Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue: Clarification of the Look-Through Approach**

**Check (applicable entity):**

 P/C Life Health

Modification of existing SSAP [x]  [x]  [x]

New Issue or SSAP [ ]  [ ]  [ ]

Interpretation [ ]  [ ]  [ ]

Description of Issue:

This agenda item has been drafted due to an inconsistency in the understanding and application of the look-through approach of valuation of subsidiary, controlled and affiliated (SCA) entities. It clarifies and explicitly states how many levels downstream in an organization a reporting entity can look-through to value its SCA entity and when goodwill is permitted to be admitted. A look-through approach is the process of admitting audited investments in entities owned by an unaudited downstream noninsurance holding company. *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* states that a reporting entity may look-through a downstream noninsurance holding company to the value of an SCA or SSAP No. 48 entity with audited financial statements. In the application of the look-through approach of valuing SCAs the three issues below have been noted, along with an illustration of the organizational structure of an insurance company’s group. The guidelines focused on in this agenda item are explicitly noted in the scenarios below.

1. Levels to look-through: A look-through should only be performed for one direct line of ownership below the SCA entity to companies in which the SCA has direct ownership. Many companies have filed Sub 2 filings using the look-through approach to an entity that is located multiple levels below the SCA in the organizational chart or to an entity that is controlled indirectly by some companies within a group but does not have an affiliation with the SCA itself. (Consideration is also being given to companies with multiple shell holding companies within their group structure. Comments are requested on the prevalence of these scenarios for further consideration.)

* ABC Insurance Company (ABC) owns DEF Holding Company (DEF) , which owns GHI Inc. (GHI), which owns JKL Co. (JKL).
* ABC can file an SCA filing for DEF by using DEF’s audit report to validate DEF’s value on ABC’s financial statements.
* If DEF is an 8.b.iii entity without any other material assets or liabilities, ABC can file an SCA filing by performing a look-through to GHI and using GHI’s audit report to validate its value on ABC’s financial statements.
* Regardless of DEF’s structure, ABC cannot look-through to JKL and overlook DEF’s ownership of GHI in the process.

In this example, DEF Holding Company is an SCA of ABC Insurance Company. If DEF Holding Company is an 8.b.iii entity without any other material assets or liabilities, and does not have an audit report, a look-through can be performed to GHI Inc. GHI Inc.’s audit report should include its investment in JKL Co. In no situation can ABC file an SCA filing for DEF and look-through to JKL Co. and overlook GHI Inc. (the first level of ownership).



* + - * Yellow Insurance Company owns two SCAs, Blue Co. and Red Co.; each SCA owns one other company, Green Co. and Orange Co., respectively.
			* Yellow can file an SCA filing for both Blue Co. and Red Co., using their respective audit reports to validate their values on Yellow Insurance Company’s financial statements.
			* Yellow cannot file an SCA filing and look-through Blue Co. to Orange Co.; likewise, Yellow also cannot file an SCA filing and look-through Red Co. to Green Co.

In this example, Yellow Insurance Company owns two SCAs: Blue Co. and Red Co. Yellow can file an SCA filing for its ownership of Green Co. by looking through Blue Co., but not by looking through Orange Co. Likewise, Yellow can file an SCA filing for its ownership of Orange Co. by looking through Red Co., but not for Green Co.

1. Admitted goodwill permitted for a look-through: If a company performs a look-through, goodwill may only be admitted for the audited look-through entity; a company may not add goodwill from the purchase of the unaudited holding company to the value of the look-through entity, even though the unaudited holding company is the SCA.



* If ABC Insurance Company (ABC) files an SCA filing for DEF Holding Company (DEF), it can admit goodwill from ABC’s purchase of DEF (subject to the goodwill limitations detailed in SSAP No. 68).
* If ABC files an SCA filing for DEF and performs a look-through to GHI Inc. (GHI), it can admit goodwill from DEF’s purchase of GHI (subject to the goodwill limitations detailed in SSAP No. 68) to the value of the SCA, but it cannot admit goodwill from ABC’s purchase of DEF.
* If ABC files an SCA filing for DEF, any goodwill resulting from the acquisition of GHI and JKL will already be reported on DEF’s complying financial statements, so additional goodwill cannot be added, as that would be considered double-counting of goodwill.

In this example, DEF Holding Company is an SCA of ABC Insurance Company. If DEF Holding Company does not have an audit report, ABC Insurance Company can look-through to GHI Inc. GHI Inc.’s audit report should include its investment in JKL Co. If the look-through approach is used, only the goodwill from the acquisition of the look-through entity, GHI Inc can be added to the value of DEF. If an audit of the SCA itself is not provided to support its value, the goodwill from the acquisition of the SCA cannot be included in the value of the SCA.

1. Look-through approach to multiple entities: The look-through approach may not be used if the SCA holding company owns other assets which are deemed to be material to the holding company, other than the entities it directly owns. The look-through approach does allow an unaudited holding company to look-through to multiple companies that it owns directly.



* ABC Insurance Company (ABC) owns one SCA, DEF Holding Company (DEF), which owns three entities: A, B and C.
* ABC can file an SCA filing and look-through to A, B or C.
* If DEF is an 8.b.iii entity without any other material assets or liabilities, ABC can file an SCA filing and look-through to A, B and C, or only one or two of those entities.

Existing Authoritative Literature:

SSAP No. 68—Business Combinations and Goodwill

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

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

SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities

### Limited Exceptions to the Audit Requirements for Downstream Noninsurance Holding Companies

1. This statement requires that investments in SCA entities be recorded using one of the valuation methods described in paragraph 8 in order to be admitted assets. Each of the paragraph 8.b. valuation methods require the financial statements of SCA entities, including downstream noninsurance holding companies, to be audited in order for the investments in SCA entities to be admitted assets. Likewise, SSAP No. 48 requires the financial statements of joint ventures, partnerships, and/or limited liability companies in which the downstream noninsurance holding company has a minor ownership interest or otherwise lacks control, i.e., ownership interest is less than 10% to be audited (U.S. GAAP) in order to be admitted assets. There is a limited exception to the requirement to have audited financial statements of a downstream noninsurance holding company, provided that the entities owned by the downstream noninsurance holding company (paragraph 8.b.iii. entity) have audited financial statements as described in paragraphs 26 and 27.
2. The process of admitting audited investments in entities owned by an unaudited downstream noninsurance holding company SCA entity will be known as a “look through.” In order to admit the investments in audited SCAs or the audited non SCA SSAP No. 48 entities owned by an unaudited downstream noninsurance holding company, a reporting entity may apply the look through approach, provided all of the following conditions are met:
3. The downstream noninsurance holding company is an 8.b.iii entity, and
4. The downstream noninsurance holding company does not own any other assets which are material to the downstream holding company other than the audited SCA entities and/or audited non SCA SSAP No. 48 entities, and
5. The downstream noninsurance holding company is not subject to liabilities, commitments, contingencies, guarantees or obligations which are material to the downstream noninsurance holding company.

If an investment in a downstream noninsurance holding company meets the requirements set forth above, the reporting entity can admit the individual audited SCA entities and/or audited non SCA SSAP No. 48 entities; however, unaudited immaterial assets of the downstream noninsurance holding company are to be carried at the lesser of the paragraph 8 valuation or nonadmitted (e.g. some equity method investments are required to be carried at a negative value due to either statutory adjustments or to parental obligations to keep funding the subsidiary).

1. If a reporting entity holds an investment in a downstream noninsurance holding company, the reporting entity may look-through the downstream noninsurance holding company to the value of (i) SCA entities having audited financial statements and/or (ii) joint ventures, partnerships, and/or limited liability companies having audited financial statements in which the downstream noninsurance holding company has a minor ownership interest or otherwise lacks control, i.e., ownership interest is less than 10% in lieu of obtaining an audit of the financial statements of the downstream noninsurance holding company (provided the limited exception to the audited financial statements requirement contained in paragraphs 26-27 applies).
2. If a reporting entity utilizes the look-through approach for the valuation of the downstream noninsurance holding company instead of obtaining audited financial statements of the downstream noninsurance holding company, the financial statements of the reporting entity shall include the following disclosures:
3. The name of the downstream noninsurance holding company;
4. The carrying value of the investment in the downstream non insurance holding company;
5. The fact that the financial statements of the downstream noninsurance company are not audited;
6. The fact that the reporting entity has limited the value of its investment in the downstream noninsurance holding company to the value contained in the audited financial statements, including adjustments required by this statement, of SCA entities and/or non-SCA SSAP No. 48 entities owned by the downstream noninsurance holding company and valued in accordance with paragraphs 22-25;
7. The fact that all liabilities, commitments, contingencies, guarantees or obligations of the downstream noninsurance holding company, which are required to be recorded as liabilities, commitments, contingencies, guarantees or obligations under applicable accounting guidance, are reflected in the reporting entity’s determination of the carrying value of the investment in the downstream noninsurance holding company, if not already recorded in the financial statements of the downstream noninsurance holding company.

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

**Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:**

None

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

Staff Recommendation:

Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, as detailed below, to clarify the existing guidance for look-through entities. These revisions would clarify the following:

1. Goodwill may be admitted for an entity if its value has been supported by an audit report. (As such, if there is no audit report supporting the recognition of goodwill, the goodwill is required to be nonadmitted.)
2. The look-through provision can only be applied to the downstream level directly below the noninsurance holding company and not to multiple levels below the noninsurance holding company.

**As noted, consideration is being given to companies with multiple shell holding companies within their group structure. Comments are requested on the prevalence of these scenarios.**

SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities

1. The process of admitting audited investments in entities owned by an unaudited downstream noninsurance holding company SCA entity will be known as a “look through.” In order to admit the investments in audited SCAs or the audited non SCA SSAP No. 48 entities owned by an unaudited downstream noninsurance holding company, a reporting entity may apply the look through approach, provided all of the following conditions are met:
2. The downstream noninsurance holding company is an 8.b.iii entity, and
3. The downstream noninsurance holding company does not own any other assets which are material to the downstream holding company other than the audited SCA entities and/or audited non SCA SSAP No. 48 entities, and
4. The downstream noninsurance holding company is not subject to liabilities, commitments, contingencies, guarantees or obligations which are material to the downstream noninsurance holding company.

Goodwill may be admitted for an entity if its value has been supported by an audit report. If an investment in a downstream noninsurance holding company meets the requirements set forth above, the reporting entity can admit the individual audited SCA entities and/or audited non SCA SSAP No. 48 entities; however, unaudited immaterial assets of the downstream noninsurance holding company are to be carried at the lesser of the paragraph 8 valuation or nonadmitted (e.g. some equity method investments are required to be carried at a negative value due to either statutory adjustments or to parental obligations to keep funding the subsidiary).

1. If a reporting entity holds an investment in a downstream noninsurance holding company, the reporting entity may look-through the downstream noninsurance holding company to the value of (i) SCA entities having audited financial statements and/or (ii) joint ventures, partnerships, and/or limited liability companies having audited financial statements in which the downstream noninsurance holding company has a minor ownership interest or otherwise lacks control, i.e., ownership interest is less than 10% in lieu of obtaining an audit of the financial statements of the downstream noninsurance holding company (provided the limited exception to the audited financial statements requirement contained in paragraphs 25-26 applies). The look-through provision can only be applied to the entities directly held by the downstream noninsurance holding company and not to multiple levels below the noninsurance holding company.

Note: NAIC Staff will also update all references for the approach detailed in this agenda item from “look through” to “look-through” in SSAP No. 68 and SSAP No. 97. Revisions are not shown to keep in mind the length of this document.

Staff Review Completed by:

**Fatima Sediqzad - NAIC Staff**

**March 2019**

**Status:**

On April 6, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to clarify the existing guidance for look-through entities. The revisions clarify that goodwill may be admitted for an entity only if its value has been supported by an audit report and that the look-through provision can only be applied to the downstream level directly below the noninsurance holding company and not to multiple levels below the noninsurance holding company. The agenda item identifies that consideration is being given to multiple-level shell holding companies, and requests information on when these structures occur and the prevalence of these scenarios.

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