

## Statements of Statutory Accounting Principles No. 88

### Investments in Subsidiary, Controlled and Affiliated Entities, A Replacement of SSAP No. 46

#### STATUS

Type of Issue:	Common Area
Issued:	June 14, 2004
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Affects:	Supersedes SSAP No. 46 Supersedes the title and paragraphs 2 and 3 of SSAP No. 32 Supersedes SSAP No. 68 paragraphs 4, 5 and 6 Nullifies INT 99-03, INT 99-28, INT 00-01, INT 01-22. INT 01-24
Affected by:	Superseded by SSAP No. 97
Interpreted by:	INT 99-00, INT 00-24, INT 01-07, INT 02-07, INT 03-03, INT 03-16, INT 04-10, INT 06-07

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<b>STATUS</b> .....	<b>1</b>
<b>SCOPE OF STATEMENT</b> .....	<b>3</b>
<b>SUMMARY CONCLUSION</b> .....	<b>3</b>
Definitions .....	3
Applying the Market Valuation, Audited Statutory Equity and Audited GAAP Equity Methods.....	4
Investments in Downstream Holding Companies .....	9
Investment in Preferred Stock or Surplus Notes of a Subsidiary, Controlled and Affiliated Entity .....	10
Impairment .....	10
Consolidation .....	11
Amendments to SSAP No. 68 .....	11
Disclosures .....	11
Relevant Literature .....	12
Effective Date and Transition.....	13
<b>AUTHORITATIVE LITERATURE</b> .....	<b>13</b>
Statutory Accounting.....	13
Generally Accepted Accounting Principles.....	13
<b>RELEVANT ISSUE PAPERS</b> .....	<b>13</b>
<b>ILLUSTRATION OF ACCOUNTING FOR SCAS</b> .....	<b>14</b>
<b>ILLUSTRATED BALANCE SHEETS</b> .....	<b>17</b>
<b>APPENDIX A TRANSITION GUIDANCE FOR YEAR-END 2006 REPORTING QUESTIONS AND ANSWERS</b> .....	<b>20</b>

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**Investments in Subsidiary, Controlled, and Affiliated Entities, A Replacement of SSAP No. 46****SCOPE OF STATEMENT**

1. This statement establishes statutory accounting principles for investments in subsidiaries, controlled and affiliated entities, hereinafter referred to as SCA entities.
2. This statement supersedes the conclusions reached in *SSAP No. 46—Investments in Subsidiary, Controlled, and Affiliated Entities* (SSAP No. 46).

**SUMMARY CONCLUSION****Definitions**

3. Parent and subsidiary are defined as follows:
  - a. Parent—An entity that directly or indirectly owns and controls the reporting entity;
  - b. Subsidiary—An entity that is, directly or indirectly, owned and controlled by the reporting entity.
4. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* (SSAP No. 48). Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments.
5. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by common management, or (d) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.
6. Control as defined in paragraph 5 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13% and therefore each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in *FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18*. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting securities of an investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. Examples of situations where the presumption of control may be in doubt include the following:
  - a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.
  - b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.

- c. An entity where the insurer has given up participating rights<sup>1</sup> as a shareholder to the investee.

7. Investments in SCA entities 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.

### **Applying the Market Valuation, Audited Statutory Equity and Audited GAAP Equity Methods**

8. The admitted investments in SCA entities shall be recorded using either the market valuation approach (as described in paragraph 8.a.), or one of the equity methods (as described in paragraph 8.b.).

- a. In order to use the market valuation approach for SCA entities, the following requirements apply:
  - i. The subsidiary must be traded on one of the following three major exchanges: (1) the New York Stock Exchange, (2) the American Stock Exchange, or (3) the NASDAQ National exchange;
  - ii. The reporting entity must submit subsidiary information to the Securities Valuation Office (SVO) for its calculation of the subsidiary's market value. Such calculation could result in further discounts in market value above the established base discounts based on ownership percentages detailed below;
  - iii. Ownership percentages for determining the discount rate shall be measured at the holding company level;
  - iv. If an investment in a SCA results in an ownership percentage between 10% and 50%, a base discount percentage between 0% and 20% on a sliding scale basis is required;
  - v. If an investment in a SCA results in an ownership percentage greater than 50% up to and including 80%, a base discount percentage between 20% and 30% on a sliding scale basis is required;
  - vi. If an investment in a SCA results in an ownership percentage greater than 80% up to and including 85%, a minimum base discount percentage of 30% is required.
  - vii. Further, the SCA must have at least two million shares outstanding, with a total market value of at least \$50 million in the public's control; and
  - viii. Any ownership percentages exceeding 85% will result in the SCA being recorded on an equity method.
- 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

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<sup>1</sup> The term "participating rights" refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee's ordinary course of business and is distinguished from the more limited type of rights referred to as "protective rights". Refer to the sections entitled: "Protective Rights" and "Substantive Participating Rights" in EITF 96-16, *Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights*. The term "participating rights" shall be used consistent with the discussion of substantive participating rights in this EITF.

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 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). 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 audit is not complete as of the filing deadline. The recorded statutory equity shall be adjusted for audit adjustments, if any, as soon as the annual audit has been completed. Annual consolidated audits are allowed if completed in accordance with the Model Regulation Requiring Annual Audited Financial Reports as adopted by the SCA's domiciliary state;
- ii. Investments in 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. 16—Electronic Data Processing Equipment and Software* and *SSAP No. 79—Depreciation of Nonoperating System Software*
  - (c) Sale/lease or rental of furniture, fixtures, equipment or leasehold improvements as described in *SSAP No. 19—Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of 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

Generally Accepted Accounting Principles (GAAP) financial statements shall be adjusted to a statutory basis of accounting (refer to paragraph 9). For purposes of this section, revenue means GAAP revenue reported in the audited GAAP financial statements excluding realized and unrealized capital gains/losses. Paragraphs 17-19 provide guidance for investments in holding companies;

- iii. Investments in noninsurance SCA entities that do not qualify under subparagraph 8.b.ii. shall be recorded based on the audited GAAP equity of the investee;
- iv. Investments in foreign insurance SCA entities shall be recorded based on the underlying audited U.S. GAAP equity of the respective entity adjusted to a statutory basis of accounting in accordance with paragraph 9 and adjusted for reserves of the foreign insurance SCA with respect to the business it assumes directly and indirectly from a U.S. insurer using the statutory accounting principles promulgated by the NAIC in the *Accounting Practices and Procedures Manual*.

The recorded GAAP equity shall be adjusted for any audit adjustments resulting from either the annual GAAP audit of the respective entity or, if the entity is a member of a consolidated group of insurers, the annual audit of the consolidated group of companies, as soon as determined. GAAP is defined as those pronouncements included in the United States GAAP Hierarchy as described in *AICPA Statement of Auditing Standard No. 69, The Meaning of "Presents Fairly in Conformity With GAAP"*. Foreign SCA entities are defined as those entities incorporated or otherwise legally formed under the laws of a foreign country. Foreign insurance SCA entities are defined as alien insurers formed according to the legal requirements of a foreign country. Investments in foreign noninsurance SCA entities shall follow the guidance in 8 b. ii., and 8 b. iii. above.

9. Statutory basis for accounting for investments in noninsurance SCA entities, subject to paragraph 8.b.ii. and foreign insurance SCA entities, subject to paragraph 8.b.iv., shall be based on the underlying audited U.S. GAAP equity of the respective entity with the following adjustments:

- a. Nonadmit assets pursuant to the following statutory accounting principles as promulgated by the NAIC in the *Accounting Practices and Procedures Manual*;
  - i. *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*
  - ii. *SSAP No. 19—Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements*
  - iii. *SSAP No. 20—Nonadmitted Assets*
  - iv. *SSAP No. 29—Prepaid Expenses*
  - v. *SSAP No. 16—Electronic Data Processing Equipment and Software*
  - vi. *SSAP No. 79—Depreciation of Nonoperating System Software*
- b. Expense costs that are capitalized in accordance with GAAP but are expensed pursuant to statutory accounting as promulgated by the NAIC in the *Accounting Practices and Procedures Manual* (e.g., deferred policy acquisition costs);

- c. Adjust depreciation for certain assets in accordance with the following statutory accounting principles:
  - i. *SSAP No. 16—Electronic Data Processing Equipment and Software and SSAP No. 79—Depreciation of Nonoperating System Software*
  - ii. *SSAP No. 19—Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements*
- d. Nonadmit the amount of goodwill of the SCA in excess of 10% of the audited GAAP equity of the SCA's last audited financial statements.
- e. Nonadmit amount of the net deferred tax assets (DTAs) of the SCA in excess of 10% of the audited GAAP equity of the SCA's last audited financial statements.
- f. Adjust the GAAP annuity account value reserves of a foreign insurance SCA, with respect to the business it wrote directly, using the commissioners' annuity reserve valuation method (CARVM) as defined in paragraphs 12 and 13 of Appendix A-820 (including the reserving provisions in the various Actuarial Guidelines which support CARVM). The valuation interest rate and mortality tables to be used in applying CARVM should be that prescribed by the foreign insurance SCA's country of domicile. If the Foreign SCA's country of domicile does not prescribe the necessary tables and/or rates, no reserve adjustment shall be made.

The recorded GAAP equity shall be adjusted for any audit adjustments resulting from either the annual GAAP audit of the respective entity or, if the entity is a member of a consolidated group of insurers, the audit of the consolidated group of companies, as soon as determined. GAAP is defined as those pronouncements included in the United States GAAP Hierarchy as described in *AICPA Statement of Auditing Standards No. 69, The Meaning of "Presents Fairly in Conformity With GAAP."*

10. The audited statutory equity method as described in paragraph 8.b.i. and 8.b. ii. shall be applied by recording an initial and subsequent investment in an investee at cost (excluding any investment in an investee's preferred stock and/or surplus notes), which is defined in SSAP No. 68 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. Investments in an SCA's preferred stock and /or surplus notes are addressed in paragraphs 20 and 21. After the date of acquisition, the investment amount shall be adjusted for the amortization of goodwill and the reporting entity's share of the change in special surplus funds, other than special surplus funds and unassigned funds (surplus), as defined in *SSAP No. 72—Surplus and Quasi-reorganizations*, and as adjusted appropriately for the items in paragraph 9. This represents the carrying amount of the investment.

11. If the reporting entity is using an equity method (as described in paragraphs 8.b.i. through 8.b.iv.), the reporting entity's share of undistributed earnings and losses of the investee shall be included in unrealized gains and losses of the reporting entity. The reporting entity's share of other changes in the investee's surplus (e.g., the change in the investee's nonadmitted assets) shall be recorded by the investor as a component of unrealized capital gains and losses on investments. If the reporting entity uses the market valuation approach outlined in paragraph 8.a., changes in that valuation shall be included in unrealized gains and losses. Dividends or distributions received from an investee shall be recognized in investment income when declared to the extent that they are not in excess of the undistributed accumulated earnings attributable to the investee. Dividends or distributions declared in excess of the undistributed accumulated earnings attributable to the investee shall reduce the carrying amount of the investment.

12. For investments in entities recorded based on the underlying audited GAAP equity of the investee, the amount to be recorded shall be defined as the initial investment in an investee at cost (excluding any investments in an investee's preferred stock), which is defined in SSAP No. 68. Investments in an SCA's preferred stock are addressed in paragraphs 20 and 21. The carrying amount of the investment shall be adjusted to recognize the reporting entity's share of the audited GAAP basis earnings or losses of the investee after the date of acquisition, adjusted for any dividends received. A reporting entity's share of adjustments that are recorded directly to the investee's stockholder's equity under GAAP shall also be recorded as adjustments to the carrying value of the investment with a corresponding amount recorded directly to unrealized capital gains and losses on investments. For entities subject to paragraphs 8.b.ii. or 8.b.iv. additional adjustments are required in accordance with paragraph 9.

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:

- a. A difference between the cost of an investment and the underlying equity in the statutory or GAAP book value, as applicable, of the acquired company at the date of acquisition shall be accounted for in accordance with SSAP No. 68 however, positive goodwill for noninsurance SCA entities subject to paragraph 8.b.ii. and foreign insurance SCA entities subject to paragraph 8.b.iv. shall be subject to the admissibility criteria in paragraph 9.d. rather than the admissibility criteria of paragraph 7 of SSAP No. 68.
- b. A transaction of an investee of a capital nature that affects the reporting entity's share of stockholders' equity of the investee shall be reflected as an unrealized gain or loss (e.g., where the investee issues additional stock or a new class of stock that impacts the reporting entity's equity ownership in the investee, the reporting entity's recorded investment shall be adjusted to reflect the transaction);
- c. Realized gains or losses on the sale of an investment in a SCA entity shall be recorded in an amount equal to the difference at the time of sale between the selling price and carrying amount of the investment plus any previously recorded unrealized gain or loss;
- d. If financial statements of an investee are not sufficiently timely for the reporting entity to apply an equity method to the investee's current results of operations, the reporting entity shall record its share of the earnings or losses of an investee from the most recent available financial statements. A lag in reporting shall be consistent from period to period. This paragraph does not apply to a SCA valued under paragraph 8.b.i.;
- 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 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. 5—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;
- f. When an investee has outstanding cumulative preferred stock, the reporting entity shall compute its share of earnings (losses) after deducting the investee's preferred dividends, whether or not such dividends are declared;



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

14. Once the reporting entity elects to use a valuation approach for a particular subsidiary, the reporting entity may not change the valuation method to another method without the approval of the domiciliary commissioner. For instance, if an entity selects the market valuation method, it may not change to an equity method or vice versa without approval from the domiciliary commissioner. Further, in order for an entity to transfer from a paragraph 8.a., or 8.b.ii. valuation to a paragraph 8.b.iii. valuation, the SCA shall not exceed the 20% threshold (as defined in paragraphs 8.b.ii.) for three consecutive years prior to making the change. When an investment qualifies for use of another method of accounting, the reporting entity shall adopt the new method of accounting and the investment shall be adjusted to reflect the reporting entity's equity interest in the SCA entity under the new method. A corresponding amount shall be recorded as an unrealized gain or loss.

15. A reporting entity that owns an interest in itself via direct ownership of shares of an upstream intermediate or ultimate parent shall reduce the value of such shares for the reciprocal ownership. If the shares of the parent are owned indirectly by a reporting entity, via a downstream SCA entity, the directly held entity, which owns the parent's shares, shall have its value reduced for the reciprocal ownership.

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

### **Investments in Downstream Holding Companies**

17. Valuation of a downstream holding company depends upon the nature of the SCA entities it holds in accordance with paragraph 8 and the guidance contained in the applicable SSAP for non-SCA investments. 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., then the downstream holding company would look to its underlying assets and record them as follows:

- a. Investments by a 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 17.b. above shall be recorded based upon the guidance in paragraph 8.b.iii.; and
- d. Investments by a downstream holding company in foreign insurance SCA entities shall be recorded based upon the guidance in paragraph 8.b.iv.

18. In lieu of separate GAAP audits of SCA entities of the downstream holding company, the insurer can choose to have a GAAP audit performed at the holding company level with a consolidating balance sheet showing GAAP equity of all the SCA entities. The consolidating balance sheet shall then be adjusted for GAAP to SAP differences of the insurance entities and paragraph 8.b.ii., 8 b. iii and 8.b.iv. entities under the downstream holding company. This adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level insurance company.

19. A purchased downstream holding company is valued in accordance with the provisions of paragraph 17 and the provisions of SSAP No. 68.

### **Investment in Preferred Stock or Surplus Notes of a Subsidiary, Controlled and Affiliated Entity**

20. When the reporting entity also holds an investment in preferred stock or surplus note(s) of an SCA and the carrying amount determined in accordance with paragraphs 8.b. and 9 includes preferred stock or surplus note(s), the investment in the SCA must be separated into its components. The carrying amount of the SCA is reduced by the value of the SCA's preferred stock or surplus note(s).

21. Investments in the preferred stock of an SCA shall be accounted for and reported in accordance with the provisions of *SSAP No. 32—Investments in Preferred Stock* (SSAP No. 32). This statement amends the title of SSAP No. 32 as follows:

*SSAP No. 32—Investments in Preferred Stock (including investments in preferred stock of subsidiary, controlled, or affiliated entities)*

This statement amends paragraphs 2 and 3 of SSAP No. 32 to the following:

2. Investments in preferred stock of subsidiaries, controlled or affiliated entities are included within the scope of this statement.

3. Preferred stock (including investment in affiliates), which may or may not be publicly traded and may include shares against which exchange traded call options are outstanding, shall include:

22. Investments in the surplus notes of an SCA shall be accounted for and reported in accordance with the provisions of *SSAP No. 41—Surplus Notes*.

23. The following example is provided to illustrate the accounting and reporting. The reporting entity holds 100% of the preferred stock. The SCA issued the preferred stock for \$50,000. The investment in the SCA, measured in accordance with this SSAP is \$250,000 including the preferred stock of the SCA. The investment in the SCA is \$200,000 (\$250,000-50,000) and the preferred stock is measured and reported in accordance with SSAP No. 32.

### **Impairment**

24. For any decline in the fair value of an investment in a SCA entity that is other than temporary, the investment 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. The write down shall first be considered as an adjustment to any portion of the investment that is nonadmitted (e.g., goodwill). The new cost basis shall not be changed 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. An impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to recover the carrying amount of the investment or there is evidence indicating inability of the investee to sustain earnings, which would justify the carrying amount of the investment. A fair value of an investment that is below the carrying amount based on the

statutory equity method or the existence of investee operating losses may indicate a loss in value, however, they are not necessarily indicative of a loss in value that is other than temporary.

### Consolidation

25. Majority-owned subsidiaries shall not be consolidated for individual entity statutory reporting. This does not exempt certain reporting entities that are members of an affiliated group from the requirement to issue consolidated or combined annual statements as supplemental information in accordance with NAIC guidelines.

### Amendments 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.i. 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.

### Disclosures

27. The significance of an investment to the reporting entity's financial position and results of operations shall be considered in evaluating the extent of disclosures of the financial position and results of operations of an investee. The following disclosures shall be made for all investments in SCA entities that exceed 10% of the total admitted assets of the reporting entity:

- a. Financial statements of a reporting entity shall disclose (i) the name of each SCA entity and percentage of ownership of common stock, (ii) the accounting policies of the reporting entity with respect to investments in SCA entities, and (iii) the difference, if any, between the amount at which the investment is carried and the amount of underlying equity in net assets (i.e., goodwill, other nonadmitted assets, market value or discounted market value adjustments) and the accounting treatment of the difference;
- b. For those SCA entities for which a quoted market price is available, the aggregate value of each SCA investment based on the quoted market price and the difference, if any,

between the amount at which the investment is carried and the quoted market price shall be disclosed;

- c. Summarized information as to assets, liabilities, and results of operations shall be presented for SCA entities, either individually or in groups;
- d. Conversion of outstanding convertible securities, exercise of outstanding options and warrants and other contingent issuances of an investee may have a significant effect on an investor's share of reported earnings or losses. Accordingly, material effects of possible conversions, exercises or contingent issuances shall be disclosed in notes to the financial statements of the reporting entity; and
- e. For those SCA entities in which the reporting entity elected, or was required, to change its valuation method as described in paragraph 14, a description of the reason for the change and the amount of adjustment recorded as unrealized gains or losses shall be disclosed. The entity shall also disclose whether commissioner approval was obtained in accordance with paragraph 14.

28. A reporting entity that calculates its investment in a foreign insurance subsidiary by adjusting annuity GAAP account value reserves using CARVM and the related Actuarial Guidelines shall disclose the interest rates and mortality assumptions used in the calculation as prescribed by the insurance department of the foreign country.

29. Any commitment or contingent commitment to a SCA entity shall be disclosed (e.g., guarantees or commitments to provide additional capital contributions).

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

- a. A description of the impaired assets and the facts and circumstances leading to the impairment; and
- b. The amount of the impairment and how fair value was determined.

31. Refer to the preamble for further discussion regarding disclosure requirements. The disclosures in paragraph 27.d. shall be included in the annual audited statutory financial reports only.

### Relevant Literature

32. This statement adopts the *Purposes and Procedures Manual of the NAIC Securities Valuation Office*.

33. This statement adopts *FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18* as guidance to be considered in determining the existence of control.

34. This statement rejects *APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock, AICPA Accounting Interpretations, 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, and 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, 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.*

### **Effective Date and Transition**

35. This statement is effective for years beginning on and after January 1, 2005. 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*.

### **AUTHORITATIVE LITERATURE**

#### **Statutory Accounting**

- *Purposes and Procedures Manual of the NAIC Securities Valuation Office*

#### **Generally Accepted Accounting Principles**

- *FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18*

### **RELEVANT ISSUE PAPERS**

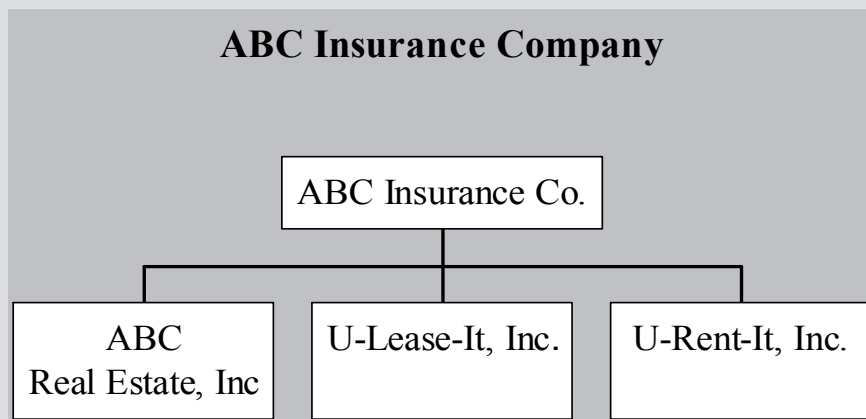
- *Issue Paper No. 118—Investments in Subsidiary, Controlled and Affiliated Entities, A Replacement of SSAP No. 46*

**ILLUSTRATION OF ACCOUNTING FOR SCAS**

This illustration, accompanying this Statement, is intended to provide an example of the application of paragraphs 8.b.ii. and 8.b.iii. Where an SCA meets the criteria of 8 b. ii., the illustration further demonstrates the necessary adjustments described in paragraph 9. While not all inclusive, the illustration is representative of the process and adjustments necessary to comply with this Statement. That is, the reporting entity must, first, determine which sub-section of paragraph 8 applies with respect to each SCA. Secondly, where the reporting entity has determined that an SCA meets the criteria of section 8 b. ii. or 8 b. iv., then the carrying amount is adjusted in accordance with the sub-section, which includes adjustments contained in the provisions of paragraph 9.

The ABC Insurance Company owns 100% of three subsidiaries:

1. ABC Real Estate, Inc. – owns and manages real estate properties and has no inter-company transactions
2. U-Lease-It, Inc. – leases furniture and equipment to local businesses including the insurance company. Lease fees received from ABC were \$10 million each in 20x2 and 20x1.
3. U-Rent-It, Inc. – leases EDP equipment to local businesses including the insurance company. Lease fees received from ABC were \$2 million each in 20x2 and 20x1.



Determination and application of adjustments to audited GAAP equity methods (paragraph 8.b. of SSAP No. 88)

ABC Real Estate, Inc.-the company is not engaged in any activities described in 8.b.ii. No adjustments are made and ABC Insurance Company records its investment based upon audited GAAP equity in accordance with 8.b.iii.

U-Lease-It, Inc.-the company is engaged in activities described in 8.b.ii., leasing furniture and equipment. The fees paid by ABC and reflected in income of U-Lease-It, Inc. exceed 20% of GAAP revenue calculated as follows:

U-Lease-It, Inc.	(Millions)	
	<u>20x1</u>	<u>20x2</u>
GAAP revenue	46.5	46.4
Less:		
Realized capital gains/(losses)	<u>6</u>	<u>(.2)</u>
Adjusted GAAP revenue	45.9	46.6
Lease fees from ABC	10.0	10.0
Fees/adjusted GAAP revenue	21.8%	21.5%

U-Rent-It, Inc.-the company is engaged in activities described in 8 b.ii., leasing EDP equipment. The fees paid by ABC and reflected in income of U-Rent-It, Inc. do not exceed 20% of GAAP revenue. No adjustments are made and ABC Insurance Company records its investment based upon audited GAAP equity in accordance with 8 b. iii. The calculation test is as follows:

U-Rent-It, Inc.	(Millions)	
	<u>20x2</u>	<u>20x1</u>
GAAP revenue	32.6	30.5
Lease fees from ABC	2.0	2.0
Fees/GAAP revenue	6.1%	6.6%

Adjustments to audited GAAP equity for U-Lease-It, Inc.

	(Millions)	
	<u>20x2</u>	<u>20x1</u>
Audited GAAP equity	129	130
Nonadmit furniture & equipment	(250)	(260)
Nonadmit excess goodwill *	<u>(2)</u>	<u>(2)</u>
Adjusted GAAP equity	(123)	(132)

\*Goodwill adjustment - 20x2=\$15- (10% x \$130[20x1GAAP equity] and 20x1=\$15-(10% x \$129.9 [20x0 GAAP equity])

Note: No DTA adjustment since the amount is less than 10% of GAAP equity

**Schedule D affiliated common stocks for ABC Insurance Company**

	<u>(Millions)</u>	
	<u>20x2</u>	<u>20x1</u>
ABC Real Estate Inc.	223	219
U-Lease-It, Inc.	(123)	(132)
U-Rent-It, Inc.	<u>30</u>	<u>27</u>
Total	130	114

Note: The change in carrying value between years of \$16 million is reported as an unrealized gain in 20x2



## ILLUSTRATED BALANCE SHEETS

## ABC Insurance Company

	<u>20x2</u>	<u>20x1</u>		<u>20x2</u>	<u>20x1</u>
<u>Net Admitted Assets</u>			<u>Liabilities</u>		
Bonds	11,210	11,150	Policy reserves	12,516	12,394
Common stock (unaffiliated)	325	315	Contract claims	30	29
Common stock (affiliated)	130	114			
Real estate	120	125	Expenses due and accrued	14	13
Mortgage loans	1,685	1,640	Misc. liabilities	<u>250</u>	<u>245</u>
Cash	<u>10</u>	<u>7</u>	Total liabilities	12,810	12,681
Sub-total	13,480	13,351	Common stock	100	100
Other assets	<u>20</u>	<u>14</u>	Unassigned funds	<u>590</u>	<u>584</u>
Total	13,500	13,365	Total equity	<u>690</u>	<u>684</u>
			Total	13,500	13,365

## ABC Real Estate, Inc.

	<u>20x2</u>	<u>20x1</u>		<u>20x2</u>	<u>20x1</u>
<u>Assets</u>			<u>Liabilities</u>		
Cash	10	7	Notes payable	260	220
Bonds (available for sale)	110	103	Misc. liabilities	<u>17</u>	<u>11</u>
Real estate investments	330	280	Total liabilities	277	231
Other assets	<u>50</u>	<u>60</u>			
Total	500	450	Common stock	15	15
			Retained earnings	<u>208</u>	<u>204</u>
			Total equity	<u>223</u>	<u>219</u>
			Total	500	450

**U-Lease-It, Inc.**

	<u>20x2</u>	<u>20x1</u>		<u>20x2</u>	<u>20x1</u>
<u>Assets</u>			<u>Liabilities</u>		
Cash	5	7	Accounts payable	15	12
Bonds (available for sale)	20	18	Notes payable	<u>183</u>	<u>190</u>
Furniture & equipment	250	260	Total liabilities	198	202
Investments in subs (15.0 mil. Goodwill)	45	42	Common stock	15	15
Federal tax recoverable (DTA)	<u>7</u>	<u>5</u>	Retained earnings	<u>114</u>	<u>115</u>
Total	327	332	Total equity	<u>129</u>	<u>130</u>
			Total	327	332

<u>Summary of Operations</u>			
	<u>20x2</u>	<u>20x1</u>	
Revenues:			
Interest income	8.1	9.0	
Realized capital gains/ (losses)	0.6	(0.2)	
Investment in sub	3.0	2.6	
Lease fees	<u>34.8</u>	<u>35.0</u>	
Total	46.5	46.4	
Expenses:			
General administration	6.4	6.2	
Depreciation	<u>42.4</u>	<u>41.0</u>	
Total	48.8	47.2	
Net income before taxes	(2.3)	(0.8)	
Federal income tax benefit	<u>0.8</u>	<u>0.3</u>	X
Net income	(1.5)	(0.5)	
Unrealized capital gains/ losses	0.4	0.6	

## U-Rent-It, Inc.

	<u>20x2</u>	<u>20x1</u>		<u>20x2</u>	<u>20x1</u>
<u>Assets</u>			<u>Liabilities</u>		
Cash	6	6	Accounts payable	3	4
Bonds (available for sale)	5	4	Notes payable	<u>202</u>	<u>199</u>
EDP equipment	220	216	Total liabilities	205	203
Other assets	<u>4</u>	<u>4</u>	Common stock	10	10
Total	235	230	Retained earnings	<u>20</u>	<u>17</u>
			Total equity	<u>30</u>	<u>27</u>
			Total	235	230
<u>Summary of Operations</u>					
	<u>20x2</u>	<u>20x1</u>			
Revenues:					
Interest income	0.5	0.4			
Lease fees	<u>32.1</u>	<u>30.1</u>			
Total	32.6	30.5			
Expenses:					
General Administration	3.0	3.0			
Depreciation	<u>25.7</u>	<u>24.5</u>			
Total	28.7	27.5			
Net income before taxes	3.9	3.0			
Federal income tax	<u>(1.3)</u>	<u>(1.0)</u>			
Net income	2.6	2.0			
Unrealized capital gains/losses	0.4	0.6			

**APPENDIX A TRANSITION GUIDANCE FOR YEAR-END 2006 REPORTING QUESTIONS AND ANSWERS**

The National Association of Insurance Commissioners issued Statement of Statutory Accounting Principle No. 88—*Investments in Subsidiary, Controlled, and Affiliated Entities, A Replacement of SSAP No. 46* (SSAP No. 88) with an effective date of January 1, 2005. This statement included a number of changes that have resulted in questions by reporting entities, auditors and regulators. The purpose of this appendix (Appendix A) is to provide transition guidance on areas that have not been interpreted or applied consistently. This appendix is intended to provide clear reporting guidance for year-end 2006 (and prior year 2005). The Statutory Accounting Principles Working Group intends to finalize work on SSAP No. 88 and complete the SSAP No. 88 Implementation Guide (planned as Appendix B) in 2007 for year-end 2007 and going forward.

**Question 1.** Is an audit of only the balance sheet acceptable to meet the SCA audit requirements of SSAP No. 88?

**Answer 1.** Yes, (for 2005 and 2006 reporting only). The Statutory Accounting Principles Working Group intended that in order to meet the requirements of SSAP No. 88, paragraphs 8 and 9, that audits be conducted in accordance with the Model Regulation Requiring Annual Audited Financial Reports, as adopted by the SCA's domiciliary state, and in accordance with GAAP, as defined as those pronouncements included in the United States GAAP Hierarchy as described in AICPA Statement of Auditing Standards No. 69, *The Meaning of "Presents Fairly in Conformity With GAAP."*

During the course of development of the SSAP No. 88 Implementation Guide, the Statutory Accounting Principles Working Group became aware that some reporting entities and independent accounting firms had interpreted the guidance relating to the equity value of subsidiaries to imply that an audit of only the balance sheet was sufficient to meet the audit requirements included in SSAP No. 88. An audited balance sheet will be deemed sufficient to meet the SCA audit requirements of SSAP No. 88 for subsidiaries reported under paragraphs 8.b.ii., 8.b.iii. and 8.b.iv., for year-end 2005 and 2006 reporting only. Note that U.S. insurance subsidiaries (paragraph 8.b.i entities) will continue to be required to meet applicable state laws regarding audit requirements. In addition, if an audit of the financial statements (i.e., balance sheet, summary of operations, statement of changes in capital and surplus, and cash flows) was obtained for 2005, then an audit of only the balance sheet is not sufficient for 2006.

**Question 2a.** If a downstream non insurance holding company is merely holding (1) subsidiary, controlled, and affiliated (SCA) entities and/or (2) joint ventures, partnerships, and/or limited liability companies in which the downstream non insurance 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"), does not own any other additional assets, and is not held liable for any other liabilities, commitments, contingencies, guarantees or obligations of the investment in the downstream non insurance holding company, is an audit of the financial statements of the downstream non insurance holding company required, or is a "look-through" permitted?

**Answer 2a.** The Working Group is aware that many were confused by the meaning of the language in SSAP No. 88, paragraphs 17 and 18, and will clarify that language for 2007. The divergence in interpretation focused on the number of audits required under SSAP No. 88 for downstream subsidiary, controlled, and affiliated entities including holding companies.

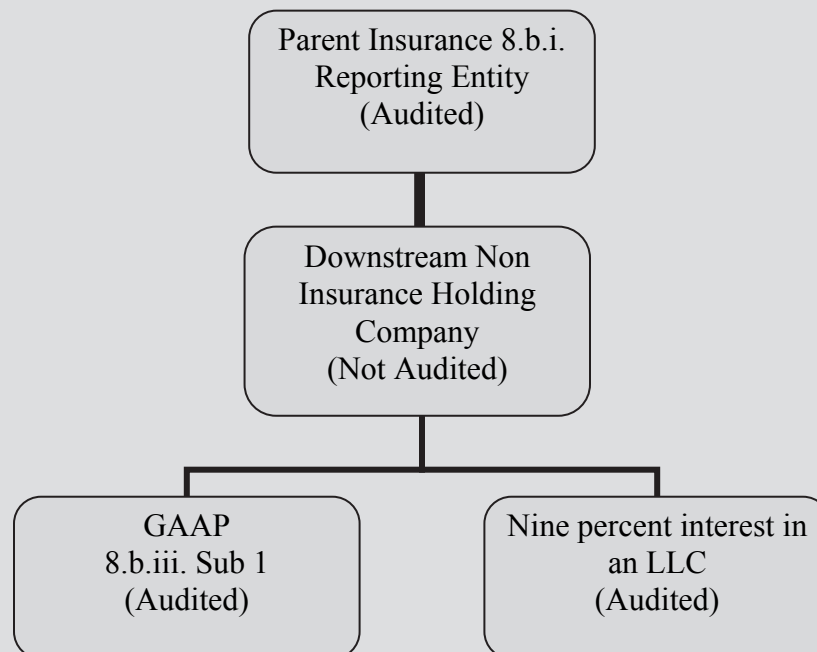
Some believed that an audit of the financial statements of a downstream non insurance holding companies was not required if the downstream non insurance holding company was merely holding SCA entities and/or non SCA SSAP No. 48 entities and had no other assets or liabilities. In short, it was interpreted that the financial statements of the downstream non insurance holding company need not be audited if the

financial statements of the SCA entities and/or the non SCA SSAP No. 48 entities owned by the downstream non insurance holding company were audited, i.e., a “look-through” approach could be used. SSAP No. 88 indicates that SCA entities are to be valued using one of the valuation methods described in paragraph 8. All of the paragraph 8.b. valuation methods require the financial statements of SCA entities to be audited, including downstream non insurance holding companies, in order to be admitted assets. Likewise, SSAP No. 48 requires the financial statements of non SCA SSAP No. 48 entities to be audited (U.S. GAAP) in order to be admitted assets. For year-end 2005 and 2006 reporting only, it is acceptable to apply the “look through” approach for downstream non insurance holding companies that do not hold assets other than SCA entities and/or non SCA SSAP No. 48 entities, or liabilities, commitments, contingencies, guarantees or obligations, provided the financial statements of the SCA entities and/or the non SCA SSAP No. 48 entities are separately audited.

**Question 2b.** Can the “look-through” approach be applied to non insurance holding companies that hold assets other than SCA entities and/or non SCA SSAP No. 48 entities and/or liabilities, commitments, contingencies, guarantees or obligations? Can the “look-through” approach be applied to downstream non insurance holding companies that hold other unaudited immaterial investments?

**Answer 2b.** If a downstream non insurance holding company holds assets other than SCA entities and/or non SCA SSAP No. 48 entities, the financial statements of the downstream non insurance holding company shall be audited. If the financial statements of the downstream non insurance holding company are not audited, investments in unaudited SCA and/or unaudited non SCA SSAP No. 48 entities, as well as any other assets of the downstream non insurance holding company, are nonadmitted. All liabilities, commitments, contingencies, guarantees or obligations of the downstream non insurance holding company, which are required to be recorded as liabilities, commitments, contingencies, guarantees or obligations 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 non insurance holding company, if not already recorded in the financial statements of the downstream non insurance holding company.

**Numerical Illustration to questions 2a and 2b:**



**Downstream Non Insurance Holding Company Balance Sheet**

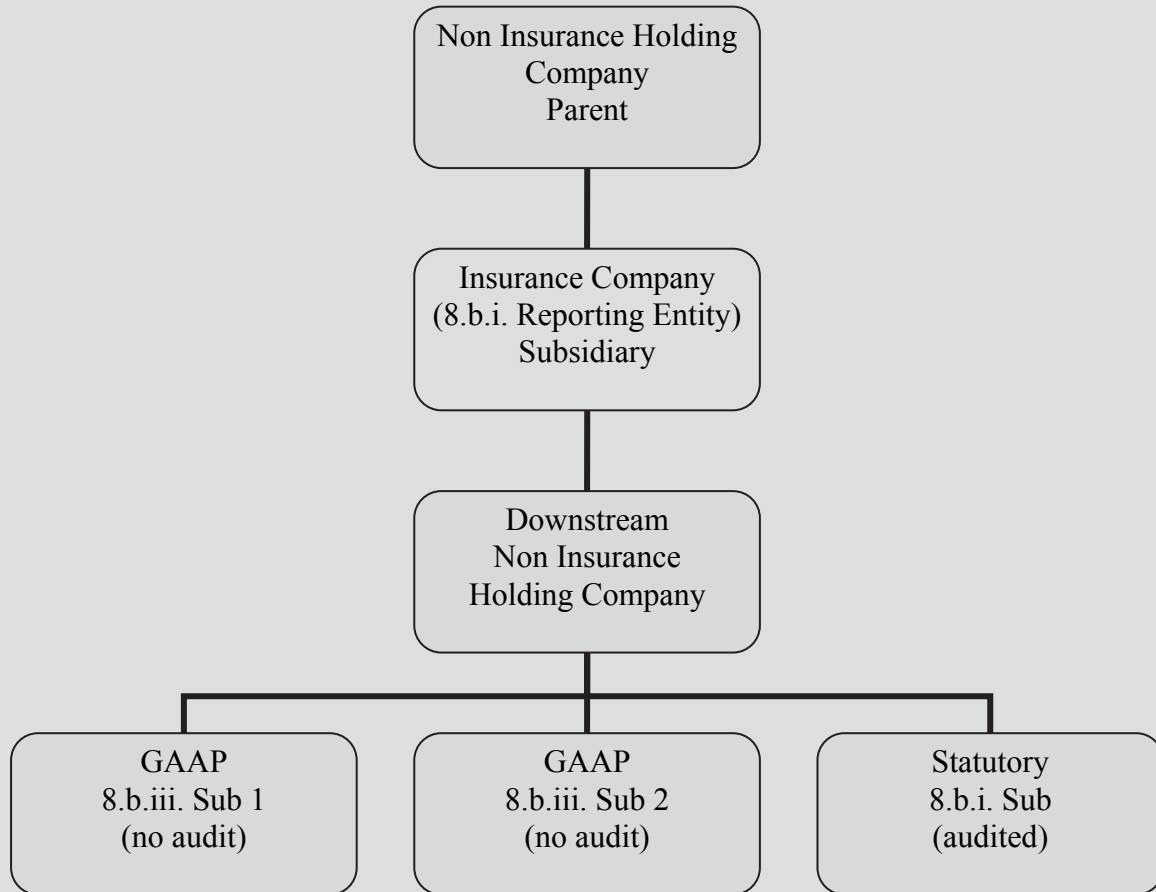
<b>Assets</b>		<b>Liabilities</b>	
GAAP Sub 1	100	Miscellaneous	150
Nine percent interest in an audited LLC	200		
Miscellaneous	50	<b>Equity</b>	
		Common Stock	200
<b>Total Assets</b>	<b>350</b>	<b>Total Liabilities &amp; Equity</b>	<b>350</b>

**Investment in Downstream Non Insurance Holding Company, including the investments in a SCA entity and a non SCA SSAP No. 48 entity** **150**

**Calculation:**

Add:		
GAAP Sub 1		100
Nine percent interest in an audited LLC		200
Total		<u>300</u>
Less:		
Miscellaneous Liabilities		<u>150</u>
<b>Net Investment in Downstream Non Insurance Holding Company, Including the investments in a SCA entity and a non SCA SSAP No. 48 entity</b>		<b><u>150</u></b>

**Question 3.** As illustrated below, would an audit of the consolidated financial statements of the Non Insurance Holding Company Parent with consolidating balance sheets of the insurance companies and GAAP Sub 1 and GAAP Sub 2 meet the requirements for audited financial statements of the subsidiaries under SSAP No. 88, paragraph 18?



**Answer 3.** No. It was never the intent of SSAP No. 88 to allow an audit of the consolidated financial statements of the non insurance holding company parent with consolidating balance sheets of the insurance company subsidiary, GAAP Sub 1 and GAAP Sub 2, and Statutory Sub to meet the requirements for audited financial statements of the subsidiaries under SSAP No. 88, paragraph 18.

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