Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue: Attribution of Goodwill**

**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 was drafted to expand the statutory guidance regarding the attribution of purchase price and goodwill from an acquisition and to add explicit language regarding the accounting treatment for these scenarios; specifically, for situations in which an insurance company acquires a holding company that owns multiple companies. There has not been consistency in the application of these scenarios in the SCA filings.

NAIC Staff has illustrated an actual SCA filing in the example below. The names of the companies and the amounts used in the example have been changed.

ABC Insurance Company
(8.b.i. Reporting Entity)
Parent

Non-Insurance Holding
Company D
Parent

Insurance
Company Y

(8.b.i. entity)

Non-Insurance Company Z

(8.b.iii. entity)

Non-Insurance
Company X (8.b.iii. entity)

ABC Insurance Company purchased 100% of Holding Company D for $200 million, which resulted in goodwill of $150 million. Holding Company D owns 100% of three subsidiaries: Company X, Company Y and Company Z. Company X and Company Z are both non-insurance entities, while Company Y is a U.S. insurance entity. The attribution of purchase price and goodwill are necessary for the reasons listed below.

* Standalone financials - If Companies X, Y and Z present standalone financials, the purchase price and goodwill will need to be allocated down from the acquisition of Holding Company D. Company Y will present its financial statements separately in the Annual Statement it is required to file.
* Look-through - If Holding Company D is not audited, the goodwill from the acquisition of Holding Company D may not be admitted as part of Holding Company D’s value, but a look-through can be performed to one and/or all of the companies that D owns. With the look-through, the purchase price and goodwill would need to be allocated to each subsidiary that Holding Company D owns at the time of its acquisition and each subsidiary’s equity could be admitted, along with the goodwill from the acquisition, subject to goodwill limitations.
* Taxes - The purchase price and goodwill would also need to be allocated down to each entity that Holding Company D owns for tax purposes. *SSAP No. 101—Income Taxes* permits an entity to admit its adjusted gross deferred tax assets (DTAs) against its own deferred tax liabilities (DTLs) but not against gross DTLs of other members of the affiliated or consolidated group. This must be done on an entity-by-entity basis.
* Sale of entity - If the insurance reporting entity subsequently sells one or more of the entities that Holding Company D owns, it would need the allocated purchase price and goodwill amount to calculate any gain or loss resulting from the sale.

Existing Authoritative Literature:

**Bold and underlined guidance is for emphasis.**

SSAP No. 68—Business Combinations and Goodwill

### Statutory Purchases of SCA Investments

1. The statutory purchase method of accounting is defined as accounting for a business combination as the acquisition of one entity by another. It shall be used for all purchases of SCA entities including partnerships, joint ventures, and limited liability companies. The acquiring reporting entity shall record its investment at cost. Cost is defined as the sum of: (a) any cash payment, (b) the fair value of other assets distributed, (c) the fair value of any liabilities assumed, and (d) any direct costs of the acquisition.(INT 00-28) Contingent consideration issued in a purchase business combination that is embedded in a security or that is in the form of a separate financial instrument shall be recorded by the issuer at fair value at the acquisition date.
2. 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.
3. 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.
4. For those acquired SCA entities accounted for in accordance with paragraph 8.b.i. of SSAP No. 97 under the statutory purchase method, the historical bases of the acquired entity shall continue to be used in preparing its statutory financial statements. Therefore, pushdown accounting is not permitted.
5. Positive goodwill recorded under the statutory purchase method of accounting shall be admitted subject to the following limitation: Positive goodwill from all sources, including life, accident and health, and deposit-type assumption reinsurance, is limited in the aggregate to 10% of the acquiring[[1]](#footnote-1) entity’s capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for its most recently filed statement with the domiciliary state commissioner adjusted to exclude any net positive goodwill, EDP equipment and operating system software, and net deferred tax assets. **Additionally, all positive goodwill shall be nonadmitted when the underlying investment in the SCA or partnership, joint venture and limited liability company is nonadmitted[[2]](#footnote-2).** When negative goodwill exists, it shall be recorded as a contra-asset. Positive or negative goodwill resulting from the purchase of an SCA, joint venture, partnership or limited liability company shall be amortized to unrealized capital gains and losses on investments over the period in which the acquiring entity benefits economically, not to exceed 10 years. Positive or negative goodwill resulting from life, accident and health, and deposit-type assumption reinsurance shall be amortized to operations as a component of general insurance expenses over the period in which the assuming entity benefits economically, not to exceed 10 years. Goodwill shall be evaluated separately for each transaction.(INT 01-18)

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

11. For investments in entities recorded on an equity method (paragraph 8.b.i. through 8.b.iv.) after the date of acquisition, the investment amount shall be 1) adjusted for the amortization of statutory goodwill as defined in SSAP No. 68, and 2) adjusted, with a corresponding unrealized gain or loss, for the reporting entity’s share of undistributed earnings and losses of the investee (net of dividends declared[[3]](#footnote-3)). (This results in a reduction of the investment amount when dividends declared are in excess of the undistributed accumulated earnings attributable to the investee.)

### Admissibility Requirements of Investments in Downstream Holding Companies

1. To meet the admissibility requirements of this statement, unless the limited exception to the audited financial statements requirement discussed in paragraphs 25 and 26 applies, an annual audit of the financial statements of SCA entities, including the downstream holding company valued under paragraphs 8.b.i through 8.b.iv. must be obtained. The requirement for audited financial statements may be met by utilizing any one of the following methods:
2. Audited US GAAP financial statements of the downstream SCA holding company. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA’s domiciliary state.) The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities and non-SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet shall then be adjusted for GAAP to SAP differences for paragraph 8.b.i., 8.b.ii. and 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or
3. Audited foreign GAAP-basis financial statements of the downstream SCA holding company. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA’s domiciliary state.) The audited foreign GAAP basis financial statements shall include an audited footnote disclosure within the financial statements that reconciles each consolidated entity’s net income and equity on a foreign basis of accounting to a U.S. GAAP basis. The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities non SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet shall then be adjusted for GAAP to SAP differences of the insurance entities and paragraph 8.b.ii., and 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or
4. Individual audits of the downstream holding company and the downstream holding company’s investments in individual SCA entities.
5. If the downstream noninsurance holding company does not meet the requirements of paragraph 25, audited GAAP financial statements, as described in paragraph 22, are required for the downstream noninsurance holding company and its SCA and non SCA investments in order for the investment in the downstream noninsurance holding company to be classified as an admitted asset.
6. A purchased downstream holding company is valued in accordance with the provisions of paragraphs 21-24 and the provisions of SSAP No. 68.

**SSAP No. 101—Income Taxes**

**Exhibit A – Implementation Questions and Answers**

8.9 Parent Company P files a consolidated federal income tax return with its insurance subsidiaries, R, S and T. Assume consolidated taxes that could be recovered through loss carryback total $450. However, in the prior carryback years $200 was paid by each of the subsidiaries, R, S and T. The difference between the amount paid by the subsidiaries ($600) and the amount available through loss carryback ($150) is attributable to interest expense incurred by Company P. Pursuant to the group’s written income tax allocation agreement, in the case of loss carrybacks, taxes recoverable are limited to the consolidated taxes paid in the carryback years.

8.10 Because the adjusted gross DTA admitted under paragraph 11.a. for each reporting entity cannot exceed what each entity paid and could reasonably be expected to be refunded by P, no more than $450 in total may be admitted by the subsidiaries (under paragraph 11.a.). If the adjusted gross DTA associated with the subsidiaries’ temporary differences that reverse in the 11.a. period exceed the $450 of taxes recoverable through loss carryback on a consolidated basis, the adjusted gross DTA admitted by the insurance subsidiaries under paragraph 11.a. should be allocated among the subsidiaries, consistent with the principles of its written income tax allocation agreement. This allocation would, in most instances, be based on each subsidiary’s share of reversing temporary differences.

8.11 Under paragraph 11.c., an entity may admit its adjusted gross DTAs, after application of paragraphs 11.a. and 11.b., based upon offset against its own existing gross DTLs and not against gross DTLs of other members of the affiliated or consolidated group.

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

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 25 and 26.
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).

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

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

None

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

Staff Recommendation:

Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *SSAP No. 68—Business Combinations and Goodwill* to expand statutory accounting guidance to explicitly state that the attribution of purchase price and goodwill are required for a holding company’s subsidiaries upon acquisition of said holding company. The goodwill shall still be reported on the purchasing entity’s financial statements but may be required to be nonadmitted due to the stipulations of this agenda item.

Staff Review Completed by:

**Fatima Sediqzad - NAIC Staff**

**March 2019**

**Proposed Revisions:**

SSAP No. 68—Business Combinations and Goodwill

### Statutory Purchases of SCA Investments

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2. 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.
3. A business combination accounted for under the statutory purchase method and in which the acquired entity is valued in accordance with paragraphs 8.b.ii., 8.b.iii. or, 8.b.iv. of SSAP No. 97 shall determine the amount of positive goodwill or negative goodwill created by the combination using the reporting entity’s share of the GAAP net book value of the acquired entity, adjusted to a statutory basis of accounting in accordance with paragraph 9 of SSAP No. 97 in the case of acquired entities valued in accordance with paragraphs 8.b.ii. or 8.b.iv. of SSAP No. 97. If the acquired entity is a holding company, the purchase price and goodwill shall be calculated to determine the amount of goodwill that should be attributed to the downstream entities that were acquired as part of the holding company acquisition. (This is required because a reporting entity that subsequently qualifies and elects to look-through the holding company pursuant to SSAP No. 97, paragraphs 25-26 is only permitted to admit the goodwill attributed to the downstream entities that are admitted through the SSAP No. 97 look-through approach.) Business combinations accounted for under the statutory purchase method and in which the acquired entity is valued in accordance with, paragraph 8.b.i. of SSAP No. 97 shall determine the amount of positive or negative goodwill created by the business combination using the insurer’s share of the statutory book value of the acquired entity.
4. For those acquired SCA entities accounted for in accordance with paragraph 8.b.i. of SSAP No. 97 under the statutory purchase method, the historical bases of the acquired entity shall continue to be used in preparing its statutory financial statements. Therefore, pushdown accounting is not permitted.

**Status:**

On April 6, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 68—Business Combinations and Goodwill* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, as shown above, to explicitly state that the acquisition of a holding company requires the purchase price and goodwill amount to be attributed downstream to the entities that the holding company directly owns.

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1. The “acquiring” entity is intended to reflect the insurance reporting entity that reports the investment resulting in goodwill. The goodwill limitation test shall be completed at the individual reporting company level. [↑](#footnote-ref-1)
2. This includes, but is not limited to, situations in which the investment is nonadmitted as the audited financial statements for the SCA, joint venture, partnership or limited liability company includes substantial doubt on the entity’s ability to continue as a going concern, or on the basis/contents of the audit opinion pursuant to paragraph 20 of SSAP No. 97. [↑](#footnote-ref-2)
3. Dividends are recognized in investment income when declared. [↑](#footnote-ref-3)