

**Statutory Accounting Principles (E) Working Group  
Packet 2  
March 16, 2024**

**ROLL CALL**

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

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

Note: This meeting will be recorded for subsequent use.

**A. Hearing 2 - REVIEW of COMMENTS on EXPOSED ITEMS with March comment deadlines**

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

1. Ref #2019-21: SSAP No. 21R—Principles-Based Bond Project
2. Ref #2022-12: Review of INT 03-02: Modification to an Existing Intercompany Pooling Arrangement

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-21 SSAP No. 21R (Julie)	SSAP No. 21R—Principles-Based Bond Project	2.1 – SSAP No. 21R	Minor Comments Received	IP’s – 2

Summary:

On Feb. 20, 2024, the Working Group exposed an updated *SSAP No. 21R—Other Admitted Assets* for a shortened comment period ending March 7, 2024. The shortened comment period intends to allow for adoption consideration during the Spring National Meeting.

During the Feb. 20 call, the Working Group received information on the revisions incorporated, which considered the interested party comments. In addition to the guidance edits, the ability for companies to apply the residual guidance early was incorporated. The stated effective date is Jan. 1, 2025, but the guidance would permit reporting entities to early adopt the residual guidance for Dec. 31, 2024.

Interested Parties’ Comments:

Interested parties recommend a couple of suggested edits as follows:

- The reference to line “a.” in paragraph 27 is repeated in the numbering, The reference in the second line should be changed to “b.” and the remaining items following that line adjusted accordingly.
- The phrase “... as the present value of cash flows expected to be collected is less than the amortized cost basis of the securities” in line 27f should be deleted as it doesn’t add any clarification but is confusing as to the intent.

Interested parties have no comment on the other changes made to SSAP No. 21.

Recommendation:

**NAIC staff recommends that the Working Group adopt the exposed SSAP No. 21R with the editorial change to correct the paragraph numbering to remove the double “a” in paragraph 27 and renumber accordingly.**

NAIC staff does not suggest incorporating the other interested parties’ edit as the disclosure noted is specific to situations in which the entity recognizes a bifurcated other-than-temporary impairment based on estimated cash flows (credit impairment) and does not reflect a full OTTI to fair value (for both credit and interest related impairment). The guidance in SSAP No. 21R for non-bond debt securities points to SSAP No. 43R for OTTI guidance, and the disclosures are consistent with the SSAP No. 43R OTTI disclosures and the ability to bifurcate impairment. If this phrase is removed, then the disclosure will be applicable for all OTTI, and that is not the intent. The disclosure immediately preceding the referenced disclosure captures all OTTI.

Below are the SSAP No. 21R applicable disclosures for reference. The highlighted portion is what interested parties recommended to delete, but staff is not recommending that change as it would change the scope of the disclosure.

27.e All securities within the scope of this statement with a recognized other-than-temporary impairment, disclosed in the aggregate, classified on the basis for the other-than-temporary impairment: (1) intent to sell, (2) inability or lack of intent to retain the investment in the security for a period of time sufficient to recover the amortized cost basis, or (3) present value of cash flows expected to be collected is less than the amortized cost basis of the security.

27.f For each security with an other-than-temporary impairment, recognized in the current reporting period by the reporting entity, as the present value of cash flows expected to be collected is less than the amortized cost basis of the securities:

- The amortized cost basis, prior to any current-period other-than-temporary impairment.
- The other-than-temporary impairment recognized in earnings as a realized loss.
- The fair value of the security.
- The amortized cost basis after the current-period other-than-temporary impairment.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-12 (Robin)	Review of INT 03-02: Modification to an Existing Intercompany Pooling Arrangement	2.2 – Form A 2.3 – INT 03-02	Comments Received	IP’s – 5

Summary:

This agenda item was originally introduced in 2022 and proposed to nullify *INT 03-02: Modification to an Existing Intercompany Pooling Arrangement*. The INT was proposed to be nullified as it is inconsistent with *SSAP No. 25— Affiliates and Other Related Parties* guidance regarding economic and non-economic transactions between related

parties. The guidance in INT 03-02 can result with, in essence, unrecognized gains (dividends) or losses by allowing the use of the statutory book valuation when using assets (such as bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements. Treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance pooling transactions. At the 2023 Fall National Meeting the item was deferred to allow time for more illustrations and discussions with interested parties.

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

Interested Parties Comments:

For Spring 2024 discussion, interested parties recommended replacing the guidance in INT 03-02 with additional guidance in

- SSAP No. 25 – excerpted below (received informally) The recommendation for SSAP No. 25 is an update to their June 2023 recommendation to address the concern that the prior guidance in INT 03-02 was being too broadly applied.
- SSAP No. 63, proposed new paragraph 8 as excerpted below (see full SSAP No. 63 mark up in context in attachment 2.4 comments). The SSAP No. 63 revisions were originally proposed in June 2023 by interested parties. Interested parties requested that their June 2023 comments be included again,( excerpted below.) Note that the June 2023 comments were previously in the minutes and will not be reattached to the minutes for this meeting.

*SSAP No. 25—Affiliates and Other Related Parties*

4. If a company transfers assets or liabilities to effectuate a modification to an existing intercompany pooling arrangement, the transaction, including the transfer of assets, shall be accounted for in accordance with the guidance in SSAP No. 63—Underwriting Pools. The guidance in SSAP No. 63 regarding the transfers of assets or liabilities to effectuate a modification of an intercompany pooling arrangements shall not be applied or analogized to other transactions involving transfers of assets and liabilities.

*SSAP No. 63—Underwriting Pools*

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

- a. The appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new intercompany pooling agreement(s) that serves to substantively modify an existing intercompany pooling arrangement is statutory book value for assets and statutory value for liabilities.
- b. The net amount of the assets and liabilities being moved among entities as a result of a modification to an intercompany pooling shall be used to settle the intercompany

payable/receivable (i.e., the assets that are transferred in conjunction with the modification) to minimize the amount of assets transferred in the modification.

New disclosure paragraph 12

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

June 2023 Comments from interested parties that accompanied the proposed revisions to SSAP No. 63

The Working Group re-exposed the intent to nullify INT 03-02, effective December 31, 2023. The nullification is proposed as INT 03-02 is inconsistent with SSAP No. 25 – *Affiliates and Other Related Parties*, guidance regarding economic and non-economic transactions between related parties. The guidance in INT 03-02 can result with, in essence, unrecognized gains (dividends) or losses through the use of statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements. Treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions.

Interested parties note that there are several issues associated with nullifying INT 03-02 and transferring the assets that support the insurance liabilities at fair value versus book value as provided in the current guidance in the INT including the following:

- Inconsistent accounting among affiliates for a modification of the intercompany pooling agreement when some of the transfers generate a realized gain and others do not, depending on the assets transferred;
- The transfer of a bond in an intercompany pooling transaction that generates a realized gain would cause the intercompany pooling modification to be accounted for as retroactive reinsurance, which would violate the accounting guidance currently contained in SSAP No. 63;
- The use of retroactive reinsurance contradicts the basis of presentation in Schedule P for business subject to intercompany pooling agreements;
- Inconsistent presentation of underwriting assets and liabilities among participants in the pooling agreement; and
- Inconsistent accounting for intercompany transactions, as some gains would be deferred while other gains will be realized at the parent level, depending on the insurer’s corporate ownership structure.

Depending on market interest rates at the time of a pooling modification, a gain or loss will result from the transfer of bonds at fair value. In times of declining interest rates, the fair value of bonds generally increase. During these times, if a bond with a fair value in excess of book value is transferred as part of a pooling modification and the transfer is accounted for at fair value, the transferor will recognize a gain. This gain will disqualify the transferor and transferee from accounting for the pooling modification as prospective reinsurance based on the accounting guidance in SSAP No. 62R paragraph 36d. However, the same pooling modification can have other participants qualify for prospective reinsurance due to no gain on transfer of the assets.

*Prospective reinsurance versus retroactive reinsurance*

The transferors, i.e., the ceding pool entities, that qualify for prospective reinsurance will record the premium and loss accounts as prospective reinsurance (i.e., the cedent’s participation share of the total intercompany pool written and earned premium, reserves and losses are reported in the cedent’s financial statements).

The transferors, i.e., the ceding pool entities, that do not qualify for prospective reinsurance will report written premiums, earned premiums, loss and loss adjustment reserves and losses and loss adjustment expenses without recognition of the retroactive reinsurance. Therefore, insurance accounts subject to pooling will not be reduced for cessions to the lead company of the pool or retrocessions by the lead company to the pool participants. Similarly, any transferees that do not qualify for prospective reinsurance, i.e., the assuming pool entities, will exclude the retroactive reinsurance from loss and loss expense reserves and all schedules and exhibits. SSAP No. 62R requires the following for retroactive reinsurance:

- The ceding entity and the assuming entity shall report by write-in item on the balance sheet, the total amount of all retroactive reinsurance, identified as retroactive reinsurance reserve ceded or assumed, recorded as a contra-liability by the ceding entity and as a liability by the assuming entity;
- The ceding entity shall, by write-in item on the balance sheet, restrict surplus resulting from any retroactive reinsurance as a special surplus fund, designated as special surplus from retroactive reinsurance account;
- The surplus gain from any retroactive reinsurance shall not be classified as unassigned funds (surplus) until the actual retroactive reinsurance recovered exceeds the consideration paid;
- The special surplus from retroactive reinsurance account for each respective retroactive reinsurance agreement shall be reduced at the time the ceding entity begins to recover funds from the assuming entity in amounts exceeding the consideration paid by the ceding entity.

As a result of the inconsistent accounting between pool entities that are required to account for the intercompany pooling as prospective reinsurance and the pool entities that are required to use retroactive reinsurance, the financial statements of the pool will be extremely confusing and lack useful financial information. The stand-alone financial statements of the legal entities of the pool will not be consistent and the combined audited financial statements of the pool will reflect insurance accounts that are accounted for and reported using different accounting methodologies for the same underlying transactions.

As a practical matter, it would be nearly impossible for an insurer to report intercompany pooling results and balances using both prospective and retroactive reinsurance. Premium, claim, and loss systems are not built to handle such inconsistent accounting for the same underlying transactions.

*SSAP No. 62R versus SSAP No. 63*

The application of retroactive reinsurance as a result of the nullification of INT 03-02 would also result in a conflict with the guidance in SSAP No. 63, *Underwriting Pools*. The highlighted wording in paragraphs 8 and 9 of SSAP No. 63 instructs the preparer to record the premiums and losses based on the legal entity's participation in the pool. The use of retroactive reinsurance would violate that guidance. Regarding the last sentence of paragraph 7, the use of retroactive reinsurance would also result in timing differences between entities in the pool as a result of certain entities deferring gains in surplus.

7. Intercompany pooling arrangements involve establishment of a conventional quota share reinsurance agreement under which all of the pooled business is ceded to the lead entity and then retroceded back to the pool participants in accordance with their stipulated shares. Arrangements whereby there is one lead company that retains 100% of the pooled business and all or some of the affiliated companies have a 0% net share of the pool may qualify as intercompany pooling. In these arrangements, only the policy issuing entity has direct liability to its policyholders or claimants; other pool participants are liable as reinsurers for their share of the issuing entity's obligations. Although participants may use different assumptions (e.g., discount rates) in recording transactions, the timing of recording transactions shall be consistently applied by all participants.

8. Underwriting results relating to voluntary and involuntary pools shall be accounted for on a gross basis whereby the participant's portion of premiums, losses, expenses, and other operations of the pools are recorded separately in the financial statements rather than netted against each other. Premiums and losses shall be recorded as direct, assumed, and/or ceded as applicable. If the reporting entity is a direct writer of the business, premiums shall be recorded as directly written and accounted for in the same manner as other business which is directly written by the entity. To the extent that premium is ceded to a pool, premiums and losses shall be recorded in the same manner as any other reinsurance arrangement. A reporting entity who is a member of a pool shall record its participation in the pool as assumed business as in any other reinsurance arrangement.

9. Underwriting results relating to intercompany pools shall be accounted for and reported as described in paragraph 8. While it is acceptable that intercompany pooling transactions be settled through intercompany arrangements and accounts, intercompany pooling transactions shall be reported on a gross basis in the appropriate reinsurance accounts consistent with other direct, assumed and ceded business.

### *Schedule P*

Data reported in Schedule P is required to be reported net of intercompany pooling (i.e., only the reporting entity's share of the pool business is reported in Schedule P). This includes data related to premiums, losses and loss adjustment expenses, and claim counts.

Additionally, the *NAIC Annual Statement Instructions* for Schedule P require that when changes to pooling agreements impact prior accident years, historical data values in Schedule P must be restated based on the new pooling percentages. This instruction effectively recognizes that Schedule F only provides useful information related to changes in intercompany pooling agreements if such changes are treated as prospective reinsurance.

Because intercompany pooling data would not be reflected in the Schedule P of the pool entities that are required to use retroactive reinsurance accounting, distorted data would result because only a portion of the intercompany pool's loss, premium, and claim count data would be reported on Schedule P (i.e., the only pooled data reported in Schedule P would be of the pool participants that qualify for using prospective reinsurance). Note that the use of retroactive reinsurance will apply until all of the claims subject to retroactive reinsurance are settled; therefore, the distortion of Schedule P for the pool entities will likely occur for decades depending on the underlying business. As a result, the Schedule P data for the intercompany pool used by actuaries, analysts, regulators, and the NAIC (including analysis used to update RBC factors) will not be useful or meaningful.

### *Other intercompany pooling issues*

Because intercompany pooling agreements subject certain insurance assets (e.g., agents balances) to pooling, a mismatch would occur in the financial statements of pool participants that are required to use retroactive reinsurance accounting versus the participants that are not. For the ceding entities, insurance assets would reflect the reporting entity's share of the pool business, but premiums and losses will reflect the entity's business excluding the pooling. This would occur because insurance assets such as agents balances are not subject to retroactive reinsurance accounting.

### *Consistency of accounting*

The NAIC has noted concerns that the "guidance in INT 03-02 can result with in essence, unrecognized gains (dividends) or losses through the using the statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements." The NAIC also notes that the "treatment of transfers of assets between affiliates should be consistent for all

intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions.” Interested parties note the following:

- As our examples illustrate, the transfer of assets using fair value in an intercompany pooling modification can result in reported realized gains reflected in certain pool participants’ financial statements, as well as the combined audited statutory financial statements of the intercompany pool even though the assets remain in the pool.
- The transfer of assets at fair value in an intercompany pooling modification can also result in inconsistent accounting for intercompany transactions, as some gains would be deferred while other gains will be realized at the parent level, depending on the ownership structure of the entities in the intercompany pool.

*SSAP No. 63*

SSAP No. 63 has limited accounting guidance related to intercompany pooling agreements and instead primarily provides a discussion of what an intercompany pooling agreement is and contains a reference to INT 03-02 in paragraph 5. We believe that a more effective approach to addressing the concerns over moving invested assets at book value in a modification of an intercompany agreement would be to incorporate portions of INT 03-02 into SSAP No. 63, require that insurers settle the movement of assets and liabilities on a net basis (i.e., the net of pool assets less pool liabilities) to minimize the movement of assets, require disclosure if assets with fair values that differ from cost or amortized cost are transferred as part of the modification, and include a cross reference in SSAP No. 25 to the updated guidance in SSAP No. 63 for transfers of assets associated with a modification of an intercompany pooling agreement. This approach would also provide guidance on such modification where none would exist in the absence of INT 03-02. Please see recommended changes to SSAP No. 63 in the attached.

Since the guidance regarding the transfers of assets associated with modifications of intercompany agreements would be located in SSAP No. 63, we recommend that SSAP No. 25 include a new paragraph 4 to direct the reader to the guidance in SSAP No. 63 as follows:

4. If a company transfers assets or liabilities to effectuate a modification to an existing intercompany pooling arrangement, the transaction, including the transfer of assets, shall be accounted for in accordance with the guidance in SSAP No. 63 – Underwriting Pools.

Recommendation:

NAIC staff recommends Working Group discussion on the following options:

1. **NAIC staff continues to recommend against maintaining an exception to allow the transfer of assets at book value for amendments to intercompany pooling agreements. This is an exception to the broad intercompany asset transfer guidance in SSAP No. 25 which has been under greater scrutiny in recent years. NAIC staff also continues to recommend nullification of INT 03-02.**

Measurement of gain to the ceding entity on intercompany transaction is of crucial importance in determining the accounting under *SSAP No. 62R—Property and Casualty Reinsurance*. NAIC staff notes that the intent is to measure the total impact of the reinsurance on the related parties (not to avoid gain recognition). Using book value of assets can be distorting if the difference between fair value of the assets used and book value is material.

- *SSAP No. 62R—Property and Casualty Reinsurance*, paragraph 26d allows a broad exception to retroactive reinsurance accounting for intercompany reinsurance agreements among affiliates that are 100% owned by the same ultimate controlling entity, **provided there is no gain to the ceding entity.**

- SSAP No. 62, paragraph 27 requires retroactive reinsurance agreements between insurers under common control to use a deposit accounting with nonadmission of the reinsurance payment and no reserve credit **if there is a gain to the ceding entity.**

**2. However, if the Working Group wants to maintain an exception for use of book value for the transfer of assets for intercompany pooling, NAIC staff recommends that the exception be narrow and specific.**

The Insurance Holding Company System Regulatory Act- Model #440 requires that reinsurance agreements between insurers and affiliates including reinsurance pooling agreements be filed for approval with their domiciliary regulator and also that purchases and sales or exchanges of assets be reviewed. Therefore there is already existing regulator review of such reinsurance transactions.

If the Working Group wants to maintain the exception, for modifications to intercompany pooling agreements, NAIC staff recommends exposing the interested parties' revisions to SSAP No. 25 and SSAP No. 63 with the modifications shaded in gray below. The modifications in shaded in gray suggested by NAIC staff are to emphasize the modification to SSAP No. 25 is the **valuation** of assets and the wording in SSAP No. 63 is to emphasize that **the other reinsurance guidance** also continues to apply. Finally, INT 03-02 would be nullified if the other guidance is adopted, so the intent to nullify would also be noted.

**3. NAIC staff is aware that some states such as CT require a Model #440 Form D filing for transfers of non-cash contributions or distributions. NAIC staff inquires if the Working Group is interested in adding such a requirement to ensure that the department review includes the review of transferred assets.**

*Revisions suggested by interested parties with gray shading additions from NAIC staff:*

*SSAP No. 25—Affiliates and Other Related Parties*

4. \_\_\_\_\_ If a company transfers assets or liabilities to effectuate a modification to an existing intercompany pooling arrangement, the transaction, including the transfer of assets, shall be accounted for and valued in accordance with the guidance in SSAP No. 63—*Underwriting Pools*. The guidance in SSAP No. 63 regarding the transfers of assets or liabilities to effectuate a modification of an intercompany pooling arrangements shall not be applied or analogized to other transactions involving transfers of assets and liabilities.

*SSAP No. 63—Underwriting Pools*

8. \_\_\_\_\_ Insurance groups that utilize intercompany pooling arrangements often modify these arrangements from time to time for various business reasons. These business reasons commonly include mergers, acquisitions, dispositions, or a restructuring of the group's legal entity structure. In order to effectuate a relatively simple modification, such as changing pooling participation percentages without changing the pool participants, companies often simply amend the existing pooling agreement. Alternatively, in order to effectuate a more complex modification, such as changing (by adding or removing) the number of pool participants, a company may commute the existing pooling agreement and execute a new pooling agreement(s). In conjunction with executing the appropriate intercompany pooling agreements, a transfer of assets and liabilities amongst the impacted affiliates may also be required in order implement the new pooling agreement(s). Note that other applicable reinsurance guidance including retroactive reinsurance accounting guidance if applicable continues to apply. The following subparagraphs provide guidance specific to modifications of intercompany pooling arrangements and shall not be applied to an analogous transaction or event.

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



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

New disclosure paragraph 12

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

**B. Meeting 2 - Consideration of Maintenance Agenda – Pending List**

- 1. Ref #2024-06: Risk Transfer Analysis on Combination Reinsurance Contracts

Ref #	Title	Attachment #
2024-06 (Robin)	Risk Transfer Analysis on Combination Reinsurance Contracts	2.4 – Form A

Summary:

This agenda item is to address a December 2023, referral by the Valuation Analysis (E) Working Group (VAWG) regarding reinsurance risk transfer and reserve credit for a particular form of reinsurance being observed by regulators in the life industry. The referral noted that:

VAWG has identified that issues arise when evaluating reinsurance for risk transfer in accordance with *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*, when treaties involve more than one type of reinsurance, and there is interdependence of the types of reinsurance, including but not limited to an experience refund that is based on the aggregate experience. In such cases, VAWG regulators find that these types of reinsurance must be evaluated together and cannot be evaluated separately for the purpose of risk transfer. For example, where a treaty includes coinsurance and YRT with an aggregate experience refund and the inability to independently recapture the separate types of reinsurance, it is not adequate to separately review the coinsurance and YRT pieces of the transaction for risk transfer. The treaty as a whole is non- proportional. This complexity is not immediately apparent to the regulatory reviewer, and it is important that this issue be raised broadly, so that individual state regulators are aware. Individual regulators are encouraged to contact VAWG if they would like additional perspective when reviewing such treaties.

Generally, VAWG regulators observe that some companies are reporting an overstated reserve credit due to a bifurcated risk transfer analysis. Specifically, some companies reported a proportional reserve credit for a coinsurance component, despite in aggregate the reinsurer only being exposed to loss in tail scenarios. From an actuarial perspective, there is consensus among VAWG members that it is not appropriate for a ceding company to take a proportional reserve credit that reflects the transfer of all actuarial risks when not all actuarial risks are transferred.

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

*SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* contains guidance for life and health reinsurance agreements. Additionally, *SSAP No. 61R* refers to *Appendix A-791, Life and Health Reinsurance Agreements* for risk transfer criteria applicable to all forms of life and health reinsurance other than YRT and certain non-proportional contracts such as stop loss and catastrophe reinsurance. YRT agreements are required to comply with certain parts of A-791. Furthermore, contracts that do not meet the conditions for reinsurance accounting in *SSAP No. 61R*, including the applicable parts of A-791, receive deposit accounting.

As noted in the referral above, regulators have observed reinsurance transactions that combine both coinsurance and YRT, typically applicable to different underlying policies, but that are interdependent. There exists an aggregate experience refund and recapture provisions that allow for recapture by the cedant, but only if both components are recaptured simultaneously.

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

The concern raised by regulators is that the substance of this interdependent agreement design is more akin to the risk transferred under a nonproportional reinsurance agreement. This is because in aggregate, proportionate amounts of the risk are not transferred. The agreements are designed to compensate the cedant for aggregate experience only in tail scenarios, which is accomplished through the design of the aggregate experience refund. In most reasonably expected scenarios, the net effect of the reinsurance is such that the cedant pays a financing charge to the reinsurer for a designated period of time until an expected recapture date and no additional net funds exchange hands. As a result, taking a full proportional reserve credit on the coinsured component is not reflective of the actual risk being transferred. SSAP No. 61R, paragraph 36 notes that the reinsurance credit is only for the risk reinsured. As noted in the referral, there was consensus among VAWG members that it is not appropriate for a ceding company to take a proportional reserve credit that reflects the transfer of all actuarial risks when not all actuarial risks are transferred. NAIC staff agrees with the VAWG consensus and proposes to incorporate a version of existing guidance from *SSAP No. 62R—Property and Casualty Reinsurance* that addresses this point. The inclusion of this guidance is intended to require risk transfer to be analyzed for the entire contract when multiple interdependent types of reinsurance are present.

*SSAP No. 62R—Property and Casualty Reinsurance Exhibit A – Implementation Questions and Answers*, question 10 provides guidance on interdependent contract features. This agenda item proposes to incorporate key aspects of SSAP No. 62R, Exhibit A question 10 into SSAP No. 61R to provide more clarity on evaluation of risk transfer on contracts with interdependent features. The answer requires that features of the contract(s) that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in determining if a particular contract transfers risk. The *SSAP No. 62R—Property and Casualty Reinsurance Exhibit A – Implementation Questions and Answers* question 10 provides the following:

10A: A contract is not defined, but is essentially a question of substance. It may be difficult in some circumstances to determine the boundaries of a contract. **For example, the profit-sharing provisions of one contract may refer to experience on other contracts and, therefore, raise the question of whether, in substance, one contract rather than several contracts exist.**

The inconsistency that could result from varying interpretations of the term *contract* is limited by requiring that features of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. Therefore, if agreements with the reinsurer or related reinsurers, in the aggregate, do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured.

As historical background, the guidance for SSAP No. 62R, Exhibit A, question 10, originated from *GAAP EITF Topic D-34, Accounting for Reinsurance: Questions and Answers about FASB Statement No. 113* (EITF D-34) NAIC staff recommends that the Working Group move this item to the active listing of the maintenance agenda, categorized as a SAP clarification, and expose revisions to *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*. The proposed revisions incorporate guidance to SSAP No. 61R which is consistent with the guidance currently in SSAP No. 62R, Exhibit A Implementation Questions and Answers, question 10 and also add

reference to A-791, paragraph 6 guidance in the YRT guidance paragraph. (See Authoritative Literature in the agenda item). FASB Statement No. 113 was adopted with modification in both SSAP No. 62R and SSAP No. 61R. Topic 944 Reinsurance Contracts in the current FASB Codification Implementation Guide continues to include the guidance from EITF D-34

The example reinsurance contract that VAWG observed contained yearly renewable term reinsurance. Per SSAP No. 61R, paragraph 19, only certain parts of *A-791 Life and Health Reinsurance Agreements* apply to YRT contracts. Specifically, YRT contracts only have to pass A-791, paragraphs 2.b., 2.c., 2.d., 2.h., 2.i., 2.j. or 2.k. to result in reinsurance accounting. In addition, paragraph 3 of A-791 on deferral of gain on cession of prior year blocks of business also applies. As described above, YRT contracts do not transfer all of the risk inherent in the contract as they typically only cover a percentage of the net amount at risk for typically one year. Note that the reinsurance accounting credit from a YRT contract per the guidance in SSAP No. 61R, paragraph 37 is computed as the one-year term mean reserve on the amount of insurance ceded. Therefore, a YRT credit is typically less than what a proportional coinsurance contract which transfers all significant risks would typically provide.

The VAWG reinsurance contract example also included coinsurance contracts which must pass all of A-791 to receive reinsurance accounting. The example contract contained a shared experience refund between the two contract types. This interdependent feature is a key element. NAIC staff agrees with VAWG that an interdependent reinsurance payment in a contract requires a single risk transfer assessment. However, the combined interdependent contract when assessed in aggregate would likely cause it to either not meet the conditions for reinsurance accounting or would result in a smaller reinsurance credit than VAWG observed some entities taking.

A-791, paragraph 2e contains the guidance which limits the amounts paid to the reinsurer to the income realized on the underlying reinsured policy and paragraph 2f contains the guidance on transferring all the significant risk of the business reinsured. Adding YRT coverage with coinsurance would likely result in a “fail” of the criteria in A-791 because not all of the significant risks of the underlying reinsured policies would be likely to be passed to the reinsurer (thus failing the criteria in A-791, paragraph 2f). Combining YRT and coinsurance in the same contract could also cause that contract to fail A-791 if the reinsurance contract charged more than the income on the underlying policy.

In addition, A-791, paragraph 6 requires that the reinsurance contract include provisions that the agreement shall constitute the entire agreement between the parties with respect to the business being reinsured thereunder and that there are no understandings between the parties other than as expressed in the agreement. This paragraph does not currently apply to YRT but is being recommended to apply.

Recommendation:

**NAIC staff recommends that the Working Group move this item to the active listing of the maintenance agenda, categorized as a SAP clarification, and expose revisions to SSAP No. 61R—*Life, Deposit-Type and Accident and Health Reinsurance* as illustrated below. The proposed revisions incorporate guidance to SSAP No. 61R which is consistent with the guidance currently in SSAP No. 62R, Exhibit A Implementation Questions and Answers, question 10 and also add reference to A-791, paragraph 6 guidance in the YRT guidance paragraph.**

As described in the summary of issues, NAIC staff agrees that risk transfer analysis of a reinsurance contract or contracts with interdependent features that directly or indirectly compensate the reinsurer, requires that all parts of the contract be evaluated in aggregate. Appendix A-791, paragraph 6 already contains guidance that the agreement must constitute the entire agreement. **While NAIC staff agrees with the concern that VAWG raised regarding some entities taking too large of a reinsurance credit, the existing guidance in SSAP No. 61R regarding risk transfer requires that reporting entities should not take reinsurance credit for amounts greater than the risk ceded should be sufficient to address those concerns. However, NAIC staff would be willing to develop a more extensive implementation guidance or other revisions if desired.**

SSAP No. 61R proposed revisions:

#### Transfer of Risk

17. Reinsurance agreements must transfer risk from the ceding entity to the reinsurer in order to receive the reinsurance accounting treatment discussed in this statement. If the terms of the agreement violate the risk transfer criteria contained herein, (i.e., limits or diminishes the transfer of risk by the ceding entity to the reinsurer), the agreement shall follow the guidance for Deposit Accounting. In addition, any contractual feature that delays timely reimbursement violates the conditions of reinsurance accounting.

18. For purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract, is essentially a question of substance. It may be difficult in some circumstances to determine the boundaries of a contract. For instance, the profit-sharing provisions of one contract may refer to experience on other contracts and, therefore, raise the question of whether, in substance, one contract rather than several contracts exist. The inconsistency that could result from varying interpretations of the term contract is limited by requiring that features of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. Therefore, if agreements with the reinsurer or related reinsurers, in the aggregate, do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured.

19. This paragraph applies to all life, deposit-type and accident and health reinsurance agreements except for yearly renewable term reinsurance agreements and non-proportional reinsurance agreements such as stop loss and catastrophe reinsurance. All reinsurance agreements covering products that transfer significant risk shall follow the guidance for reinsurance accounting contained in this statement. All reinsurance contracts covering products that do not provide for sufficient transfer of risk shall follow the guidance for Deposit Accounting.

20. Yearly renewable term (YRT) reinsurance agreements that transfer a proportionate share of mortality or morbidity risk inherent in the business being reinsured and do not contain any of the conditions described in Appendix A-791, paragraphs 2.b., 2.c., 2.d., 2.h., 2.i., 2.j. or 2.k., shall follow the guidance for reinsurance accounting, including paragraphs 55-57 of this statement that apply to indemnity reinsurance. Contracts that fail to meet the requirements for reinsurance accounting shall follow the guidance for Deposit Accounting. For all treaties entered into on or after January 1, 2003, the deferral guidance in paragraph 3 of A-791 shall also apply to YRT agreements. YRT agreements shall follow the requirements of A-791, paragraph 6 regarding the entire agreement and the effective date of agreements. Since YRT agreements only transfer the mortality or morbidity risks to the reinsurer, the recognition of income shall be reflected on a net of tax basis, as gains emerge based on the mortality or morbidity experience.

#### **The comment letters are included in Attachment 2.5 (8 pages).**

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2024/03-16-24SpringNationalMeeting/Hearing-Packet2/2.0-03-2024-SAPWGHearingAgenda2.docx>

## Exposed Revisions to SSAP No. 21R at SAPWG Meeting on Feb. 20, 2024

### Summary of Revisions:

1. Paragraphs 21, 22, 24 and 24: Minor clarifying/corresponding edits.
2. Paragraphs 28-29: Revisions bring in the adopted residual definition from SSAP No. 43R and SSAP No. 48. The last sentence in paragraph 29 is new and specifically addresses residuals: “Additionally, it would be expected that the equity position in an ABS Issuer, as defined in SSAP 26R, would be classified as a residual tranche.”
3. Paragraph 30: Revisions eliminate the descriptions and SSAP locations for the definition of residuals and specify that residuals, per the paragraph 28-29 definition, shall be accounted and reported in accordance with the guidance in SSAP No. 21R.
4. Paragraphs 31: Revisions replace “securitization” with “structure” to broadly reference all residuals that could be captured within the guidance.
5. Paragraph 32: Revisions clarify that residuals shall either be accounted for 1) at the lower amortized cost or fair value, with amortized cost calculated under the allowable earned yield method, or 2) under the practical expedient method, which reflects a return of principal concept.
6. Paragraphs 33 & 34: Revisions reflect terminology changes, to refer to the allowable earned yield method as amortized cost rather than BACV.
7. Paragraph 34 (Deleted): Revisions eliminate the guidance that directed reclassification of residual tranches to other SSAPs/reporting schedules in situations when residual tranches cease to meet the definition of a residual tranche. (For example, in situations in which the senior debt has been repaid.) It is not customary to reclassify investments under statutory accounting principles, and in speaking with interested party representatives, any such situations are likely not to be material and will not continue for extended periods of time. As the reclassification would introduce a number of financial statement reporting questions (as the residual would have to be disposed and then reacquired on the subsequent schedule) and as investment classification generally only occurs at acquisition, the guidance has been eliminated. With this deletion, if a residual is classified as a residual, it would remain with that classification and follow the SSAP No. 21R guidance until it is disposed by the reporting entity.
8. Paragraph 36: Revisions separate the OTTI calculation between those items measured at the allowable earned yield method and those that follow the practical expedient. (The original guidance would have required those companies that follow the practical expedient to calculate the allowable earned yield for determining OTTI, which would defeat the purpose of selecting the practical expedient.) Revisions then clarify terminology to reference amortized cost for the allowable earned yield method and BACV for OTTI under the practical expedient.
9. Paragraph 37: Revisions incorporate transition guidance for residuals that were accounted for under a different SSAP as of December 31, 2024. The transition guidance addresses situations in which the residual was previously accounted for at the lower of amortized cost or fair value as well as situations in which the residuals were previously accounted for at equity value or fair value.
10. Paragraph 41: Revisions prescribe the Jan. 1, 2025, effective date, permitting early application of the residual guidance.

**SSAP No. 21R—Other Admitted Assets**

*Debt Securities That Do Not Qualify as Bonds*

20. The guidance within paragraphs 20-28 of this statement shall apply for any security, as defined in *SSAP No. 26R—Bonds*, whereby there is a fixed schedule for one or more future payments (referred to herein as debt securities), but for which the security does not qualify for bond reporting under SSAP No. 26R as an issuer credit obligation or an asset backed security. Investments in scope of this guidance are limited to:

- a. Debt securities for which the investment does not reflect a creditor relationship in substance.
- b. Debt securities that do not qualify for bond reporting due to a lack of substantive credit enhancement.
- c. Debt securities that do not qualify for bond reporting due solely to a lack of meaningful cash flows.

21. Debt securities as described in this statement meet the definition of assets as defined in SSAP No. 4 and are admitted assets to the extent they conform to the requirements of this statement. The guidance in these paragraphs shall not be inferred to other securities or investment structures that are not otherwise addressed in statutory accounting, nor shall it be applied to any investments that are captured within other statutory accounting guidance.

22. Debt securities in scope of this standard that do not qualify as bonds under SSAP No. 26R and for which the primary source of repayment is derived through rights to underlying collateral, qualify as admitted assets if the underlying collateral primarily qualify as admitted invested assets. As detailed in paragraph 29, in the section pertaining to residual tranches, any residual tranches or first loss positions held from the same securitization that did not qualify as a bond under SSAP No. 26R also only qualify as admitted assets to the extent the underlying collateral primarily qualifies as admitted invested assets.

23. Debt securities in scope of this statement shall be initially reported at acquisition at cost, including brokerage and other related fees on *Schedule BA: Other Long-Term Invested Assets*.

24. Debt securities captured in scope of this statement shall be reported at the lower of amortized cost or fair value. Changes in measurement to reflect a lower value or to reflect changes in fair value shall be recorded as unrealized gains or losses.

25. Debt securities that do not qualify as bonds in the scope of this statement shall follow the guidance in *SSAP No. 43R—Asset-Backed Securities* for calculating amortized cost, for determining and recognizing other-than-temporary impairments and for allocating unrealized and realized gains and losses between the asset valuation reserve (AVR) and interest maintenance reserve (IMR).

26. Investment income shall be recorded, with assessments for collectability and nonadmittance completed and recognized, pursuant to *SSAP No. 34—Investment Income Due and Accrued*.

27. Securities captured within this section shall be included in all invested asset disclosures, along with the following disclosures:

- a. Fair values in accordance with *SSAP No. 100R—Fair Value*.
- a. Concentrations of credit risk in accordance with SSAP No. 27;

- b. Basis at which the securities are stated;
- c. The adjustment methodology used for each type of security (prospective or retrospective);
- d. Descriptions of sources used to determine prepayment assumptions.
- e. All securities within the scope of this statement with a recognized other-than-temporary impairment, disclosed in the aggregate, classified on the basis for the other-than-temporary impairment: (1) intent to sell, (2) inability or lack of intent to retain the investment in the security for a period of time sufficient to recover the amortized cost basis, or (3) present value of cash flows expected to be collected is less than the amortized cost basis of the security.
- f. For each security with an other-than-temporary impairment, recognized in the current reporting period by the reporting entity, as the present value of cash flows expected to be collected is less than the amortized cost basis of the securities:
  - i. The amortized cost basis, prior to any current-period other-than-temporary impairment.
  - ii. The other-than-temporary impairment recognized in earnings as a realized loss.
  - iii. The fair value of the security.
  - iv. The amortized cost basis after the current-period other-than-temporary impairment.
- g. All impaired securities (fair value is less than cost or amortized cost) for which an other-than-temporary impairment has not been recognized in earnings as a realized loss (including securities with a recognized other-than-temporary impairment for non-interest related declines when a non-recognized interest related impairment remains):
  - v. The aggregate amount of unrealized losses (that is, the amount by which cost or amortized cost exceeds fair value) and
  - vi. The aggregate related fair value of securities with unrealized losses.
- h. The disclosures in (i) and (ii) above should be segregated by those securities 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.
- i. 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.
- j. When it is not practicable to estimate fair value, the investor should disclose the following additional information, if applicable:
  - 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.

- k. For securities sold, redeemed, or otherwise disposed as a result of a callable feature (including make whole call provisions), disclose the number of CUSIPs sold, disposed or otherwise redeemed and the aggregate amount of investment income generated as a result of a prepayment penalty and/or acceleration fee.

*Residual Tranches or Interests/Loss Positions*

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

29. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined. Additionally, it would be expected that the equity position in an ABS Issuer, as defined in SSAP 26R, would be classified as a residual tranche.

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

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



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

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

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

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

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

- a. Reporting entities applying the practical expedient shall continue to report residuals on Schedule BA, including those with a zero BACV. Any subsequent distributions shall be reported as interest income until the structure matures/terminates, is unwound, or no longer meets the definition of a residual.
- b. Reporting entities are required to apply the practical expedient to all residuals held.
- c. Reporting entities that wish to discontinue use of the practical expedient approach and move towards the Allowable Earned Yield method are required to specify and disclose an explicit transition date, and only apply the Allowable Earned Yield method to residuals acquired after that date. Residuals held prior to the disclosed accounting method transition date shall continue to follow the practical expedient until those residuals mature/terminate or are unwound.

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

- a. For residuals measured using the Allowable Earned Yield method, as detailed in paragraphs 33-34, an OTTI shall be considered to have occurred if the present value of expected cash flows

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

- b. For residuals measured under the practical expedient, as detailed in paragraph 35, an OTTI shall be considered to have occurred if the fair value of the residual is less than the BACV. The reporting entity shall recognize a realized loss equal to the difference between the fair value and the BACV, with the fair value becoming the new BACV. After the OTTI is recognized, distributions received from the residual shall continue to be recorded in accordance with paragraph 33. Subsequent recoveries in cash flows shall not result in increases to the BACV.

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

- a. Reporting entity shall determine whether they will follow the Allowable Earned Yield method detailed in paragraphs 33-34, or the practical expedient detailed in paragraph 35, for all residuals.
- b. Residuals previously accounted for under SSAP No. 26R or SSAP No. 43R shall prospectively apply the Allowable Earned Yield measurement method elected under this Statement using the amortized cost as of December 31, 2024 as the starting point in the calculation. Residuals that will follow the practical expedient shall be recognized on January 1, 2025 at the lower of amortized cost or fair value as of December 31, 2024, realizing any unrealized loss existing at that date.
- c. Residuals reported under the equity method or fair value as of December 31, 2024 (as they were previously captured in scope of SSAP No. 30R, 32R or 48) with unrealized gains or losses recognized, shall recognize any unrealized position as realized, with the reported value as of December 31, 2024 becoming the January 1, 2025 cost basis for subsequent measurement under this statement.

### Effective Date and Transition

40. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The guidance for structured settlements when the reporting entity acquires the legal right to receive payments is effective December 31, 2018.

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

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

**Issue:** Review of INT 03-02: *Modification to an Existing Intercompany Pooling Arrangement*

**Check (applicable entity):**

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Description of Issue:**

This agenda item provides a review of Interpretation (INT) 03-02: *Modification to an Existing Intercompany Pooling Arrangement*, because of conflicts between INT 03-02 and *SSAP No. 25—Affiliates and Other Related Parties*. This agenda item was prompted by the recent focus of Statutory Accounting Principles (E) Working Group on related party transactions, recent queries to NAIC about how broadly to apply the guidance in INT 03-02 and the review of the SSAP No. 62R, paragraph INT 03-02 addresses the valuation of bonds in instances when bonds are used instead of cash for the payment among affiliates for amounts due on modifications to existing intercompany reinsurance pooling contracts. The discrepancy between the INT 03-02 and SSAP No. 25 has been identified through recent discussions evaluating related party transactions. Key excerpts of INT 03-02 are in the Authoritative Literature section below.

The primary accounting question that is a concern for this agenda item is INT 03-02, paragraph 11b which asks, “What is the appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement?” The response provided in INT 03-02, paragraph 13 is, “The appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement is statutory book value for assets and statutory value for liabilities. Book value is defined in the glossary of the *Accounting Practices and Procedure Manual*.”

INT 03-02 lists that it is an interpretation of the following three reinsurance statements: *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*, *SSAP No. 62R—Property and Casualty Reinsurance* and *SSAP No. 63—Underwriting Pools*. *SSAP No. 25—Affiliates and Other Related Parties* is not listed as an interpreted statement. However, as described below, the consensus in INT 03-02, paragraph 13 is not consistent with the guidance in SSAP No. 25 regarding economic transactions between related parties.

The result of the consensus in INT 03-02, paragraph 13 allows assets used in affiliated payments for reinsurance contracts, which modify existing intercompany reinsurance pooling agreements, to be transferred using statutory book value. Note that in most cases, this means that bonds which are likely the primary assets that would be used, would typically have a statutory book value that reflects amortized cost. The valuation of assets using statutory book value on transfer to an affiliate, can result in substantial differences from the cash equivalent (fair value) for the payment due. For example, bonds reported at amortized cost book value could have a corresponding fair value that is materially higher or lower. This difference in valuation can result in an unacknowledged dividend or with the passing on of an investment loss.

SSAP No. 25 describes economic transactions and non-economic transactions (See Authoritative Literature). Economic transactions are defined as arm’s-length transactions which results in the transfer of the risks and rewards of ownership and represents a consummated act thereof, i.e., “permanence.” SSAP No. 25, paragraph 18 indicates that economic transactions between related parties shall be recorded at fair value at the date of the transaction and also notes that to the extent that the related parties are affiliates under common control, the controlling reporting

entity shall defer the effects of such transactions that result in gains or increases in surplus until such time that the asset is sold outside the group.

It is quite possible, by using transfers at book value instead of fair value, to design a transaction with a very significant economic effect. The following example illustrates the concern with the results of the guidance in INT 03-02. For this example, \$100 million is due on an existing intercompany reinsurance pooling agreement. INT 03-02 would allow bonds to be settled using statutory book value which may not be reflective of the fair value equivalent of a cash settlement.

Asset used to settle	Book Value (millions) measurement for settlement	Fair Value (millions)	Result	Consistent with SSAP No. 25 for an economic transaction?
Cash	\$100	\$100	No difference in basis	Yes
Bonds	\$100	\$ 85	\$15 difference in fair value means the paid party received an amount less than what is actually owed. This approach could allow reporting entities to transfer impaired assets to affiliates in lieu of assessing OTTI.	No
Bonds	\$100	\$110	\$10 difference in fair value means the paid party has received an asset greater than what was owed. This dynamic could result in an unrecognized gain or dividend.	No

The INT 03-02 direction to use statutory book value for the transfer of bonds between affiliated entities in most instances would conflict with the primary guidance on affiliated transactions contained in *SSAP No. 25—Affiliates and Other Related Parties*. For example, economic transactions between related parties are valued using fair value. (There are more nuances in SSAP No. 25 when payments have the possibility of being economic for one entity and noneconomic for an upper-level parent). NAIC staff recommends that the treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different if assets are transferred instead of cash for intercompany reinsurance.

Under INT 03-02, for intercompany reinsurance transactions, takes an approach that either SSAP No. 25 or SSAP No. 62R may apply, but multiple Working Group discussions have noted that SSAP No. 25 provides the overarching guidance that is relevant in evaluating all related party transactions. INT 03-02, paragraph 8 indicates that the statutory accounting intention is to avoid surplus gains for the ceding entity as a result of implementing a modification to an intercompany pooling arrangement. However, the guidance in SSAP No, 62R, paragraph 37 uses a more punitive method of accounting if there is a gain in surplus to the ceding entity as a result of the intercompany reinsurance transaction. Therefore, NAIC staff would characterize the SSAP No. 62R guidance as imposing an accounting penalty if there is a gain, rather than seeking to avoid recognizing such a gain. The INT also characterizes SSAP No. 25 as being for isolated transactions, which is inconsistent with discussions of the Working Group on the applicability of SSAP No. 25.

SSAP No. 62R, paragraph 36d (see Authoritative Literature) includes an exception to retroactive reinsurance accounting which allows prospective accounting treatment for intercompany reinsurance agreements and any amendments thereto, among companies 100% owned by a common parent or ultimate controlling person provided there is no gain in surplus as a result of the transaction. Paragraph 37 provides that if there is a gain to the ceding entity that a more restrictive method of accounting is required which is less beneficial to the financial statements. Whereas the INT tries to argue that statutory intent is to avoid surplus gain, NAIC staff would note that the goal is not to avoid gain as a result of the reinsurance transaction, but to impose a different accounting if there is a gain.

NAIC staff would characterize evaluating reinsurance agreements for SSAP No. 62R, paragraph 36d or paragraph 37 as using the cash flows or corresponding equivalent fair value (cash equivalent) of the amounts payable or receivable in the reinsurance transactions to determine if there is a gain or loss to the ceding entity. The reinsurance cash flows evaluated should be the same as if the bond was sold for fair value and resulting cash equivalent obligation was paid. The fact that the bond sold has a gain or loss is not part of the reinsurance contract evaluation, the reinsurance contract that is an economic transaction evaluation is based on the cash equivalent value of the assets transferred less the liabilities transferred. The evaluation of gain or loss on the intercompany reinsurance transaction should give the same answer if either cash or assets were transferred.

### **Existing Authoritative Literature:**

03-02: *Modification to an Existing Intercompany Pooling Arrangement* is attached in full. The following excerpts are from INT 03-02:

8. Therefore, based on the foregoing guidance and background, the statutory accounting intent is to avoid surplus gains for the ceding entity as a result of implementing a modification to an intercompany pooling arrangement. On that basis, such a modification does not represent an economic transaction to the insurance group or to the impacted companies. As such, the transfer of both the assets and the liabilities valued at statutory book value ensures that there is no impact to surplus as a result of implementing a modification to an existing pooling arrangement.
11. The accounting issues are:
  - a. What is the relevant guidance for modifications to intercompany pooling arrangements?
  - b. What is the appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement?

The Working Group reached a consensus as follows:

12. SSAP No. 62R provides accounting for property and casualty reinsurance agreements including specific guidance on intercompany pooling agreements. SSAP No. 62R provides two methods of accounting for changes in intercompany pooling agreements, depending on whether or not the pooling results in a gain in surplus.

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

### *SSAP No. 25—Affiliates and Other Related Parties*

#### **Transactions Involving the Exchange of Assets or Liabilities**

14. An arm's-length transaction is defined as a transaction in which willing parties, each being reasonably aware of all relevant facts and neither under compulsion to buy, sell, or loan, would be willing to participate. A transaction between related parties involving the exchange of assets or liabilities shall be designated as either an economic transaction or non-economic transaction. An economic transaction is defined as an arm's-length transaction which results in the transfer of the risks and rewards of ownership and represents a consummated act thereof, i.e., "permanence." The appearance of permanence is also an important criterion in assessing the economic substance of a transaction. In order for a transaction to have economic substance and thus warrant revenue (loss) recognition, it must appear unlikely to be reversed. If subsequent events or transactions reverse the effect of an earlier transaction prior to the issuance of the financial statements, the reversal shall be considered in determining whether economic substance existed

in the case of the original transaction. Subsequent events are addressed in SSAP No. 9—Subsequent Events. An economic transaction must represent a bonafide business purpose demonstrable in measurable terms. A transaction which results in the mere inflation of surplus without any other demonstrable and measurable betterment is not an economic transaction. The statutory accounting shall follow the substance, not the form of the transaction.

15. In determining whether there has been a transfer of the risks and rewards of ownership in the transfer of assets or liabilities between related parties, the following—and any other relevant facts and circumstances related to the transaction—shall be considered:

- a. Whether the seller has a continuing involvement in the transaction or in the financial interest transferred, such as through the exercise of managerial authority to a degree usually associated with ownership;
- b. Whether there is an absence of significant financial investment by the buyer in the financial interest transferred, as evidenced, for example, by a token down payment or by a concurrent loan to the buyer;
- c. Whether repayment of debt that constitutes the principal consideration in the transaction is dependent on the generation of sufficient funds from the asset transferred;
- d. Whether limitations or restrictions exist on the buyer's use of the financial interest transferred or on the profits arising from it;
- e. Whether there is retention of effective control of the financial interest by the seller.

16. A transaction between related parties may meet the criteria for treatment as an economic transaction at one level of financial reporting, but may not meet such criteria at another level of financial reporting. An example of such a transaction is a reporting entity purchasing securities at fair value from an affiliated reporting entity that carried the securities at amortized cost. This transaction meets the criteria of an economic transaction at this level of financial reporting, and therefore, the selling reporting entity would record a gain and the acquiring reporting entity would record the securities at their cost (fair value on the transaction date). At the common parent level of reporting, this transaction has resulted in the mere inflation of surplus, and therefore, is a non-economic transaction. The parent reporting entity shall defer the net effects of any gain or increase in surplus resulting from such transactions by recording a deferred gain and an unrealized loss. The deferred gain shall not be recognized by the parent reporting entity unless and until arms-length transaction(s) with independent third parties give rise to appropriate recognition of the gain.

17. A non-economic transaction is defined as any transaction that does not meet the criteria of an economic transaction. Similar to the situation described in paragraph 16, transfers of assets from a parent reporting entity to a subsidiary, controlled or affiliated entity shall be treated as non-economic transactions at the parent reporting level because the parent has continuing indirect involvement in the assets.

18. When accounting for a specific transaction, reporting entities shall use the following valuation methods:

- a. Economic transactions between related parties shall be recorded at fair value at the date of the transaction. To the extent that the related parties are affiliates under common control, the controlling reporting entity shall defer the effects of such transactions that result in gains or increases in surplus (see paragraph 16);
- b. Non-economic transactions between reporting entities, which meet the definition of related parties above, shall be recorded at the lower of existing book values or fair values at the date of the transaction;
- c. Non-economic transactions between a reporting entity and an entity that has no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, shall be recorded at the fair value at

the date of the transaction; however, to the extent that the transaction results in a gain, that gain shall be deferred until such time as permanence can be verified;

- d. Transactions which are designed to avoid statutory accounting practices shall be reported as if the reporting entity continued to own the assets or to be obligated for a liability directly instead of through a subsidiary.

Examples of transactions deemed to be non-economic include security swaps of similar issues between or among affiliated companies, and swaps of dissimilar issues accompanied by exchanges of liabilities between or among affiliates.

### Transactions Involving Services

19. Transactions involving services between related parties can take a variety of different forms. One of the significant factors as to whether these transactions will be deemed to be arm's length is the amount charged for such services. In general, amounts charged for services are based either on current market rates or on allocations of costs. Determining market rates for services is difficult because the circumstances surrounding each transaction are unique. Unlike transactions involving the exchange of assets and liabilities between related parties, transactions for services create income on one party's books and expense on the second party's books, and therefore, do not lend themselves to the mere inflation of surplus. These arrangements are generally subject to regulatory approval.

20. Transactions involving services provided between related parties shall be recorded at the amount charged<sup>1</sup>. Regulatory scrutiny of related party transactions where amounts charged for services do not meet the fair and reasonable standard established by Appendix A-440, may result in (a) amounts charged being recharacterized as dividends or capital contributions, (b) transactions being reversed, (c) receivable balances being nonadmitted, or (d) other regulatory action. Expenses that result from cost allocations shall be allocated subject to the same fair and reasonable standards, and the books and records of each party shall disclose clearly and accurately the precise nature and details of the transaction. See *SSAP No 70—Allocation of Expenses* for additional discussion regarding the allocation of expenses.

*SSAP No. 62R—Property and Casualty Reinsurance* provides the following (**bolding added for emphasis**):

36. The accounting principles for retroactive reinsurance agreements in paragraph 34 shall not apply to the following types of agreements (which shall be accounted for as prospective reinsurance agreements unless otherwise provided in this statement):

- a. Structured settlement annuities for individual claims purchased to implement settlements of policy obligations;
- b. Novations, (i.e., (i) transactions in which the original direct insurer's obligations are completely extinguished, resulting in no further exposure to loss arising on the business novated or (ii) transactions in which the original assuming entity's obligations are completely extinguished) resulting in no further exposure to loss arising on the business novated, provided that (1) the parties to the transaction are not affiliates (or if affiliates, that the transaction has the prior approval of the domiciliary regulators of the parties) and (2) the accounting for the original reinsurance agreement will not be altered from retroactive to prospective;

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<sup>1</sup> The amount charged shall be reviewed when there are any modifications or waivers subsequent to the establishment of the contract terms. If waivers or modifications to amounts charged occur, the related party transaction shall be reassessed to determine whether the contract continues to reflect fair and reasonable standards. If the transaction was with a parent or other stockholder and the charge for services has been fully waived, then the guidance in *SSAP No. 72* for recognition as contributed capital (forgiveness of reporting entity obligation) or as a dividend (forgiveness of amount owed to the reporting entity) shall apply.

- c. The termination of, or reduction in participation in, reinsurance treaties entered into in the ordinary course of business;
  - d. **Intercompany reinsurance agreements, and any amendments thereto, among companies 100% owned by a common parent or ultimate controlling person provided there is no gain in surplus as a result of the transaction; or**
  - e. Reinsurance/retrocession agreements that meet the criteria of property/casualty run-off agreements described in paragraphs 102-105.
37. **Retroactive reinsurance agreements resulting in surplus gain to the ceding entity (with or without risk transfer)** entered into between affiliates or between insurers under common control (as those terms are defined in Appendix A-440) shall be reported as follows:
- a. The consideration paid by the ceding entity shall be recorded as a deposit and reported as a nonadmitted asset; and
  - b. No deduction shall be made from loss and loss adjustment expense reserves on the ceding entity's balance sheet, schedules, and exhibits.

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

INT 03-02 was exposed in March of 2003 and adopted in June 2003. The interpretation was not subsequently amended. The final vote on this consensus had three members opposed. The March 2003 exposure received six different comment letters to the Emerging Accounting Issues (E) Working Group from: 1) Ohio (EAIWG member); 2) New Hampshire (EAIWG member); 3) Interested parties, 4) Liberty Mutual and 5) PriceWaterhouseCoopers (one of the very few letters ever submitted directly by the firm.) and 6) CNA. Five out of the six commenters noted concerns that the proposed guidance (which was ultimately adopted) would conflict with SSAP No. 25 guidance regarding economic transactions. While the interested parties comment letter was more neutral, the verbal comments provided supported the use of SSAP No. 25.

Several commenters recommended not adopting the guidance regarding the use of book value and instead following SSAP No. 25 guidance for economic and non-economic transactions. The commenters noted that SSAP No. 25 directs the use of fair value when such transactions meet the definition of an economic transactions and that tax regulations would provide a result similar to SSAP No. 25. Multiple comments noted concerns similar to those highlighted in the illustration above. Commenters also noted that intercompany pooling reinsurance transaction are economic transactions. They noted that when assets (such as bonds valued at amortized cost) are transferred, if the assets have a different fair value than book value, that difference should be recognized since the transferor no longer controls the assets. Commenters also noted that treatment for reinsurance transactions for asset transfers should not be different than the treatment for other intercompany transactions.

CNA comments were supportive of adopting the exposed consensus, the comment letter provided illustrations and noted that intercompany reinsurance agreements were subject to regulatory approval. The comments tried to illustrate concerns possibly having premature gain / surplus recognition. .

The June 2003 minutes Emerging Accounting Issues (E) Working Group discussion on the INT 03-02 are excerpted below.

The working group was referred to INT 03-02: *Modification to an existing intercompany pooling arrangement* (Attachment D). Written comments were received from Ohio, New Hampshire and interested parties. Ohio and New Hampshire believe that the transfer of assets and liabilities in an intercompany pooling arrangement constitute an economic transaction and the accounting guidance in SSAP No. 25—*Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties* (SSAP No. 25), should be followed. As such, the assets should be transferred at fair value and the ceding entity should record a



realized gain or loss. Keith Bell (Travelers) spoke on behalf of interested parties. Interested parties commented that if the transaction was considered to be an economic transaction, SSAP No. 25 should be followed. If the modification of an intercompany pooling arrangement is considered a noneconomic transaction, the guidance in SSAP No.62—*Property and Casualty Reinsurance*(SSAP No. 62) is applied, as such, statutory book value should be used for assets and statutory value should be used for liabilities. Jeff Alton (CNA) presented his comments by summarizing the statements made in his comment letter. Mr. Alton stated that no revenue recognition should occur and suggested using a modified statutory book value for transferring assets and liabilities. Mr. Clark stated that the Statutory Accounting Principles Working Group must address the recommended transfer at modified statutory book value as this recommendation would require substantive adjustments to statutory accounting principles. Shelly Zimmerman (Liberty Mutual) provided comments which supported that intercompany pooling changes should follow the accounting guidance in SSAP No. 25 as these are economic transactions between affiliates. Jean Connelly (PriceWaterhouseCoopers) provided comments that summarize those outlined in the comment letter. Ms. Connelly stated that intercompany pooling arrangements are economic transactions and that INT 03-01 provides a substantive change to SSAP No. 25.

Mr. Johnson then stated that he believes there is a stronger case for non-economic transaction treatment and as such, statutory book value is appropriate for valuation purposes. Additionally, all these transactions are subject to regulatory review under the Insurance Holding Company Act, affording regulators some control over the approval of these transactions. Mr. Fritsch commented that if this guidance is not adopted in the form of a new interpretation, SSAP No. 25 should be followed. Mr. Alton stated that he believes the current guidance in effect for intercompany pooling arrangements exists in SSAP No. 62, paragraph 30d which supports surplus neutrality: hence, the need is for an interpretation of paragraph 30d. Mr. Johnson stated that language clarification in SSAP No.61—*Life, Deposit-Type and Accident and Health Reinsurance*(SSAP No. 61) and SSAP No. 62 should be addressed as a project of the reinsurance subgroup of the SAPWG. Mr. Johnson made a motion to adopt Interpretation 03-02 with deletion of the first two sentences in paragraph 11. Mr. Stolte seconded the motion. Mr. Johnson requested a roll call vote. There were 9 yeas from Alabama, Connecticut, Florida, Illinois, Louisiana, Michigan, Texas, Pennsylvania and Virginia. There were 3 nays from New York, Ohio, and Wisconsin. Therefore, the working group adopted Interpretation 03-02 by consensus. Mr. Johnson also made a motion to refer to the Reinsurance Subgroup of the SAPWG, review of the current guidance in SSAP No. 61, SSAP No. 62 and SSAP No. 63—*Underwriting Pools and Associations Including Intercompany Pools*. Mr. Ford seconded the motion. The working group unanimously adopted the referral.

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

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

**Staff Review Completed by:** Robin Marcotte – NAIC Staff, July - 2022

**Staff Recommendation:** NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose the intent to nullify INT 03-02, as it is inconsistent with SSAP No. 25 guidance regarding economic and non-economic transactions between related parties. The guidance in INT 03-02 can result with in essence, unrecognized gains (dividends) or losses through the using the statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements. Treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions.

**Status:**

On August 10, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed the intent to nullify INT 03-02.

On December 13, 2022, the Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and re-exposed the intent to nullify INT 03-02. This re-exposure requested industry to provide comments on specific instances in which the interpretation was being applied. In addition, the following key points were noted for consideration during the exposure in response to some of the comments received.

1. In the current interest rate environment, the fair value of many bonds is below book value. For example, a bond with an amortized cost of 100 with a fair value of 85. The way INT 03-02 is written a bond with a fair value of 85 could be used to settle an intercompany reinsurance pooling obligation of 100. If the reporting entity paid with cash, they would be required to pay \$100. The actual cash value of obligations when they are extinguished is a relevant measure of the transaction.
2. Using book value for measurement of payments between affiliates can result in either unrecognized of in effect dividend or losses. SSAP No. 25 requires such transfers of assets between affiliates to use fair value. If a subsidiary can pay the parent with assets that have a lower fair value than book value (ex, owes \$100 but pays with a bond of 85), this has a similar effect as an unrecognized capital contribution to the subsidiary. SSAP No. 72 requires a capital contribution to be valued using fair value.
3. At the ultimate parent level such transfer of assets (in accordance with SSAP No. 25 guidance) may be noneconomic in that the parent continues to hold an interest in the same assets. Therefore, at the parent level, such transfers of assets may result in the deferral of gains. Staff believes that losses would not be deferred at the ultimate parent level.
4. While it may be more expedient to pay intercompany reinsurance pooling transactions with assets, the valuation used should be similar to if the obligation was extinguished with cash. Therefore, an entity can still choose to pay with assets, they just need to be valued consistently with SSAP No. 25 guidance.
5. SSAP No. 62R, paragraph 36d provides an exception to retroactive reinsurance accounting guidance which allows for prospective accounting treatment for intercompany reinsurance among 100% owned affiliated provided there is no gain to the ceding entity. If there is again to the ceding entity, there is guidance in SSAP No. 62R, paragraph 37 which requires a more punitive method of accounting than either prospective or retroactive reinsurance accounting. Therefore, NAIC staff comment is that the statutory accounting objective is to provide different treatment for retroactive reinsurance contracts if there is a gain to the ceding entity. This is another reason that the guidance in INT 03-02 is problematic. The object is to correctly measure the effects of the contract, which drives the accounting. The objective is not to obscure whether there is a gain to the ceding entity, which can happen in the event that the assets used in payment are not measured correctly.
6. Interested parties noted that modifications to intercompany pooling arrangements are typically effective retroactive to the beginning of the year. Staff notes that the payment value when the transaction is settled should be equivalent to the cash value of what is owed on the date of extinguishment of the liability.
7. Many of the interested parties' comments regarding GAAP use of book value are more relevant to consolidated basis accounting which is not consistent with the legal entity basis of statutory accounting.
8. Interested parties' comments noted that there is a difference in treatment for intercompany pooling participants who are not 100% owned by a common parent. NAIC staff notes that retroactive pooling agreement changes with participants that are not 100% under common control do not meet the exception to retroactive accounting provided in SSAP No. 62R, paragraph 36d. NAIC staff notes that SSAP No. 62R, paragraph 37 provides guidance for retroactive reinsurance agreements among affiliates where there is a gain to the ceding entity. Therefore, the regulatory objective is not to avoid gain but to properly account for intercompany retroactive contracts that include gains.

On March 22, 2023, the Working Group re-exposed the intent to nullify INT 03-02, effective December 31, 2023. The nullification is proposed as INT 03-02 is inconsistent with SSAP No. 25 guidance regarding economic and non-economic transactions between related parties. The guidance in INT 03-02 can result with, in essence, unrecognized gains (dividends) or losses through the using the statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements. Treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group re-exposed the intent to nullify INT 03-02 and directed NAIC staff to work with industry regarding some of their comments and examples to be submitted by industry.

On December 1, 2023, the Statutory Accounting Principles (E) Working Group deferred action on this agenda item and directed NAIC staff to continue working with interested parties on the proposal.

[https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2024/03-16-24 Spring National Meeting/Hearing - Packet 2/2.2 - 22-12 - Review INT 03-02.docx](https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2024/03-16-24SpringNationalMeeting/Hearing-Packet2/2.2-22-12-ReviewINT03-02.docx)

## Interpretation of the Emerging Accounting Issues (E) Working Group

### INT 03-02: Modification to an Existing Intercompany Pooling Arrangement

**NOTE: The Statutory Accounting Principles (E) Working Group has exposed the intent to nullify this Interpretation.**

#### INT 03-02 Dates Discussed

March 9, 2003; June 22, 2003; August 10, 2022; December 13, 2022; March 22, 2023; August 13, 2023; December 1, 2023

#### INT 03-02 References

##### **Current:**

*SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*

*SSAP No. 62R—Property and Casualty Reinsurance*

*SSAP No. 63—Underwriting Pools*

#### INT 03-02 Issue

1. Insurance groups that utilize intercompany pooling arrangements often modify these arrangements from time to time for various business reasons. These business reasons commonly include mergers, acquisitions, dispositions or a restructuring of the group's legal entity structure. As an insurance group's business objectives and strategies evolve, it may be necessary for the insurance group's legal entity structure to similarly evolve in order to address the insurance group's business needs.
2. SSAP No. 63, paragraphs 5 and 7, defines and describes intercompany pooling as an arrangement among affiliated entities whereby "all of the pooled business is ceded to the lead entity and then retroceded back to the pool participants in accordance with their stipulated shares." This arrangement is established through "a conventional quota share reinsurance agreement..." Arrangements whereby there is one lead company that retains 100% of the pooled business and all or some of the affiliated companies have a 0% net share of the pool may qualify as intercompany pooling."
3. Therefore, in order to effectuate a modification to the existing intercompany pooling arrangement, companies must either 1) amend the existing reinsurance agreement, or 2) execute new agreements. The latter scenario may entail executing at least two agreements: a commutation of the existing agreement, and a new quota share agreement(s) that covers both past and future periods.
4. To illustrate, in order to effectuate a relatively simple modification, such as changing pooling participation percentages without changing the pool participants, companies often simply amend the existing pooling agreement. Alternatively, in order to effectuate a more complex modification, such as changing (by adding or removing) the number of pool participants, a company must commute the existing pooling agreement and execute a new quota share agreement(s). In conjunction with executing the appropriate reinsurance agreements, a transfer of assets and liabilities amongst the impacted affiliates is also required in order to implement the new reinsurance agreement(s). At issue is the appropriate valuation basis to be used for assets and liabilities that are transferred pursuant to the new reinsurance agreement(s).
5. Since SSAP No. 63 does not specifically address modifications to intercompany pooling arrangements, insurance groups that modify their intercompany pooling arrangements must refer elsewhere in Statutory Accounting Principles (SAP) for relevant guidance. The obvious guidance for such transactions is SSAP No. 62R since an intercompany pooling arrangement is, by definition, affiliated

reinsurance. There is, however, a minority opinion that *SSAP No. 25—Affiliates and Other Related Parties* appears to apply due to the affiliated nature of these transactions. Since the guidance and intent of SSAP No. 62R and SSAP No. 25 provide for different valuation bases, this interpretation serves to provide definitive guidance as to which SSAP is relevant for these transactions and, therefore, clarify the appropriate valuation basis to be used for assets and liabilities transferred pursuant to a modification to an intercompany pooling arrangement.

SSAP No. 62R Approach:

6. This approach refers to the guidance and statutory accounting intent from SSAP No. 62R since intercompany pooling arrangements are defined and established through reinsurance. Further, since modifications to intercompany pooling agreements typically involve the transfer of net liabilities incurred since the inception of the existing pooling agreement (i.e., prior to the effective date of the new agreement), the retroactive reinsurance accounting guidance in paragraphs 33-39 of SSAP No. 62R is applicable. Paragraph 33 states that this special accounting treatment is warranted “due to the potential abuses involving the creation of surplus to policyholders and the distortion of underwriting results...” However, paragraph 36.d. specifically applies to intercompany reinsurance arrangements, and amendments to intercompany reinsurance agreements, since the reinsurance agreement is among companies 100% owned by a common parent. This paragraph allows prospective accounting treatment for intercompany reinsurance agreements that do not result in a gain in surplus as a result of the transaction.

7. To provide historical perspective, prior to the adoption (with modification) of FASB *Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* (FAS 113) as SAP, paragraph 36.d. was added as one of the SAP modifications. The intent of adding paragraph 36.d. was to specifically exclude intercompany reinsurance agreements among entities 100% owned by a common parent from retroactive reinsurance accounting requirements as a result of amending or modifying these agreements, provided there is no surplus gain. The presumption in this intent was that there would be no gains to the ceding entity resulting from implementing amendments or modifications to these types of reinsurance agreements.

8. Therefore, based on the foregoing guidance and background, the statutory accounting intent is to avoid surplus gains for the ceding entity as a result of implementing a modification to an intercompany pooling arrangement. On that basis, such a modification does not represent an economic transaction to the insurance group or to the impacted companies. As such, the transfer of both the assets and the liabilities valued at statutory book value ensures that there is no impact to surplus as a result of implementing a modification to an existing pooling arrangement.

SSAP No. 25 Approach:

9. An approach different from that which refers to reinsurance accounting guidance is to refer to the guidance in SSAP No. 25 since some may view a modification to an intercompany pooling agreement as a related party transaction involving the exchange of assets or liabilities. In this case, paragraphs 14-18 of SSAP No. 25 would appear applicable. This guidance specifies differing valuation bases, depending on whether the transaction is considered an economic or a non-economic transaction. SSAP No. 25, paragraph 14, states that “...The appearance of permanence is also an important criterion in assessing the economic substance of a transaction. In order for a transaction to have economic substance and thus warrant revenue (loss) recognition, it must appear unlikely to be reversed ...” Since insurance groups often modify intercompany pooling arrangements, this type of transaction is not permanent, and may be construed as a non-economic transaction. SSAP No. 25, paragraph 18.b., states that “non-economic transactions ... shall be recorded at the lower of existing book value or fair value at the date of the transaction.”

### Modification to an Existing Intercompany Pooling Arrangement

10. It appears that this guidance is intended to address matters involving discrete or isolated transfers of assets and/or liabilities between affiliates rather than transfers of assets and liabilities effected in relation to executing reinsurance transactions (the guidance for which is SSAP No. 62R). Additionally, application of this guidance would result in a change to the surplus of the insurance group as a result of implementing a modification to an existing intercompany pooling arrangement. As previously stated, the statutory accounting intent is to avoid surplus gains for the insurance group as a result of implementing a modification to an intercompany pooling arrangement.

11. The accounting issues are:

- a. What is the relevant guidance for modifications to intercompany pooling arrangements?
- b. What is the appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement?

### INT 03-02 Discussion

The Working Group reached a consensus as follows:

12. SSAP No. 62R provides accounting for property and casualty reinsurance agreements including specific guidance on intercompany pooling agreements. SSAP No. 62R provides two methods of accounting for changes in intercompany pooling agreements, depending on whether or not the pooling results in a gain in surplus.

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

### INT 03-02 Status

14. No further discussion is planned.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2024/03-16-24SpringNationalMeeting/Hearing-Packet2/2.3-22-12aINT03-02.docx>

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

**Issue: Risk Transfer Analysis on Combination Reinsurance Contracts**

**Check (applicable entity):**

	P/C	Life	Health
Modification of Existing SSAP	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Description of Issue:**

This agenda item is to address a December 2023, referral by the Valuation Analysis (E) Working Group (VAWG) regarding reinsurance risk transfer and reserve credit for a particular form of reinsurance being observed by regulators in the life industry. The referral noted that:

VAWG has identified that issues arise when evaluating reinsurance for risk transfer in accordance with *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*, when treaties involve more than one type of reinsurance, and there is interdependence of the types of reinsurance, including but not limited to an experience refund that is based on the aggregate experience. In such cases, VAWG regulators find that these types of reinsurance must be evaluated together and cannot be evaluated separately for the purpose of risk transfer. For example, where a treaty includes coinsurance and YRT with an aggregate experience refund and the inability to independently recapture the separate types of reinsurance, it is not adequate to separately review the coinsurance and YRT pieces of the transaction for risk transfer. The treaty as a whole is non- proportional. This complexity is not immediately apparent to the regulatory reviewer, and it is important that this issue be raised broadly, so that individual state regulators are aware. Individual regulators are encouraged to contact VAWG if they would like additional perspective when reviewing such treaties.

Generally, VAWG regulators observe that some companies are reporting an overstated reserve credit due to a bifurcated risk transfer analysis. Specifically, some companies reported a proportional reserve credit for a coinsurance component, despite in aggregate the reinsurer only being exposed to loss in tail scenarios. From an actuarial perspective, there is consensus among VAWG members that it is not appropriate for a ceding company to take a proportional reserve credit that reflects the transfer of all actuarial risks when not all actuarial risks are transferred.

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

*SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* contains guidance for life and health reinsurance agreements. Additionally, SSAP No. 61R refers to Appendix A-791, *Life and Health Reinsurance Agreements* for risk transfer criteria applicable to all forms of life and health reinsurance other than YRT and certain non-proportional contracts such as stop loss and catastrophe reinsurance. YRT agreements are required to comply with specific parts of A-791. Furthermore, contracts that do not meet the conditions for reinsurance accounting in SSAP No. 61R, including the applicable parts of A-791, receive deposit accounting.

As noted in the referral above, regulators have observed reinsurance transactions that combine both coinsurance and YRT, typically applicable to different underlying policies, but that are interdependent. There exists an aggregate experience refund and recapture provisions that allow for recapture by the cedant, but only if both components are recaptured simultaneously.

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

The concern raised by regulators is that the substance of this interdependent agreement design is more akin to the risk transferred under a nonproportional reinsurance agreement. This is because in aggregate, proportionate amounts of the risk are not transferred. The agreements are designed to compensate the cedant for aggregate experience only in tail scenarios, which is accomplished through the design of the aggregate experience refund. In most reasonably expected scenarios, the net effect of the reinsurance is such that the cedant pays a financing charge to the reinsurer for a designated period of time until an expected recapture date and no additional net funds exchange hands. As a result, taking a full proportional reserve credit on the coinsured component is not reflective of the actual risk being transferred. SSAP No. 61R, paragraph 36 notes that the reinsurance credit is only for the risk reinsured. As noted in the referral, there was consensus among VAWG members that it is not appropriate for a ceding company to take a proportional reserve credit that reflects the transfer of all actuarial risks when not all actuarial risks are transferred. NAIC staff agrees with the VAWG consensus and proposes to incorporate a version of existing guidance from SSAP No. 62R that addresses this point. The inclusion of this guidance is intended to require risk transfer to be analyzed for the entire contract when multiple interdependent types of reinsurance are present.

*SSAP No. 62R—Property and Casualty Reinsurance Exhibit A – Implementation Questions and Answers*, question 10 provides guidance on interdependent contract features. This agenda item proposes to incorporate key aspects of the SSAP No. 62R, Exhibit A question 10 into SSAP No. 61R to provide more clarity on evaluation of risk transfer on contracts with interdependent features. The answer requires that features of the contract(s) that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in determining if a particular contract transfers risk. The *SSAP No. 62R—Property and Casualty Reinsurance Exhibit A – Implementation Questions and Answers* question 10 provides the following:

10A: A contract is not defined, but is essentially a question of substance. It may be difficult in some circumstances to determine the boundaries of a contract. **For example, the profit-sharing provisions of one contract may refer to experience on other contracts and, therefore, raise the question of whether, in substance, one contract rather than several contracts exist.**

The inconsistency that could result from varying interpretations of the term *contract* is limited by requiring that features of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. Therefore, if agreements with the reinsurer or related reinsurers, in the aggregate, do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured.

As historical background, the guidance for SSAP No. 62R, Exhibit A, question 10, originated from *GAAP EITF Topic D-34, Accounting for Reinsurance: Questions and Answers about FASB Statement No. 113* (EITF D-34). NAIC staff recommends that the Working Group move this item to the active listing of the maintenance agenda, categorized as a SAP clarification, and expose revisions to *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* as illustrated below. The proposed revisions incorporate guidance to SSAP No. 61R which is consistent with the guidance currently in SSAP No. 62R, Exhibit A Implementation Questions and Answers, question 10 and also add reference to A-791, paragraph 6 guidance in the YRT guidance paragraph. (See Authoritative Literature). FASB Statement No. 113 was adopted with modification in both SSAP No. 62R and SSAP No. 61R. Topic 944 Reinsurance Contracts in the current FASB Codification Implementation Guide continues to include the guidance from EITF D-34



The example reinsurance contract that VAWG observed contained yearly renewable term reinsurance. Per SSAP No. 61R, paragraph 19, only certain parts of *A-791 Life and Health Reinsurance Agreements* apply to YRT contracts. Specifically, YRT contracts only have to pass A-791, paragraphs 2.b., 2.c., 2.d., 2.h., 2.i., 2.j. or 2.k. to result in reinsurance accounting. In addition, paragraph 3 of A-791 on deferral of gain on cession of prior year blocks of business also applies. As described above, YRT contracts do not transfer all of the risk inherent in the contract as they typically only cover a percentage of the net amount at risk for typically one year. Note that the reinsurance accounting credit from a YRT contract per the guidance in SSAP No. 61R, paragraph 37 is computed as the one-year term mean reserve on the amount of insurance ceded. Therefore, a YRT credit is typically less than what a proportional coinsurance contract which transfers all significant risks would typically provide.

The VAWG reinsurance contract example also included coinsurance contracts which must pass all of A-791 to receive reinsurance accounting. The example contract contained a shared experience refund between the two contract types. This interdependent feature is a key element. NAIC staff agrees with VAWG that an interdependent reinsurance payment in a contract requires a single risk transfer assessment. However, the combined interdependent contract when assessed in aggregate would likely cause it to either not meet the conditions for reinsurance accounting or would result in a smaller reinsurance credit than VAWG observed some entities taking.

A-791, paragraph 2e contains the guidance which limits the amounts paid to the reinsurer to the income realized on the underlying reinsured policy and paragraph 2f contains the guidance on transferring all the significant risk of the business reinsured. Adding YRT coverage with coinsurance would likely result in a “fail” of the criteria in A-791 because not all of the significant risks of the underlying reinsured policies would be likely to be passed to the reinsurer (thus failing the criteria in A-791, paragraph 2f). Combining YRT and coinsurance in the same contract could also cause that contract to fail A-791 if the reinsurance contract charged more than the income on the underlying policy.

In addition, A-791, paragraph 6 requires that the reinsurance contract include provisions that the agreement shall constitute the entire agreement between the parties with respect to the business being reinsured thereunder and that there are no understandings between the parties other than as expressed in the agreement. This paragraph does not currently apply to YRT but is being recommended to apply.

#### **Existing Authoritative Literature:**

- *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*

#### **Types of Reinsurance Arrangements**

11. Once an entity has decided to reinsure amounts in excess of its desired retention, it may proceed in one of several basic arrangements—coinsurance, modified coinsurance, yearly renewable term or non-proportional. Such contracts may have funds withheld.

#### **Coinsurance**

12. In this arrangement, the risks are reinsured on the same plan as that of the original policy. The direct writer and the reinsurer share in the risk in the same manner. The ceding entity pays the reinsurer a proportional part of the premiums collected from the insured. In return, the reinsurer reimburses the ceding entity for the proportional part of the death or accident and health claim payments and other benefits provided by the policy, including nonforfeiture values, policy dividends, experience rating refunds, commissions, premium taxes, and other direct expenses agreed to in the contract. The reinsurer must also establish the required reserves for the portion of the policy it has assumed. A single policy can be coinsured with more than one entity or under more than one reinsurance contract with the same entity as long as the combined total of reinsurance and the retention of the ceding entity is not more than 100% of the risk.

13. In coinsurance of participating policies, the reinsurer may reimburse the ceding entity for its portion of the dividends paid to the policyholder. In determining its schedule of dividends, the ceding entity takes into account the experience on the business as written. If the reinsurer reimburses dividends it will typically accept the ceding entity’s schedule but may require input into the schedule. Changes to the schedule may

have to be agreed to by the reinsurer. Coinsurance of all or a portion of a block of business also is used in situations where a severe strain is placed on the direct writing entity's surplus in the first policy year. For example, the premium received by the direct writer during the first policy year usually is insufficient to pay the high first-year commissions and other costs of issue and to establish the initial reserve. In such an example, coinsurance relieves some of the surplus strain of adding large amounts of new insurance.

### Modified Coinsurance

14. The "modified coinsurance" or "modco" arrangement is a variation of coinsurance. The ceding entity has transferred all or a portion of the net policy liabilities on the reinsured policies to the reinsurer, and the reinsurer is required to indemnify the ceding entity for the same amount. The assets necessary to support the reserves for the original policies are maintained by the ceding entity instead of the reinsurer. This is accomplished by designating in the contract the transfer of the net policy liabilities to the assuming entity and an immediate transfer back to the extent of the modco deposit. Under modified coinsurance, the assuming entity shall transfer to the ceding entity the increase in the reserve on the reinsured portion. This transaction reflects the reinsurer's risk with respect to the reinsured business and its obligation to maintain the reserves supporting such obligation. In some cases, a policy may be reinsured partially on a coinsurance arrangement and partially on a modified coinsurance arrangement. This may be accomplished through the use of two contracts or in a single contract.

### Yearly Renewable Term (YRT)

15. Under this arrangement of reinsurance, the ceding entity transfers the net amount at risk on the portion reinsured to the reinsurer and pays a one-year term premium. The "net amount at risk"—as defined in the contract—is usually the amount of insurance provided by the policy in excess of the ceding entity's reserve on it.

### Non-Proportional

16. Other forms of reinsurance are also available, such as catastrophe and stop loss coverage. These arrangements provide for financial protection to the ceding entity for aggregate losses rather than providing indemnification for an individual policy basis as described in the preceding three reinsurance arrangements. Catastrophic and stop loss reinsurance are written on an annual basis to protect the ceding entity from excessive aggregate losses. Usually, the coverage does not extend over the life of the underlying policy nor is there any requirement on the ceding entity to renew the arrangement.

### Transfer of Risk

17. **Reinsurance agreements must transfer risk from the ceding entity to the reinsurer in order to receive the reinsurance accounting treatment discussed in this statement.** If the terms of the agreement violate the risk transfer criteria contained herein, (i.e., **limits or diminishes the transfer of risk by the ceding entity to the reinsurer**), **the agreement shall follow the guidance for Deposit Accounting. In addition, any contractual feature that delays timely reimbursement violates the conditions of reinsurance accounting.**

18. This paragraph applies to all life, deposit-type and accident and health reinsurance agreements except for yearly renewable term reinsurance agreements and non-proportional reinsurance agreements such as stop loss and catastrophe reinsurance. All reinsurance agreements covering products that transfer significant risk shall follow the guidance for reinsurance accounting contained in this statement. All reinsurance contracts covering products that do not provide for sufficient transfer of risk shall follow the guidance for Deposit Accounting.

19. **Yearly renewable term (YRT)** reinsurance agreements that transfer a proportionate share of mortality or morbidity risk inherent in the business being reinsured and do not contain any of the conditions described in **Appendix A-791, paragraphs 2.b., 2.c., 2.d., 2.h., 2.i., 2.j. or 2.k.**, shall follow the guidance for reinsurance accounting, including paragraphs 55-57 of this statement that apply to indemnity reinsurance. Contracts that fail to meet the requirements for reinsurance accounting shall follow the guidance for Deposit Accounting. For all treaties entered into on or after January 1, 2003, the deferral guidance in paragraph 3 of A-791 shall also apply to YRT agreements. Since YRT agreements only transfer

the mortality or morbidity risks to the reinsurer, the recognition of income shall be reflected on a net of tax basis, as gains emerge based on the mortality or morbidity experience.

20. For non-proportional reinsurance agreements such as stop loss and catastrophe reinsurance agreements, contract terms shall be evaluated to assess whether they transfer significant risk to the reinsurer. For example, prepayment schedules and accumulating retentions from multiple years are contractual features inherently designed to delay the timing of reimbursement to the ceding entity limits the risk to the reinsurer. Regardless of what a particular feature might be called, any feature that can delay timely reimbursement violates the conditions for reinsurance accounting. Transfer of insurance risk requires that the reinsurer's payment to the ceding entity depend on and directly vary with the amount and timing of claims settled under the reinsured contracts. Contractual features that can delay timely reimbursement prevent this condition from being met. Reinsurance accounting shall apply to all non-proportional agreements that transfer significant risk and do not contain any provisions that protect the reinsurer from incurring a loss. Contracts that fail to meet the requirements for reinsurance accounting shall follow the guidance for Deposit

### Credits for Ceded Reinsurance

36. The credit taken by the ceding entity under the coinsurance arrangement is calculated using the same methodology and assumptions used in determining its policy and claim reserves. It is, of course, only for the percentage of the risk that was reinsured. Under modified coinsurance, the reserve credit is reduced by the modco deposit retained by the ceding entity. If the entity reinsures on a yearly renewable term basis, it is itself buying insurance for the portion of the ceded amount at risk. The amount of yearly renewable term reinsurance that is required on a given policy generally decreases each year as the entity's reserve increases. The net amount at risk may increase, however, on interest sensitive products such as universal life. The amount at risk on accident and health yearly renewal term reinsurance will remain level and the reinsurance premium will increase each year.

37. The reserve credit taken by the ceding entity is reported as a reduction to the reserves and not as an asset of the entity. **The ceding entity's reserve credit and assuming entity's reserve for yearly renewable term reinsurance shall be computed as the one year term mean reserve on the amount of insurance ceded. The ceding entity must use the same mortality and interest bases which were used for valuing the original policy before reinsurance.** The credit may also be computed on a pro rata basis if the result is not materially different from the credit computed on the mean reserve basis. For all types of reinsurance, the ceding entity also takes credit for other amounts due from the reinsurer such as unpaid claims and claims incurred but not reported. If contemplated by the reinsurance contract, recognition of related assets and liabilities must occur (policy loans, due and deferred premiums, etc.).

38. Non-proportional reinsurance is entered into on an annual basis to limit the claims experience of the ceding entity and thereby protect its financial integrity. When the period of the arrangement exceeds one year, the contract must be carefully reviewed to determine if the end result more closely follows proportional reinsurance. **No reserve credit is taken for non-proportional reinsurance unless the aggregate attachment point has in fact been penetrated. In order for an entity to reflect reserve credits on a prospective basis, the entity will need to demonstrate that the present value of expected recoveries using realistic assumptions, to be realized from the reinsurer are in excess of the present value of the reinsurance premiums guaranteed to be paid by the ceding entity under the terms of the contract.** Because non-proportional reinsurance aggregates experience, and does not indemnify the ceding entity for each policy loss, the use of statutory assumptions underlying the insured policies is inappropriate for determining any reserve credit to be taken by the ceding entity. Historical experience, pricing assumptions and asset shares shall be considered in determining if the reinsurer may be reasonably expected to pay any claims. The reserve credit taken shall only reflect these reasonable expectations. **This treatment of non-proportional reinsurance is similar to the way property and casualty (P&C) reinsurance is considered. This is because these modes of reinsurance more closely follow P&C indemnification principles than life insurance formula basis, and because these coverages are very similar to excess insurance on P&C products. In determining the appropriate reserve credit, the probability of a loss penetrating to the reinsurer's level of coverage (using reasonable assumptions) must be multiplied by the expected amount of recovery.** This is the same as reserve credits on coinsurance where the probability of a claim (i.e., mortality) is multiplied by the expected return (i.e., death

benefit). In that the coverage is for aggregate experience, the mortality assumptions underlying any one policy risk are inappropriate to analyze the appropriate credits for non-proportional coverage.

- **SSAP No. 61R, adopts FAS 113 with modifications.**

### Relevant Literature

86. This statement adopts with modification *FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*. The statutory accounting principles established by this statement differ substantially from GAAP, reflecting much more detailed guidance, as follows:

- a. Reserve credits taken by ceding companies as a result of reinsurance contracts are netted against the ceding entity's policy and claim reserves and unpaid claims;
  - b. First year and renewal ceding commissions on indemnity reinsurance of new business are recognized as income. Ceding commissions on ceded in-force business are included in the calculation of initial gain or loss;
  - c. As discussed in SSAP No. 50, statutory accounting defines deposit-type contracts as those contracts which do not include any mortality or morbidity risk. GAAP defines investment contracts as those that do not subject the insurance enterprise to significant policyholder mortality or morbidity risk. (The distinction is any mortality or morbidity risk for statutory purposes vs. significant mortality or morbidity risk for GAAP purposes.) Therefore, a contract may be considered an investment contract for GAAP purposes, and that same contract may be considered other than deposit-type for statutory purposes. A reinsurance treaty covering contracts that have insignificant mortality or morbidity risk (i.e., contracts classified as other than deposit-type contracts for statutory purposes, but investment contracts for GAAP purposes) that does not transfer that mortality or morbidity risk, but does transfer all of the significant risk inherent in the business being reinsured (e.g., lapse, credit quality, reinvestment or disintermediation risk) qualifies for reinsurance accounting for statutory reporting purposes, but would not qualify for reinsurance accounting treatment for GAAP purposes;
  - d. Initial gains on indemnity reinsurance of in-force blocks of business have unique accounting treatment. A portion of the initial gain (equal to the tax effect of the initial gain in surplus) is reported as commissions and expense allowances on reinsurance ceded in the statement of operations. The remainder of the initial gain is reported on a net-of-tax basis as a write-in for gain or loss in surplus in the Capital and Surplus Account. In subsequent years, the ceding entity recognizes income on the reinsurance ceded line for the net-of-tax profits that emerged on the reinsured block of business with a corresponding decrease in the write-in for gain or loss in surplus;
  - e. This statement prohibits recognition of a gain or loss in connection with the sale, transfer or reinsurance of an in-force block of business between affiliated entities in a non-economic transaction. Any difference between the assets transferred by the ceding entity and the liabilities, including unamortized IMR, shall be deferred and amortized under the interest method;
  - f. This statement requires that a liability be established through a provision reducing surplus for unsecured reinsurance recoverables from unauthorized reinsurers;
  - g. This statement prescribes offsetting certain reinsurance premiums.
87. This statement incorporates Appendices A-785 and A-791.

- **SSAP No. 61R, Glossary Excerpts:**

*Net Amount at Risk*

The excess of the death benefit of a policy over the policy reserve. It is the amount which must come from surplus in the event of a death claim.

*Non-Proportional Reinsurance*

Reinsurance that is not secured on individual lives for specific individual amounts of reinsurance, but rather reinsurance that protects the ceding entity's overall experience on its entire portfolio of business, or at least as broad as noted in paragraph 19 of SSAP No. 61 segment of it. The most common forms of non-proportional reinsurance are stop loss reinsurance and catastrophe reinsurance.

Non-proportional reinsurance is a form of casualty insurance. Usually neither the premium nor continuance of coverage is guaranteed beyond a specified term.

*Pool*

A method of allocating reinsurance among several reinsurers. Using this method, each reinsurer receives a specified percentage of risk ceded into the pool. Percentages may vary by reinsurer.

*Proportional Reinsurance*

Reinsurance on a particular life for a specified amount or share generally, though not necessarily, secured at the time the policy is issued to the insured. The continuation of coverage guarantees for the reinsurance generally parallel those in the life insurance coverage reinsured. Most life reinsurance conducted in the United States is done so on a proportional basis.

*Yearly Renewable Term (YRT)*

A form of life reinsurance under which the mortality or morbidity risks, but not the permanent plan reserves, are transferred to the reinsurer for a premium that varies each year with the amount at risk and the ages of the insureds. The amount of reinsurance, which may change annually, is generally the amount of insurance provided by the policy in excess of the primary insurer's reserve.

- **SSAP No. 62R—Property and Casualty Reinsurance Exhibit A – Implementation Questions and Answers**

10. Q: For purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract?

- A: A contract is not defined, but is essentially a question of substance. It may be difficult in some circumstances to determine the boundaries of a contract. For example, the profit-sharing provisions of one contract may refer to experience on other contracts and, therefore, raise the question of whether, in substance, one contract rather than several contracts exist.

The inconsistency that could result from varying interpretations of the term *contract* is limited by requiring that features of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. Therefore, if agreements with the reinsurer or related reinsurers, in the aggregate, do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured.

**The original GAAP source of the above in SSAP No. 62R is *EITF D-34 Accounting for Reinsurance: Questions and Answers about FASB Statement No. 113, question 13***

13. Q—For purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract?

A—Statement 113 does not define what constitutes a "contract," which is essentially a question of substance. It may be difficult in some circumstances to determine the boundaries of a contract. For

example, the profit-sharing provisions of one contract may refer to experience on other contracts and, therefore, raise the question of whether, in substance, one contract rather than several contracts exist.

Statement 113 limits the inconsistency that could result from varying interpretations of the term contract by requiring that features of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. Therefore, if agreements with the reinsurer or related reinsurers, in the aggregate, do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured.

Certain guidance relevant to determining the boundaries of a contract is provided in the accounting literature. As described in paragraph 8 of Statement 113, provisions of other related contracts may be considered part of the subject contract under certain circumstances. Likewise, paragraphs 59 and 60 of Statement 113 indicate that the Board did not intend for different kinds of exposures combined in a program of reinsurance to be evaluated for risk transfer and accounted for together, because that would allow contracts that do not meet the conditions for reinsurance accounting to be accounted for as reinsurance by being designated as part of a program. In addition, Question 12 above refers to the fact that an amendment of a contract may create a new contract. [Revised 12/98.]

The legal form and substance of a reinsurance contract generally will be the same, so that the risks reinsured under a single legal document would constitute a single contract for accounting purposes. However, that may not always be the case. Accordingly, careful judgment may be required to determine the boundaries of a contract for accounting purposes. [Revised 12/98.]

If an agreement with a reinsurer consists of both risk transfer and nonrisk transfer coverages that have been combined into a single legal document, those coverages must be considered separately for accounting purposes. [Revised 12/98.]

## **Topic 944 Reinsurance Contracts in the current FASB Codification Implementation Guide continues to include the guidance from EITF D-34**

### **Reinsurance Contracts Implementation Guidance**

#### **What Constitutes a Contract**

##### **944-20-55-27**

**This implementation guidance discusses, for purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract, which is essentially a question of substance. It may be difficult in some circumstances to determine the boundaries of a contract.**

##### **944-20-55-28**

**For instance, the profit-sharing provisions of one contract may refer to experience on other contracts and, therefore, raise the question of whether, in substance, one contract rather than several contracts exist.**

##### **944-20-55-29**

**The guidance in the Financial Services—Insurance Topic on reinsurance limits the inconsistency that could result from varying interpretations of the term contract by requiring that features of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. Therefore, if agreements with the reinsurer or related reinsurers, in the aggregate, do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured.**

##### **944-20-55-30**

Certain guidance relevant to determining the boundaries of a contract is provided in the accounting literature.

944-20-55-31

Paragraph 944-20-15-40 states that provisions of other related contracts may be considered part of the subject contract under certain circumstances.

944-20-55-32

Different kinds of exposures combined in a program of reinsurance shall not be evaluated for risk transfer and accounted for together, because that would allow contracts that do not meet the conditions for reinsurance accounting to be accounted for as reinsurance by being designated as part of a program.

944-20-55-33

In addition, paragraph 944-20-15-65 refers to the fact that an amendment of a contract may create a new contract.

944-20-55-34

The legal form and substance of a reinsurance contract generally will be the same, so that the risks reinsured under a single legal document would constitute a single contract for accounting purposes. However, that may not always be the case. Accordingly, careful judgment may be required to determine the boundaries of a contract for accounting purposes.

944-20-55-35

Paragraph 944-20-15-56 states that, if an agreement with a reinsurer consists of both risk transfer and nonrisk transfer coverages that have been combined into a single legal document, those coverages shall be considered separately for accounting purposes.

- ***A-791 Life and Health Reinsurance Agreements***

**A-791, paragraph 1, provides the following:**

1. This Appendix shall not apply to assumption reinsurance, yearly renewable term reinsurance or certain nonproportional reinsurance such as stop loss or catastrophe reinsurance.

**Q – Aside from assumption reinsurance, what other types of reinsurance are exempt from the accounting requirements?**

**A – Yearly renewable term (YRT) and 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.

**A-791, paragraph 2e contains the guidance which limits the reinsurance to the amount realized on the reinsured policy.**

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

e. The reinsurance agreement involves the possible payment by the ceding insurer to the reinsurer of amounts other than from income realized from the reinsured policies. For example, it is improper for a ceding company to pay reinsurance premiums, or other fees or charges to a reinsurer which are greater than the direct premiums collected by the ceding company;

**A-791, paragraph 2f contains the guidance on transferring all of the significant risk of the business reinsured.**

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

f. The treaty does not transfer all of the significant risk inherent in the business being reinsured. The following table identifies for a representative sampling of products or type of business, the risks which are considered to be significant. For products not specifically included, the risks determined to be significant shall be consistent with this table.

Risk categories:

- i. Morbidity
- ii. Mortality
- iii. Lapse

This is the risk that a policy will voluntarily terminate prior to the recoupment of a statutory surplus strain experienced at issue of the policy.

- iv. Credit Quality

This is the risk that invested assets supporting the reinsured business will decrease in value. The main hazards are that assets will default or that there will be a decrease in earning power. It excludes market value declines due to changes in interest rate.

- v. Reinvestment

This is the risk that interest rates will fall and funds reinvested (coupon payments or monies received upon asset maturity or call) will therefore earn less than expected. If asset durations are less than liability durations, the mismatch will increase.

- vi. Disintermediation

This is the risk that interest rates rise and policy loans and surrenders increase or maturing contracts do not renew at anticipated rates of renewal. If asset durations are greater than the liability durations, the mismatch will increase. Policyholders will move their funds into new products offering higher rates. The company may have to sell assets at a loss to provide for these withdrawals.

+ - Significant 0 - Insignificant

RISK CATEGORY

	i.	ii.	iii.	iv.	v.	vi.
Health Insurance - other than LTC/LTD*	+	0	+	0	0	0



Health Insurance - LTC/LTD*	+	0	+	+	+	0
Immediate Annuities	0	+	0	+	+	0
Single Premium Deferred Annuities	0	0	+	+	+	+
Flexible Premium Deferred Annuities	0	0	+	+	+	+
Guaranteed Interest Contracts	0	0	0	+	+	+
Other Annuity Deposit Business	0	0	+	+	+	+
Single Premium Whole Life	0	+	+	+	+	+
Traditional Non-Par Permanent	0	+	+	+	+	+
Traditional Non-Par Term	0	+	+	0	0	0
Traditional Par Permanent	0	+	+	+	+	+
Traditional Par Term	0	+	+	0	0	0
Adjustable Premium Permanent	0	+	+	+	+	+
Indeterminate Premium Permanent	0	+	+	+	+	+
Universal Life Flexible Premium	0	+	+	+	+	+
Universal Life Fixed Premium	0	+	+	+	+	+
Universal Life Fixed Premium dump-in premiums allowed	0	+	+	+	+	+
*LTC = Long Term Care Insurance LTD = Long Term Disability Insurance						

6. The reinsurance agreement shall contain provisions which provide that:
- a. **The agreement shall constitute the entire agreement between the parties with respect to the business being reinsured thereunder and that there are no understandings between the parties other than as expressed in the agreement;** and
  - b. Any change or modification to the agreement shall be null and void unless made by amendment to the agreement and signed by both parties.

**Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):** The referral from VAWG was formally received by the Working Group on January 10, 2024 and NAIC staff was directed to draft an agenda item for discussion.

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

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

**Staff Review Completed by:** Robin Marcotte – NAIC Staff - February 2024

**Staff Recommendation:**

NAIC staff recommends that the Working Group move this item to the active listing of the maintenance agenda, categorized as a SAP clarification, and expose revisions to *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* as illustrated below. The proposed revisions incorporate guidance to *SSAP No. 61R* which is consistent with the guidance currently in *SSAP No. 62R, Exhibit A Implementation Questions and Answers, question 10* and also add reference to *A-791, paragraph 6* guidance in the YRT guidance paragraph.

As described in the summary of issues, NAIC staff agrees that risk transfer analysis of a reinsurance contract or contracts with interdependent features that directly or indirectly compensate the reinsurer, requires that all parts of the contract be evaluated in aggregate. Appendix A-791, paragraph 6 already contains guidance that the agreement must constitute the entire agreement. While NAIC staff agrees with the concern that VAWG raised regarding some entities taking too large of a reinsurance credit, the existing guidance in *SSAP No. 61R* regarding risk transfer requires that reporting entities should not take reinsurance credit for

**amounts greater than the risk ceded should be sufficient to address those concerns. However, NAIC staff would be willing to develop a more extensive implementation guidance or other revisions if desired.**

SSAP No. 61R proposed revisions:

#### **Transfer of Risk**

17. Reinsurance **agreements must transfer risk from the ceding entity to the reinsurer in order to receive the reinsurance accounting treatment discussed in this statement.** If the terms of the agreement violate the risk transfer criteria contained herein, **(i.e., limits or diminishes the transfer of risk by the ceding entity to the reinsurer), the agreement shall follow the guidance for Deposit Accounting. In addition, any contractual feature that delays timely reimbursement violates the conditions of reinsurance accounting.**

18. For purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract, is essentially a question of substance. It may be difficult in some circumstances to determine the boundaries of a contract. For instance, the profit-sharing provisions of one contract may refer to experience on other contracts and, therefore, raise the question of whether, in substance, one contract rather than several contracts exist. The inconsistency that could result from varying interpretations of the term contract is limited by requiring that features of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. Therefore, if agreements with the reinsurer or related reinsurers, in the aggregate, do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured.

19. This paragraph applies to all life, deposit-type and accident and health reinsurance agreements except for yearly renewable term reinsurance agreements and non-proportional reinsurance agreements such as stop loss and catastrophe reinsurance. All reinsurance agreements covering products that transfer significant risk shall follow the guidance for reinsurance accounting contained in this statement. All reinsurance contracts covering products that do not provide for sufficient transfer of risk shall follow the guidance for Deposit Accounting.

20. **Yearly renewable term (YRT)** reinsurance agreements that transfer a proportionate share of mortality or morbidity risk inherent in the business being reinsured and do not contain any of the conditions described in **Appendix A-791, paragraphs 2.b., 2.c., 2.d., 2.h., 2.i., 2.j. or 2.k.,** shall follow the guidance for reinsurance accounting, including paragraphs 55-57 of this statement that apply to indemnity reinsurance. Contracts that fail to meet the requirements for reinsurance accounting shall follow the guidance for Deposit Accounting. For all treaties entered into on or after January 1, 2003, the deferral guidance in paragraph 3 of A-791 shall also apply to YRT agreements. YRT agreements shall follow the requirements of A-791, paragraph 6 regarding the entire agreement and the effective date of agreements. Since YRT agreements only transfer the mortality or morbidity risks to the reinsurer, the recognition of income shall be reflected on a net of tax basis, as gains emerge based on the mortality or morbidity experience.

20. For non-proportional reinsurance agreements such as stop loss and catastrophe reinsurance agreements, contract terms shall be evaluated to assess whether they transfer significant risk to the reinsurer. For example, prepayment schedules and accumulating retentions from multiple years are contractual features inherently designed to delay the timing of reimbursement to the ceding entity limits the risk to the reinsurer. Regardless of what a particular feature might be called, any feature that can delay timely reimbursement violates the conditions for reinsurance accounting. Transfer of insurance risk requires that the reinsurer's payment to the ceding entity depend on and directly vary with the amount and timing of claims settled under the reinsured contracts. Contractual features that can delay timely reimbursement prevent this condition from being met. Reinsurance accounting shall apply to all non-proportional agreements that transfer significant risk and do not contain any provisions that protect the reinsurer from incurring a loss. Contracts that fail to meet the requirements for reinsurance accounting shall follow the guidance for Deposit Accounting.

**Statutory Accounting Principles (E) Working Group  
Spring National Meeting  
Comment Letters Received – Hearing #2**

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March 7, 2024

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: Interested Parties Comments on the Ref #2019-21

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the following item that was exposed for comment by the Statutory Accounting Working Group (the Working Group) on February 20<sup>th</sup> with comments due March 7th.

**Ref #2019-21: Exposed Revisions to SSAP No. 21R at SAPWG Meeting on Feb. 20, 2024**

The Working Group exposed the following proposed changes to SSAP No. 21R, which resulted from thoughtful consideration of the many comments interested parties had most recently submitted:

1. Paragraphs 21, 22, 24 and 24: Minor clarifying/corresponding edits.
2. Paragraphs 28-29: Revisions bring in the adopted residual definition from SSAP No. 43R and SSAP No. 48. The last sentence in paragraph 29 is new and specifically addresses residuals: “Additionally, it would be expected that the equity position in an ABS Issuer, as defined in SSAP 26R, would be classified as a residual tranche.”
3. Paragraph 30: Revisions eliminate the descriptions and SSAP locations for the definition of residuals and specify that residuals, per the paragraph 28-29 definition, shall be accounted and reported in accordance with the guidance in SSAP No. 21R.

4. Paragraphs 31: Revisions replace “securitization” with “structure” to broadly reference all residuals that could be captured within the guidance.
5. Paragraph 32: Revisions clarify that residuals shall either be accounted for 1) at the lower amortized cost or fair value, with amortized cost calculated under the allowable earned yield method, or 2) under the practical expedient method, which reflects a return of principal concept.
6. Paragraphs 33 & 34: Revisions reflect terminology changes, to refer to the allowable earned yield method as amortized cost rather than BACV.
7. Paragraph 34 (Deleted): Revisions eliminate the guidance that directed reclassification of residual tranches to other SSAPs/reporting schedules in situations when residual tranches cease to meet the definition of a residual tranche. (For example, in situations in which the senior debt has been repaid.) It is not customary to reclassify investments under statutory accounting principles, and in speaking with interested party representatives, any such situations are likely not to be material and will not continue for extended periods of time. As the reclassification would introduce a number of financial statement reporting questions (as the residual would have to be disposed and then reacquired on the subsequent schedule) and as investment classification generally only occurs at acquisition, the guidance has been eliminated. With this deletion, if a residual is classified as a residual, it would remain with that classification and follow the SSAP No. 21R guidance until it is disposed by the reporting entity.
8. Paragraph 36: Revisions separate the OTTI calculation between those items measured at the allowable earned yield method and those that follow the practical expedient. (The original guidance would have required those companies that follow the practical expedient to calculate the allowable earned yield for determining OTTI, which would defeat the purpose of selecting the practical expedient.) Revisions then clarify terminology to reference amortized cost for the allowable earned yield method and BACV for OTTI under the practical expedient.
9. Paragraph 37: Revisions incorporate transition guidance for residuals that were accounted for under a different SSAP as of December 31, 2024. The transition guidance addresses situations in which the residual was previously accounted for at the lower of amortized cost or fair value as well as situations in which the residuals were previously accounted for at equity value or fair value.
10. Paragraph 41: Revisions prescribe the Jan. 1, 2025, effective date, permitting early application of the residual guidance.

Interested parties recommend a couple of suggested edits as follows:

- The reference to line “a.” in paragraph 27 is repeated in the numbering, The reference in the second line should be changed to “b.” and the remaining items following that line adjusted accordingly.
- The phrase “... as the present value of cash flows expected to be collected is less than the amortized cost basis of the securities” in line 27f should be deleted as it doesn’t add any clarification but is confusing as to the intent.

Interested parties have no comment on the other changes made to SSAP No. 21.

\* \* \* \*

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

Sincerely,

D. Keith Bell

Rose Albrizio

cc: Interested parties  
NAIC staff

## Statement of Statutory Accounting Principles No. 63

### Underwriting Pools

#### STATUS

Type of Issue .....	Common Area
Issued .....	Initial Draft
Effective Date .....	January 1, 2001
Affects .....	No other pronouncements
Affected by .....	No other pronouncements
Interpreted by .....	INT 03-02
Relevant Appendix A Guidance .....	None

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<b>STATUS</b> .....	<b>1</b>
<b>SCOPE OF STATEMENT</b> .....	<b>1</b>
<b>SUMMARY CONCLUSION</b> .....	<b>1</b>
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#### SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for underwriting pools and associations.

#### SUMMARY CONCLUSION

2. Underwriting pools and associations can be categorized as follows: (a) involuntary, (b) voluntary, and (c) intercompany.
3. Involuntary pools represent a mechanism employed by states to provide insurance coverage to those with higher than average probability of loss who otherwise would be excluded from obtaining coverage. Reporting entities are generally required to participate in the underwriting results, including premiums, losses, expenses, and other operations of involuntary pools, based on their proportionate share of similar business written in the state. Involuntary plans are also referred to as residual market plans, involuntary risk pools, and mandatory pools.

4. Voluntary pools are similar to involuntary pools except they are not state mandated and a reporting entity participates in the pool voluntarily. In addition, voluntary pools are not limited to the provision of insurance coverage to those with higher than average probability of loss, but often are used to provide greater capacity for risks with exceptionally high levels of insurable values (e.g., aircraft, nuclear power plants, refineries, and offshore drilling platforms).

5. Intercompany pooling relates to business which is pooled among affiliated entities who are party to a pooling arrangement.<sup>(INT 03-02)</sup>

6. Participation in a pool may be on a joint and several basis, i.e., in addition to a proportional share of losses and expenses incurred by the pool, participants will be responsible for their share of any otherwise unrecoverable obligations of other pool participants. In certain instances, one or more entities may be designated as servicing carriers for purposes of policy issuance, claims handling, and general administration of the pooled business, while in other cases a pool manager or administrator performs all of these functions and simply bills pool participants for their respective shares of all losses and expenses incurred by the pool. In either case, liabilities arising from pooled business are generally incurred on a basis similar to those associated with non-pooled business, and should therefore be treated in a manner consistent with the guidelines set forth in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*.

7. Intercompany pooling arrangements involve establishment of a conventional quota share reinsurance agreement under which all of the pooled business is ceded to the lead entity and then retroceded back to the pool participants in accordance with their stipulated shares. Arrangements whereby there is one lead company that retains 100% of the pooled business and all or some of the affiliated companies have a 0% net share of the pool may qualify as intercompany pooling. In these arrangements, only the policy issuing entity has direct liability to its policyholders or claimants; other pool participants are liable as reinsurers for their share of the issuing entity's obligations. Although participants may use different assumptions (e.g., discount rates) in recording transactions, the timing of recording transactions shall be consistently applied by all participants.

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

- a) The appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new intercompany pooling agreement(s) that serves to substantively modify an existing intercompany pooling arrangement is statutory book value for assets and statutory value for liabilities.
- b) The net amount of the assets and liabilities being moved among entities as a result of a modification to an intercompany pooling shall be used to settle the intercompany payable/receivable (i.e., the assets that are transferred in conjunction with the modification) to minimize the amount of assets transferred in the modification.

9. Underwriting results relating to voluntary and involuntary pools shall be accounted for on a gross basis whereby the participant's portion of premiums, losses, expenses, and other operations of the pools are



recorded separately in the financial statements rather than netted against each other. Premiums and losses shall be recorded as direct, assumed, and/or ceded as applicable. If the reporting entity is a direct writer of the business, premiums shall be recorded as directly written and accounted for in the same manner as other business which is directly written by the entity. To the extent that premium is ceded to a pool, premiums and losses shall be recorded in the same manner as any other reinsurance arrangement. A reporting entity who is a member of a pool shall record its participation in the pool as assumed business as in any other reinsurance arrangement.

10. Underwriting results relating to intercompany pools shall be accounted for and reported as described in paragraph 8. While it is acceptable that intercompany pooling transactions be settled through intercompany arrangements and accounts, intercompany pooling transactions shall be reported on a gross basis in the appropriate reinsurance accounts consistent with other direct, assumed and ceded business.

11. Equity interests in, or deposits receivable from, a pool represent cash advances to provide funding for operations of the pool. These are admitted assets and shall be recorded separately from receivables and payables related to a pool's underwriting results. Receivables and payables related to underwriting results shall be accounted for in accordance with the guidance in paragraphs 6-8. If it is probable that these receivables are uncollectible, any uncollectible amounts shall be written off against operations in the period such determination is made. If it is reasonably possible a portion of the balance is uncollectible but is not written off, disclosure requirements outlined in SSAP No. 5R shall be followed.

### **Disclosures**

12. If a reporting entity is part of a group of affiliated entities which utilizes a pooling arrangement under which the pool participants cede substantially all of their direct and assumed business to the pool, the financial statements shall include:

- a. A description of the basic terms of the arrangement and the related accounting;
- b. Identification of the lead entity and of all affiliated entities participating in the intercompany pool (include NAIC Company Codes) and indication of their respective percentage shares of the pooled business;
- c. Description of the lines and types of business subject to the pooling agreement;
- d. Description of cessions to non-affiliated reinsurers of business subject to the pooling agreement, and indication of whether such cessions were prior to or subsequent to the cession of pooled business from the affiliated pool members to the lead entity;
- e. Identification of all pool members which are parties to reinsurance agreements with non-affiliated reinsurers covering business subject to the pooling agreement and which have a contractual right of direct recovery from the non-affiliated reinsurer per the terms of such reinsurance agreements;
- f. Explanation of any discrepancies between entries regarding pooled business on the assumed and ceded reinsurance schedules of the lead entity and corresponding entries on the assumed and ceded reinsurance schedules of other pool participants;
- g. Description of intercompany sharing, if other than in accordance with the pool participation percentage, of the Aging of Ceded Reinsurance (Schedule F, Part 3) and the write-off of uncollectible reinsurance;

- h. Amounts due to/from the lead entity and all affiliated entities participating in the intercompany pool as of the balance sheet date.
  - i. For modifications to an existing intercompany pooling arrangement that involve the transfer of assets with fair values that differ from cost or amortized cost, the statement value and fair value of assets received or transferred by the reporting entity.
13. Refer to the Preamble for further discussion regarding disclosure requirements.

**Effective Date and Transition**

14. 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*.

**REFERENCES****Relevant Issue Papers**

- *Issue Paper No. 97—Underwriting Pools and Associations Including Intercompany Pools*