 364 days (this provision would exclude “net settlement” structures from being eligible under SSAP No. 2R).

2. The cash used to satisfy the prior short-term investment / cash equivalent cannot have been directly or indirectly (i.e., through a separate entity) provided by the same reporting entity.

We believe that incorporating the above elements would effectively exclude unaffiliated cash equivalent / short-term investments such as U.S. Treasury bills, commercial paper, certificates of deposits, and other legitimate short-term investment activity from the exposed provisions, but in a manner consistent with the overall principle and the application of SSAP No. 2R.

***

We look forward to continue to work with the SAPWG to refine this proposal to help achieve appropriate regulatory objectives while preserving the original principle of SSAP No. 2R for the betterment of the insurance industry, its reporting entities and its policyholders. We welcome any questions you may have for us.

Sincerely,

Joseph W. Wittrock
Senior Vice President and Chief Investment Officer
October 11, 2019

Mr. Dale Bruggeman  
Chairman  
Statutory Accounting Principles Working Group  
National Association of Insurance Commissioners  
1100 Walnut Street, Suite 1500  
Kansas City, MO 64106-2197

RE:   Exposure Draft Released for Comment During NAIC National Meeting, Ref. #2019-12

Dear Mr. Bruggeman:

Teachers Insurance and Annuity Association of America ("TIAA") appreciates the opportunity to comment on the exposure drafts released for comment by the Statutory Accounting Principles (E) Working Group (the "Working Group") during the National Association of Insurance Commissioners ("NAIC") Summer National Meeting in New York. We respectfully submit the following comments and suggestions for modifications to Exposure Draft Ref. #2019-12, ASU 2014-17, Business Combinations – Pushdown Accounting, a Consensus of the FASB Emerging Issues Task Force (the "Exposure Draft").

I. About TIAA

Founded in 1918 in the state of New York, TIAA’s initial mission was to improve the quality of life for teachers in retirement. Today, TIAA is the leading provider of retirement and financial services for those in academic, research, medical, and cultural fields. Over our century-long history, TIAA’s mission has always been to aid and

strengthen the institutions and participants we serve and to provide financial products that meet their needs. Today, TIAA is a Fortune 100 company with over $1 trillion in assets under management and administration, and our investment model and long-term approach aim to benefit the five million retirement plan participants we serve across more than 15,000 institutions.\(^2\) We are among the highest rated insurance companies in the U.S. by the four leading rating agencies: A.M. Best, Fitch, Moody’s Investors Service, and Standard & Poor’s.\(^3\) With our strong nonprofit heritage, we remain committed to the mission we embarked on in 1918 of serving the financial needs of those who serve the greater good.

To carry out this mission, our enterprise has evolved to include a diverse group of entities offering our customers a range of financial services, including asset management, retail and banking services. These diverse groups of companies help us serve customers and clients more effectively.

II. **Proposed Revisions in the Exposure Draft**

The Exposure Draft includes the following proposed revisions (with proposed changes to SSAP No. 68, Section 9):

**Issue:** ASU 2014-17, Business Combinations – Pushdown Accounting, a Consensus of the FASB Emerging Issues Task Force

**Status:** On April 6, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No 68—Business Combinations and Goodwill and SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities to reject ASU 2014-17, Business Combinations – Pushdown Accounting for statutory accounting as well as explicitly prohibit the use of pushdown accounting under statutory accounting, which includes all entities accounted for under SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies and SSAP No. 97.

On August 3, 2019, the Statutory Accounting Principles (E) Working Group exposed this agenda item with a request for comments on the three options listed below. Additionally, to ensure that goodwill resulting from an insurance reporting entity’s acquisition of an SCA when pushdown is applied is captured within the goodwill admittance limitation, the exposure includes limited revisions to reference this goodwill in SSAP No. 68—Business Combinations and Goodwill, paragraph 9. *(Note: Information provided during the Summer National Meeting on the history of pushdown and* 

\(^{2}\) Data are as of June 30, 2019.

\(^{3}\) For stability, claims-paying ability, and overall financial strength, TIAA is one of only three insurance groups in the United States to currently hold the highest possible rating from three of the four leading insurance company rating agencies: A.M. Best (A++ rating affirmed as of June 2019), Fitch (AAA rating affirmed as of May 2019) and Standard & Poor’s (AA+ rating affirmed as of October 2018), and the second-highest possible rating from Moody’s Investors Service (Aa1 rating affirmed as of September 2018).
information from AICPA and industry representatives has been captured within this agenda item under the “Activity to Date” section.

The options for Working Group consideration include:

1) **Complete rejection of pushdown accounting.** As pushdown is now an election for SEC / U.S. GAAP filers, reporting entities can avoid use of pushdown if prohibited for statutory accounting. (NAIC staff would propose a prospective effective date if electing this option to avoid restatement of those entities that have previously elected pushdown.)

2) **Permission to use pushdown for all non-insurance entities.** This option would increase optionality into the statutory financial statements. If permitted, this approach would result in different SCA values and goodwill calculations for those that follow the guidance in SSAP No. 68 and those that utilize pushdown. Under SSAP No. 68, acquired SCAs do not write-up their assets or liabilities to fair value and goodwill is calculated as the difference between purchase price and book value. Under U.S. GAAP pushdown, acquired SCAs write-up their assets and liabilities to fair value, and goodwill is calculated as the difference between the purchase price and the fair value of the acquired entity. With pushdown, the goodwill is reported at the SCA level. As such, goodwill will be an indefinite asset unless it is identified as impaired. (Under U.S. GAAP, private entities and not-for-profit entities can elect to amortize goodwill over a 10-year period, but this is not an election for public entities.) **If this option is supported, NAIC staff would recommend that the goodwill admittance limitation capture goodwill from an insurance entity’s acquisition of an SCA that is reported on the SCA financial statements.** (This option would not permit pushdown for insurance SCAs (8.b.i entities).

(If this option is considered, NAIC staff would propose restrictions on the use of pushdown that differ from U.S. GAAP. For example, under U.S. GAAP, a reporting entity could subsequent elect pushdown accounting in any reporting period after original acquisition. If pushdown was permitted, NAIC staff would propose to require the election at original acquisition and not allow subsequent elections.)

3) **Permit pushdown if elected by SEC Registrants, excluding non-insurance entities.** Although this option would introduce different accounting by type of reporting entity, it is consistent with when pushdown would have been applied under prior statutory accounting guidance. (Under the old SEC provisions, pushdown was only permitted when meeting certain SEC requirements.) This would seemingly allow the companies that have historically utilized pushdown under the SEC rules to continue acquisitions under that prior approach. **If this option is supported, NAIC staff would recommend that the goodwill admittance limitation capture goodwill from the acquisition of an SCA that is reported on the SCA financial statements.** (Also, NAIC staff would propose restrictions to the provisions to ensure the election is made at the time of original acquisition.) (This option would not permit pushdown for insurance SCAs (8.b.i entities).

Exposed Edits to SSAP No. 68—Business Combinations and Goodwill:

8. 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.

9. Positive goodwill recorded under the statutory purchase method of accounting shall be admitted subject to the following limitation: Positive goodwill from all sources, including life, accident and health, and deposit-type assumption reinsurance and goodwill resulting from the acquisition of an SCA by the insurance reporting entity that is reported on the SCA’s financial statements (resulting from the application of pushdown accounting), is limited in the aggregate
to 10% of the acquiring 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. Positive or negative goodwill resulting from the purchase of an SCA, joint venture, partnership or limited liability company shall be amortized to unrealized capital gains and losses on investments over the period in which the acquiring entity benefits economically, not to exceed 10 years. Positive or negative goodwill resulting from life, accident and health, and deposit-type assumption reinsurance shall be amortized to operations as a component of general insurance expenses over the period in which the assuming entity benefits economically, not to exceed 10 years. Goodwill shall be evaluated separately for each transaction.\(^{[INT\ 01-18]}\)

### III. TIAA Comments on Proposed Revisions

*TIAA strongly encourages the NAIC to thoroughly engage with the industry on Exposure Draft Ref. #2019-12 Business Combinations – Pushdown Accounting and the classification of the proposal as substantive or non-substantive.*

We note that the NAIC classifies as “substantive listings” those items that require a new issue paper and SSAP to address the issue. Once items are placed on this listing, they are prioritized and the formal maintenance policy is followed. Conversely, “nonsubstantive listings” are those items that are considered editorial or technical in nature and for which a new SSAP will therefore not be developed. In other words, a revision to a SSAP for these items will not be deemed to modify its conclusion or original intent.\(^4\)

While the NAIC categorized the revisions in the Exposure Draft as “nonsubstantive,” without industry analysis and further clarity in application, we believe the proposed changes to SSAP No. 68, paragraph 9, which would apply a 10% limitation on goodwill, could represent a substantive change in accounting. Without conducting an impact assessment and publishing a more thorough issue paper, we feel it is difficult for the NAIC to conclude that the proposed revisions do not modify the conclusion or original intent of the guidance with regards to all admitted Subsidiary, Controlled and Affiliated Entities (“SCAs”).

---

We acknowledge the NAIC staff’s concerns with goodwill; however, we believe staff can gain insight through deeper engagement with the industry regarding the structure of insurance entities, and the creation, accounting, and reporting of goodwill. Additionally, while we understand there are concerns with regards to goodwill treatment to non-insurance entities, we believe the NAIC can more thoroughly consider the purpose of those entities and their support of the insurance parent as these entities typically provide operational support as well as dividends that directly support policyholder obligations.

_TIAA supports pushdown accounting Option 2 as proposed by the NAIC._

TIAA does not support a complete rejection of pushdown accounting (Option 1), nor do we believe that pushdown should be permitted if elected by SEC registrants (excluding non-insurance entities) (Option 3), as we predict this approach would create competitive disadvantages and unnecessary inconsistencies in the treatment of goodwill among entities owned by an insurer. We recommend that the NAIC continue allowing pushdown for all non-insurance entities (Option 2).

_TIAA recommends the NAIC partner with industry to conduct an impact assessment._

Given the potential substantive nature of the proposal, we recommend that industry participants partner with the NAIC to evaluate the Exposure Draft, including conducting an industry impact assessment. The assessment will include an analysis of the types of insurance entities impacted by the NAIC’s proposal and the potential effects on these entities’ organizational structure and domicile. The information gathered as a result of the impact assessment can assist in preventing the formation of competitive disadvantages and other unintended negative consequences among the affected entities. We welcome the opportunity to assist the NAIC in identifying, evaluating and driving such assessment.

_TIAA encourages the NAIC to discuss transitional guidance with the industry, and consider responses to FASB’s proposed treatment of goodwill._

As noted above, given the potential substantive nature of the NAIC’s proposed accounting changes, and in light of our view that an industry impact assessment be conducted before these changes are finalized, we believe transitional guidance, in any form (i.e., disclosure, prospective, effective dates, etc.), be carefully discussed with all interested parties before proposal.
Additionally, we recognize that the Financial Accounting Standards Board ("FASB") is also considering the treatment of goodwill and, as such, we recommend that NAIC consider the responses to the FASB Invitation to Comment on File Reference No. 2019-720, Identifiable Intangible Assets and Subsequent Accounting for Goodwill. As many of the SCAs within scope of the NAIC proposal report goodwill on a GAAP basis, any future changes to GAAP could impact or potentially address the NAIC’s concerns.

IV. Conclusion

TIAA applauds the NAIC’s continued focus on this issue, and we appreciate the opportunity to comment on the Exposure Draft. We recommend that the NAIC classify Exposure Draft Ref. #2019-12 Business Combinations – Pushdown Accounting as substantive and work with the industry to perform an impact assessment that would inform an issue paper. We welcome the opportunity to discuss our views and recommendations in greater detail and any questions you have.

Sincerely,

Oluseun Salami