Statutory Accounting Principles (E) Working Group
Hearing Agenda
August 3, 2019

ROLL CALL

Dale Bruggeman, Chair	Ohio	Judy Weaver	Michigan
Jim Armstrong / Carrie Mears, Vice Chairs	Iowa	Doug Bartlett	New Hampshire
Richard Ford	Alabama	Christine Gralton	New York
Kim Hudson	California	Joe DiMemmo	Pennsylvania
Kathy Belfi	Connecticut	Doug Slape / Jamie Walker	Texas
Dave Lonchar	Delaware	Doug Stolte / David Smith	Virginia
Eric Moser	Illinois	Amy Malm	Wisconsin
Caroline Brock / Stewart Guerin	Louisiana		

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

REVIEW AND ADOPTION OF MINUTES

1. Statutory Accounting Principles (E) Working Group – May 29, 2019, Conference Call **(Attachment 1)**
2. Statutory Accounting Principles (E) Working Group – Spring National Meeting Minutes (**Attachment 2**)

Notice: The Statutory Accounting Principles (E) Working Group conducted a regulator-only call on July 2, 2019 in accordance with the NAIC policy on open meetings as the discussion included specific companies, entities or individuals. This call focused on linked surplus notes under agenda item 2018-07.

REVIEW AND ADOPTION of NON-CONTESTED POSITIONS – SSAP REVISIONS

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

1. Ref #2017-28: SSAP No. 62R – Reinsurance Credit
2. Ref #2018-03: SSAP No. 43R – Reporting NAIC Designations as Weighted Averages
3. Ref #2019-11: Reinsurance Credit Effective Date
4. Ref #2019-15EP: NAIC Accounting Practices and Procedures Manual Editorial and Maintenance Update

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2017-28 SSAP No. 62R (Robin)	**Reinsurance Credit**	**3 Issue Paper**	**No Comment**	**IP - 1**

Summary:
During the Spring National Meeting, the Working Group exposed an issue paper to document for historical purposes the adopted revisions to *SSAP No. 62R—Property and Casualty Reinsurance.*

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

Recommended Action:
NAIC staff recommends that the Working Group adopt the exposed issue paper as final.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2018-03 SSAP No. 43R (Julie)	**Reporting NAIC Designations as Weighted Averages**	**4 Agenda Item**	**No Comment**	**IP - 2**

<u>*Summary:*</u>
During the Spring National Meeting, the Working Group exposed revisions to *SSAP No. 43R—Loan-backed and Structured Securities* to require securities with differing NAIC designations by lot to be reported in overall aggregate at the lowest NAIC designation, or with separate aggregations by NAIC designation. This approach is considered consistent with existing annual statement instructions that require lower-level reporting if the information reported in the aggregate would be inaccurate.

This agenda item was originally presented in March 2018 and deferred until agenda item 2018-19: Elimination of Modified Filing Exempt (MFE) was addressed. With revisions to eliminate MFE adopted during the 2019 Fall National Meeting, this agenda item was re-introduced during the 2019 Spring National Meeting. With the elimination of MFE, only securities subject to the financial modeling process could have differing designations by lot. These instances are expected to be significantly fewer than what was possible under the prior MFE process.

<u>*Interested Parties' Comments:*</u>
Interested parties have no comment on this item.

<u>*Recommended Action:*</u>
NAIC staff recommends adopting the exposed revisions to *SSAP No. 43R—Loan-backed and Structured Securities* as final.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-11 SSAP No. 62R (Robin)	**Reinsurance Credit Effective Date**	**5 Agenda Item**	**No Comment**	**IP - 13**

<u>*Summary:*</u>
During the Spring National Meeting, the Working Group exposed revisions to *SSAP No. 62R—Property and Casualty Reinsurance* to clarify that the Jan. 1, 2019 effective date for previously adopted guidance applies to contracts in effect as of that date. The revisions indicate that if a change is required to prior application, it shall be reported as a change in accounting principle.

<u>*Interested Parties' Comments:*</u>
Interested parties have no comment on this item.

<u>*Recommended Action:*</u>
NAIC staff recommends adopting the exposed revisions to *SSAP No. 62R—Property and Casualty Reinsurance* as final.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-15EP (Jake)	Editorial Updates	6 Agenda Item	No Comment	IP - 15

Summary:
During the Spring National Meeting, the Working Group exposed editorial updates as follows:

- *SSAP No. 62R - Property and Casualty Reinsurance*
  Update the Exhibit D – Illustration of Asbestos and Pollution Counterparty Reporting Exception to match the current format of Property and Casualty Annual Statement Schedule F. For 2018 Schedule F, Reinsurance had formatting updates for in the annual statement which included multiple parts of Schedule F into Schedule F part 3.

- *SSAP No. 63—Underwriting Pools*
  Update paragraph 11g references to Schedule F, Part 8 to reference the current section of Property and Casualty Annual Statement Schedule F, Part 3.

- *SSAP No. 84—Health Care and Government Insured Receivables*
  Delete the paragraph duplicating SSAP No. 4, paragraph 3.

- *SSAP No. 86—Derivatives*
  Update language in weather derivative exhibit to eliminate “proposed” wording.

- *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
  Update the footnote to regarding items excluded from the wash sale disclosure.

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

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

REVIEW AND ADOPTION of NON-CONTESTED POSITIONS – NONAPPLICABLE GAAP

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

1. Ref #2019-16: *ASU 2015-08, Business Combinations – Pushdown Accounting – SEC Paragraphs*
2. Ref #2019-17: *ASU 2019-02, Accounting for Costs of Films and License Agreements for Program Materials*

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-16 Appendix D (Fatima/Julie)	***ASU 2015-08, Business Combinations – Pushdown Accounting – SEC Paragraphs***	**7 Agenda Item**	**No Comment**	**IP - 13**

Summary:
During the Spring National Meeting, the Working Group exposed revisions to reject *ASU 2015-08, Business Combinations – Pushdown Accounting* as not applicable to statutory accounting. Although this ASU pertains to pushdown accounting, this item removes superseded SEC paragraphs that were previously included in the FASB Codification. Although there is current discussion involving pushdown accounting (addressed in a separate agenda item), as this ASU focuses on SEC paragraphs, it is still considered not applicable to statutory accounting.

Interested Parties' Comments:
Interested parties have no comment on rejecting the ASU 2015-08 that removes superseded SEC guidance about when push-down accounting was required.

Recommended Action:
NAIC staff recommends adopting the exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2015-08, Business Combinations – Pushdown Accounting* as not applicable to statutory accounting.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-17 Appendix D (Jake)	***ASU 2019-02, Accounting for Costs of Films and License Agreements for Program Materials***	**8 Agenda Item**	**No Comment**	**IP - 15**

Summary:
During the Spring National Meeting, the Working Group exposed revisions to reject *ASU 2019-02, Improvements to Accounting for Costs of Films and License Agreements for Program Materials* as not applicable to statutory accounting.

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

Recommended Action:
NAIC staff recommends adopting the exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2019-02, Improvements to Accounting for Costs of Films and License Agreements for Program Materials* as not applicable to statutory accounting.

REVIEW of COMMENTS on EXPOSED ITEMS – EXPECTING MINIMAL DISCUSSION

The following items received comments from interested parties' that are open for discussion during the meeting. NAIC staff has separated these items as limited discussion is expected prior to considering the recommended action.

1. Ref #2016-02: *ASU 2016-02, Leases*
2. Ref #2018-04: VOSTF Bank Loan Referral
3. Ref #2018-22: Participation Agreement in a Mortgage Loan
4. Ref #2019-03: Affiliated Transactions
5. Ref #2019-06: *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts*
6. Ref #2019-08: Reporting Deposit-Type Contracts

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2016-02 SSAP No. 22R (Jake)	***ASU 2016-02, Leases***	**9- SSAP 10 - Issue Paper**	**Comments Received**	**IP – 1 Kaiser - 16**

Summary:
During the Spring National Meeting, the Working Group exposed a substantively revised SSAP No. 22R and corresponding *Issue Paper No. 16X—Leases* to incorporate guidance from *ASU 2016-02, Leases*, but maintain the operating lease concept. The current exposure reflects revisions drafted from working directly with interested party representatives.

Interested Parties' Comments:
Interested parties support the changes in the revised exposed draft.

Kaiser Permanente Comments:
We would like to propose amendments to Paragraph 16 of SSAP 22R to provide further clarity, make this practical expedient operational, and minimize GAAP to STAT differences. We believe the NAIC's primary concern is around stakeholders being able to take advantage of optionality around the treatment of nonlease components when material and not closely related to the lease. We believe that our proposal below does not compromise this risk.

First, we think the guidance can be enhanced to further emphasize the "closely related" concept by providing examples in parenthesis as shown in our proposed revisions below. This will help to provide clarity that this expedient is only intended for these items and stakeholders do not have the option of using it for other types of components not related to the lease. We then propose to change "insignificant part of lease agreement" to "not the predominant components" because often times common area maintenance (a closely related lease element) for instance can be more than insignificant (i.e. more than 10% of overall contract value) but is still not a predominant part of the lease and can be accounted for as a single lease under GAAP. We believe such situations should still be able to apply the practical expedient to keep GAAP & STAT aligned. By limiting the expedient to only nonlease components that are closely related to elements of the lease and where they are not predominant, this still prevents stakeholders from being able to arbitrarily combine nonlease related elements with lease elements and minimizes optionality.

Below are three proposed options for treatment of nonlease components in paragraph 16. Each of these are meant to accomplish the same objectives but just worded/presented in a different way. Our thought process is further described below.

Proposed Option #1

16. As a practical expedient, when nonlease components are closely related to the elements of the lease (e.g. common area maintenance, utilities, labor) and are not the predominant components in a ~~an insignificant part of a~~ lease agreement, a lessee and a lessor may, as an accounting policy election by class of underlying asset, choose not to separate nonlease components from lease components and instead to account for each separate lease component and the nonlease components associated with that lease component as a single lease component. ~~The nonlease components must be closely related to the elements of the lease to be recognized as a single lease component.~~ For lease agreements between related parties, lease and nonlease components must be separated.

Proposed Option #2

16. As a practical expedient, when nonlease components are not the predominant components in ~~an insignificant part of~~ a lease agreement, a lessee and a lessor may, as an accounting policy election by class of underlying asset, choose not to separate nonlease components from lease components and instead to account for each separate lease component and the nonlease components associated with that lease component as a single lease component. The nonlease components must be closely related to the elements of the lease to be recognized as a single lease component (e.g. common area maintenance, utilities, labor). For lease agreements between related parties, lease and nonlease components must be separated.

Proposed Option #3

16. As a practical expedient, for lease contracts between unrelated parties~~when nonlease components are an insignificant part of a lease agreement~~, a lessee and a lessor may, as an accounting policy election by class of underlying asset, choose not to separate nonlease components from lease components and instead to account for each separate lease component and the nonlease components associated with that lease component as a single lease component if both of the following are met:

a) ~~.~~ The nonlease component(s) ~~must be~~are closely related to the lease component (e.g. common area maintenance, utilities, labor); and,

~~a)~~b)The nonlease component(s) are not the predominant component(s) in the contract. ~~elements of the lease to be recognized as a single lease component. For lease agreements between related parties, lease and nonlease components must be separated~~

Additional Thoughts

The change we are proposing is use of the term "predominant" instead of "insignificant," which provides consistency with the term used in ASC 842 for GAAP. We feel that "insignificant" would be too strong and stakeholders would have little benefit at the end of the day from the practical expedient even being in place. Here are the considerations for Predominant vs. Insignificant:

1. Predominant

    a. The guidance within ASC 842 (lessor practical expedient) uses "predominant" so language is consistent with US GAAP
    b. There is interpretive guidance for ASC 842 that allows entities to perform more of a qualitative assessment rather than a detailed quantitative analysis to support whether nonlease or lease components are predominant within a contract, making the expedient more operational.
    c. Would allow more leases to qualify for the practical expedient, and therefore, reduce/mitigate STAT to GAAP differences.

d. If concern is that entities will design contracts to include non-lease components that are "not" related to lease components, this risk is still addressed by the closely related criterion being in place. The combination of both criteria would appear to still address concerns about undesired nonlease components being accounted for under the leasing guidance.

2. Insignificant

   a. Including such a strong limitation on the significance of non-lease components, can make this practical expedient non-operational for many entities. It can put significant operational burdens on preparers and systems to comply with the guidance. Additionally, it can result in STAT to GAAP differences.
   b. From a contract perspective under US GAAP, insignificant is typically viewed as ~10% or less. Within Real Estate contracts, common items such as utilities/common area maintenance would likely exceed 10% of total contract value. It is likely the expedient would not apply to these contracts if "insignificant" is used.

Recommended Action:

NAIC staff recommends adopting the exposed the substantively revised SSAP No. 22R, and the corresponding Issue Paper, with an effective date of January 1, 2020 for all new leases entered into, and for existing leases reassessed due to a change in terms and conditions, with earlier adoption permitted. This recommendation does not include incorporating any revisions as suggested by Kaiser Permanente. The exposed Issue Paper has been updated to reflect these comments and the response indicating that these comments have not been reflected in the SSAP. (Once adopted, SSAP No. 22R will be shown "clean" in the AP&P Manual, with the Issue Paper showing the tracking from SSAP No. 22 for historical purposes.)

With regards to the comments received by Kaiser Permanente:

NAIC staff considered the comments provided by Kaiser Permanente. Fundamentally, the updated SSAP No. 22R keeps the existing operating lease treatment for all leases. The guidance included in paragraph 16 will only have income statement impact (which line the nonlease expense/revenue would have been reported) and will not affect the balance sheet as it would with the financing lease treatment that is part of U.S. GAAP. The intent of paragraph 16 is to allow easier reporting of leases for companies that have leases with nonlease components included in the contract, which will allow a small amount of maintenance or other expense to be included with the leasing or rent expense, which should save time and effort for the accounting departments for the reporting entities. The most common examples for insurance companies will be common area maintenance for those that have rented facilities and offices or for maintenance contracts that are commonly used for copiers and other office equipment.

Topic 842-10-15-37 does not use a qualifier like "predominant" or "insignificant" for determining when nonlease components can be allowed to be included with lease components for lessees. NAIC staff agree that the interpretation of the use of "insignificant" would be around 10% to possibly as high as 20%. We believe that any higher, that the nonlease amounts should be broken out from the lease component. NAIC staff believe that this is reasonable and provides better financial reporting of lease and rent expense.

The language using the term "predominant" comes from lessor guidance in Topic 842-10-15-42A and 842-10-15-42B, which is the practical expedient for revenue recognition for lessors. Revenue recognition for lessors is covered in paragraphs 28 through 30 of SSAP No. 22R. The guidance in paragraphs 28 through 30 is clear on revenue recognition for lessors for statutory accounting, and while this language is not the same as that of U.S. GAAP, it is consistent with U.S. GAAP in the accounting outcomes when operating lease treatment is allowed. NAIC staff do not believe that the use of the word "predominant" is appropriate for this guidance and could allow significant nonlease costs to be incorrectly categorized on the income statement.

In short, the proposed revisions would result with a deviation from US GAAP, potentially resulting with more agreements being classified as leases under SAP. With the intent to converge with US GAAP on whether an agreement is a lease, the proposed revisions are not recommended for adoption. (NAIC staff highlights that the comments were previously received and considered with the same conclusion. Also, the comments were previously discussed with other interested parties' and they were not supported.)

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2018-04 SSAP No. 21R (Julie)	**VOSTF Bank Loan Referral**	**11 Agenda Item**	**Comments Received**	**IP - 2**

Summary:

During the Spring National Meeting, the Working Group exposed revisions to *SSAP No. 21R—Other Admitted Assets* to clarify that a security in scope of another SSAP does not get reclassified as a "collateral loan" because it is also secured with collateral. As detailed within the agenda item, the current revisions being proposed to SSAP No. 21R are just one aspect being considered as part of the Valuation of Securities (E) Task Force referral for bank loans. After considering these revisions, further assessment will occur on responding to the original Task Force referral.

Interested Parties' Comments:

As stated in our previous comment letter on this topic submitted on May 18, 2018, regarding Revolving Credit Facilities, interested parties agree that a commitment to provide lending is not an asset. Insurers report any loans under these facilities as a bank loan under SSAP No. 26R- *Bonds* only upon making an actual loan. Loans drawn under revolving credit facilities meet the definition of bank loans and should continue to be reported under SSAP No. 26R- *Bonds*.

Regarding Borrowing Base loans and DIP Loans, interested parties refer to the comments made in our May 18, 2018 letter where we stated that both types of loans have full recourse to the borrower, which is an operating company (similar to any other corporate bond). A borrowing Base Loan is a type of Revolving Credit Facility in all respects (including as to recourse, existence of financial covenants and remedies), except that a Borrowing Base Loan includes the added protection of requiring lenders to only extend funds up to a certain percentage of the value of certain assets (i.e., the Borrowing Base amount). Under an event of default by the borrower, as with secured corporate bonds, the Borrowing Base lender will have full recourse to the operating company borrower, as well as any collateral securing the applicable loan/bond (which, in the case of a Borrowing Base Loan would include collateral constituting the Borrowing Base, as well as any other assets of the borrower).

Like Borrowing Base Loans, DIP Loans are typically asset-based working capital facilities that provide both immediate cash as well as working capital during a corporate reorganization conducted under chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code"). Although it may seem counterintuitive to think of DIP Loans as safe investments, the Bankruptcy Code extends several powerful protections to DIP Lenders. DIP Loans are full recourse loans. However, the exposure makes no further proposals on these type of bank loans, so we make no further supporting comments in this letter as we firmly believe they are within the scope of SSAP No. 26R. Similarly, we offer no comments on the proposed referral to the VOSTF as the exposure offered no detail on the content of the proposed referral.

Interested parties generally support the proposed clarifications to SSAP No. 21. However, we propose the following change to the new proposed footnote to reflect the fact that some investments captured within the scope of other statements, may technically not be a security:

> New Footnote: For purposes of determining a collateral loan in scope of this statement, a collateral loan does not include investments ~~securities~~ captured in scope of other statements. For example, SSAP No. 26R includes securities (as defined in that statement) representing a creditor relationship whereby there is

a fixed schedule for one or more future payments. Investments ~~Securities~~ captured in SSAP No. 26R that are also secured with collateral shall continue to be captured within scope of SSAP No. 26R.

Recommended Action:

NAIC staff agrees with interested parties' comments that there may be fixed-income instruments captured within the scope of SSAP No. 26R that do not specifically meet the "security" definition. As such, NAIC staff agrees with the modifications proposed to eliminate the reference to "securities" and refer to investments in the two locations suggested by interested parties. NAIC staff also highlights that the new footnote is intended to apply to all investments that are captured in an investment SSAP, and the reference to SSAP No. 26R is simply an example.

NAIC staff recommends that the Working Group adopt the exposed revisions to SSAP No. 21R, with the modifications suggested by interested parties as shaded below:

Collateral Loans

4. Collateral loans are unconditional obligations[FN] for the payment of money secured by the pledge of an investment[1] and 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 outstanding principal balance on the loan and any related accrued interest shall be recorded as an admitted asset subject to the following limitations:

a. Loan Impairment—Determination as to the impairment of a collateral loan shall be based on current information and events. When it is considered probable that any portion of amounts due under the contractual terms of the loan will not be collected the loan is considered impaired. The impairment shall be measured based on the fair value of the collateral less estimated costs to obtain and sell the collateral. The difference between the net value of the collateral and the recorded asset shall be written off in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5R);

b. Nonadmitted Asset—In accordance with *SSAP No. 20—Nonadmitted Assets*, collateral loans secured by assets that do not qualify as investments shall be nonadmitted. Further, any amount of the loan outstanding which is in excess of the permitted relationship of fair value of the pledged investment to the collateral loan shall be treated as a nonadmitted asset.

New Footnote: For purposes of determining a collateral loan in scope of this statement, a collateral loan does not include investment ~~securities~~ captured in scope of other statements. For example, SSAP No. 26R includes securities (as defined in that statement) representing a creditor relationship whereby there is a fixed schedule for one or more future payments. Investments ~~Securities~~ captured in SSAP No. 26R that are also secured with collateral shall continue to be captured within scope of SSAP No. 26R.

NAIC staff appreciates the continued comments from interested parties on the types of investments they believe should be captured in the bank loan definition. As identified in the exposure, after consideration of the new footnote (detailed above) further assessment of these investments, and a referral response to the Valuation of Securities (E) Working Group will be subsequently considered. As previously noted, there has been concern that the expansion of the bank loan definition will sweep in investments that regulators believe should be characterized as collateral loans. Additional discussion is needed before moving forward with a recommendation.

[1] Investment defined as those assets listed in Section 3 of *Appendix A-001—Investments of Reporting Entities.*

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2018-22 SSAP No. 37 (Julie)	**Participation Agreement in a Mortgage Loan**	**12 Agenda Item**	**Comments Received**	**IP - 4**

Summary:
During the Spring National Meeting, the Working Group exposed revisions to *SSAP No. 37—Mortgage Loans* to clarify the structure of mortgage loans acquired through a participation agreement intended to be captured in scope and to explicitly exclude "bundled" mortgage loans. This agenda item was previously exposed during the 2018 Fall National Meeting, and the current exposure reflects the technical edits from interested parties regarding "bundled" mortgage loans (to exclude "bulk purchases" from a bundle) as well as regulator comments to clarify the requirement of a participation agreement.

Interested Parties' Comments:
Interested parties continue to be appreciative that the Working Group included several small technical edits suggested in our previous comment letter. Additionally, we support the clarification that a "bundle of mortgage loans" does not include a "bulk purchase" where the reporting entity's interest in each mortgage loan is legally separate and divisible and the purchase just facilitates the acquisition of multiple single mortgage loan agreements.

While we agree with the spirit of the additional characteristics incorporated into exposed footnote 2b, there should be two amendments. First, regarding the requirement that there be a signed participation agreement with the original lender, it is not uncommon for an insurance company to acquire a mortgage loan from an originating lender so it would not technically be the original lender. This situation can be easily addressed by changing "original lender" to read "lender of record" everywhere in footnote 2b yet still be entirely consistent with the intent of the requirement.

Secondly, we want to make sure the requirement that the participation be recorded is understood. Participation agreements are not generally recorded in public records. However, we agree that they should be properly and promptly be recorded on the book and records of the lender. We recommended adding a phrase to the last line of proposed footnote 2b that "… the participation agreement must be properly and promptly recorded on the lender of record's books and records."

Interested Parties recommended footnote 2b:

b. Reporting entity has a "participation agreement" to invest in a single mortgage loan. The reporting entity is not the lender of record ~~an original lender~~ named as a payee on the mortgage loan, but the lender of record ~~original lender~~ sells a portion of the mortgage loan to the reporting entity through an assignment of a participation interest under the participation agreement. Under a participation agreement, the reporting entity acquires an undivided interest in the single mortgage loan proceeds to be received by the lender of record ~~original lender~~. Under a participation agreement, single mortgage loan proceeds include the periodic mortgage loan principal and interest payments received by the lender of record ~~original lender~~, and all rights and proceeds received in the foreclosure of a mortgage, deed of trust, deed in lieu of foreclosure, or other similar proceeding by the lender of record ~~original lender~~. The amount of the proceeds to be received by the reporting entity is based on the ratio of its participation interest to the then-outstanding single mortgage loan balance. To qualify as a mortgage loan under the scope of this statement, the reporting entity must have a signed participation agreement with the lender of record ~~original lender~~ named in the mortgage loan, the financial rights and obligations of the reporting entity under the participation agreement are the same as the lender of record ~~original lender~~, the reporting entity's participation interest in the single mortgage loan proceeds must be pari-passu with the lender of record ~~original lender~~ named on the mortgage loan agreement, and the participation agreement must be properly and promptly recorded on the lender of record's books and records.

Recommended Action:

NAIC staff agrees with the comments received by interested parties, namely that reference to “lender of record” is more appropriate than “original lender” and with how participation agreements are recorded. As such, NAIC staff recommends that the Working Group adopt the exposed revisions to SSAP No. 37 with the modifications suggested by interested parties.

The proposed revisions to SSAP No. 37 are shown below. (The revisions to footnote 2b shown the track changes to the existing SSAP No. 37 guidance. The revisions requested by interested parties are shaded.)

2. A mortgage loan is defined as a debt obligation that is not a security, which is secured by a mortgage on real estate. In addition to mortgage loans directly originated, a mortgage loan also includes mortgage loans acquired or obtained through assignment, syndication or participation[2]. Investments that reflect “participating mortgages,” “mortgage loan fund,” “bundled mortgage loans[3],” or the “securitization of assets” are not considered mortgage loans within scope of this SSAP.

a. A security is a share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

i. It is either represented by an instrument issued in bearer or registered form, or if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.

ii. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

iii. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

[2] Examples of agreements intended to be captured within this statement:

a. Reporting entity is a “co-lender~~participant~~” in a single mortgage loan agreement that identifies more than one lender (which includes the reporting entity) ~~providing funds to a sole borrower~~ with the real estate collateral securing all lenders identified in the agreement. For these single mortgage loan agreements, each lender is incorporated directly into the loan documents. The key differentiating characteristic of a mortgage loan provided under a group “mortgage loan co-lending ~~participation~~ agreement” rather than a solely-owned mortgage loan is that no one lender of the lending group may unilaterally foreclose on the mortgage. With these agreements, the lenders must foreclose on the mortgage loan as a group.

b. Reporting entity has a “participation agreement” to invest in a single mortgage loan. ~~mortgages issued by another entity. Although t~~The reporting entity is not the lender of record ~~an original lender~~ named as a payee on the ~~original~~ mortgage loan ~~agreement~~, but the lender of record ~~original lender~~ ~~issuer~~ sells a portion of the mortgage loan to the reporting entity ~~an incoming participant lender (co-lender) and the sale is documented by~~ through an assignment or participation interest under the participation agreement ~~between the selling lender and the co-lender. With these agreements, the co-lender~~ . Under a participation agreement, the reporting entity acquires an undivided ~~participation~~ interest in the single mortgage loan proceeds to be received by the lender of record ~~original lender~~. ~~and will receive direct interest in the amount of their participation in the right to repayment of the loan and the collateral given to secure the loan.~~ Under a participation agreement, single mortgage loan proceeds include the periodic mortgage loan principal and interest payments received by the lender of record ~~original lender~~, and all rights and proceeds received in the foreclosure of a mortgage, deed of trust, deed in lieu of foreclosure, or other similar proceeding by the lender of record ~~original lender~~. The amount of the proceeds to be received by the reporting entity is based on the ratio of its participation interest to the then-outstanding single mortgage loan balance. To qualify as a mortgage loan under the scope of this statement, the reporting entity must have a signed participation agreement with the lender of record ~~original lender~~ named in the mortgage loan, ~~T~~the financial rights and obligations of the reporting entity under the participation agreement are the same as the lender of record ~~original lender~~, the reporting entity’s participation interest in the single mortgage loan proceeds must be pari-passu with the lender of record

~~original lender~~ named on the mortgage loan agreement, and the participation agreement must be properly and promptly recorded on the lender or record's books and records.~~lenders in these agreements shall be similar to those in a direct loan.~~

[3] The scope of this SSAP is limited to single mortgage loan agreements. Although single mortgage loan agreements can potentially have more than one lender (e.g., co-lenders / participations) and more than one borrower (such as in a tenancy-in-common arrangement), the concept of a "single mortgage loan" does not include arrangements in which a reporting entity acquires more than one mortgage loan in a sole transaction. (For example, if a reporting entity was to acquire an interest in a "bundle" of mortgage loans with various unrelated borrowers and collateral, this agreement would be outside of the scope of this SSAP. However, a bundle of mortgage loans does not include a "bulk purchase" where the reporting entity's interest in each mortgage loan is legally separate and divisible and the purchase just facilitates the acquisitions of multiple single mortgage loan agreements.)

Footnote 2b is also shown clean with the IP changes tracked:

b. Reporting entity has a "participation agreement" to invest in a single mortgage loan. The reporting entity is not the lender of record ~~an original lender~~ named as a payee on the mortgage loan, but the lender of record ~~original lender~~ sells a portion of the mortgage loan to the reporting entity through an assignment of a participation interest under the participation agreement. Under a participation agreement, the reporting entity acquires an undivided interest in the single mortgage loan proceeds to be received by the lender of record~~original lender~~. Under a participation agreement, single mortgage loan proceeds include the periodic mortgage loan principal and interest payments received by the lender of record~~original lender~~, and all rights and proceeds received in the foreclosure of a mortgage, deed of trust, deed in lieu of foreclosure, or other similar proceeding by the lender of record ~~original lender~~. The amount of the proceeds to be received by the reporting entity is based on the ratio of its participation interest to the then-outstanding single mortgage loan balance. To qualify as a mortgage loan under the scope of this statement, the reporting entity must have a signed participation agreement with the lender of record ~~original lender~~ named in the mortgage loan, the financial rights and obligations of the reporting entity under the participation agreement are the same as the lender of record~~original lender~~, the reporting entity's participation interest in the single mortgage loan proceeds must be pari-passu with the lender of record~~original lender~~ named on the mortgage loan agreement, and the participation agreement must be properly and promptly recorded on the lender of record's books and records.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-03 SSAP No. 25 SSAP No. 26R SSAP No. 32 SSAP No. 43R SSAP No. 48 (Julie)	**Affiliated Transactions**	**13 Agenda Item**	**Comments on Specific Wording**	**IP - 9**

Summary:

During the Spring National Meeting, the Working Group exposed revisions to clarify the principle application of *SSAP No. 25—Affiliates and Other Related Parties*, as well as an "affiliated" classification when a transaction is in substance a related party transaction. The guidance includes situations when a transaction between related parties is conducted through a non-related intermediary.

Interested Parties' Comments:

Interested parties note that the revised wording uses the terms "affiliated" and "related party" interchangeably. Although the definitions for these terms overlap, they are not identical, and we recommend that the context in the revised wording be revised to ensure that the terms are being used properly.

Recommended Action:

NAIC staff recommends adopting the exposed agenda item with revisions to reflect edits in response to the interested parties' comments. This action will result with revisions adopted to *SSAP No. 25—Affiliates and Other Related Parties, SSAP No. 26R—Bonds, SSAP No. 32—Preferred Stock, SSAP No. 43R—Loan-backed and Structured Securities*, and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, as shown below:

Proposed Revisions to SSAP No. 25: Minor edits shown below.

1. Related party transactions are subject to abuse because reporting entities may be induced to enter transactions that may not reflect economic realities or may not be fair and reasonable to the reporting entity or its policyholders. As such, related party transactions require specialized accounting rules and increased regulatory scrutiny. This statement establishes statutory accounting principles and disclosure requirements for related party transactions.

2. This statement shall be followed for all related party transactions even if the transaction is also governed by other statutory accounting principles. Furthermore, this statement shall be followed in all transactions which involve unrelated parties as intermediaries between related parties. In determining whether a transaction is a related party transaction, consideration shall be given to the substance of the agreement, and the parties whose actions or performance materially impact the insurance reporting entity under the transaction. For example, an investment acquired from a non-related intermediary, in which the investment return is predominantly contingent on the performance of a related party, shall be considered a related party ~~an affiliated~~ investment. As a general principle, it is erroneous to conclude that the mere inclusion of a non-related intermediary eliminates the requirement to assess and properly identify the related party transaction in accordance with the provisions of this statement. It is also erroneous to conclude that the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to assess and identify the investment transaction as a related party ~~/ affiliated~~ arrangement.

Proposed Revisions to *SSAP No. 26R—Bonds:* No edits from the exposure.

5. Investments within the scope of this statement issued by a related party, or acquired through a related party transaction, are also subject to the provisions and disclosure requirements of *SSAP No. 25—Affiliates and Other Related Parties*. Investments within the scope of this statement meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement and SSAP No. 25.

Proposed Revisions to *SSAP No. 32—Preferred Stock:* No edits from the exposure.

2. Investments in preferred stock of subsidiaries, controlled or affiliated entities, including preferred stock interests of certified capital companies (CAPCO) per *INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)* are included within the scope of this statement. In addition to the provisions of this statement, preferred stock investments in SCA are also subject to the provisions of SSAP No. 25 and SSAP No. 97.

9. Preferred stocks meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement, SSAP No. 25 and SSAP No. 97.

Proposed Revisions to *SSAP No. 43R—Loan-backed and Structured Securities:* *Edits shown below.*

4. Loan-backed securities are issued by special-purpose corporations or trusts (issuer) established by a sponsoring organization. The assets securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee until the issuer's obligation has been fully satisfied. The investor only has direct recourse to the issuer's assets, but may have secondary recourse to third parties through insurance or guarantee for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the

responsibility for servicing the underlying assets. Some sponsors do guarantee the performance of the underlying assets.

a. In determining whether a loan-backed structure is a related party ~~an affiliated~~ investment, consideration shall be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security. For example, although a loan-backed security may be acquired from a non-related issuer, if the assets held in trust predominantly[FN] reflect assets issued by affiliates of the insurance reporting entity, and the insurance reporting entity only has direct recourse to the assets held in trust, the transaction shall be considered an affiliated investment, and the transaction shall also subject to the accounting and reporting provisions in SSAP No. 25.

New Footnote: In applying this guidance, a reporting entity is not required to complete a detailed review of the assets held in trust to determine the extent, if any, the assets were issued by related parties. Rather, this guidance is a principle concept intended to prevent situations in which related party transactions (particularly those involving affiliates) ~~affiliated debt~~ is knowingly captured in a SSAP No. 43R structure and not identified as a related party transaction (or not reported as an affiliated investment on the investment schedule) ~~recorded as a non-affiliated" investment~~ because of the involvement of a non-related trustee or SSAP No. 43R security issuer. As identified in SSAP No. 25, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party investment ~~/ affiliated~~ arrangement.

5. Investments within the scope of this statement are also subject to the provisions and disclosure requirements of *SSAP No. 25—Affiliates and Other Related Parties* if the SSAP No. 43R transaction is a related party investment ~~/affiliated entity~~ arrangement[FN]. Loan-backed and structured securities meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement and SSAP No. 25.

New Footnote: As discussed in paragraph 4a, a SSAP No. 43R security may still be considered a related party transaction even if the asset trustee or security issuer is a non-related party.

Proposed Revisions to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies: Edits Shown*

6. Investments in these ventures, except for joint ventures, partnerships and limited liability companies with a minor ownership interest[FN], shall be reported using an equity method as defined in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* (SSAP No. 97), paragraphs 8.b.i. through 8.b.iv. A reporting entity whose shares of losses in a SSAP No. 48 entity exceeds its investment in the SSAP No. 48 entity shall disclose the information required by SSAP No. 97, paragraph 35.a.

New Footnote: With the identification of whether the reporting entity has a minor ownership interest, reporting entities must also identify whether the investment is an related party ~~affiliate~~ transaction. Pursuant to the concepts reflected in SSAP No. 25, consideration shall be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security. For example, if the underlying assets within a SSAP No. 48 entity represent assets issued by an affiliate, then the SSAP No. 48 entity shall be considered a related party (affiliate) investment, with the transaction subject to the accounting and reporting provisions of SSAP No. 25. As identified in SSAP No. 25, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party ~~/ affiliated~~ arrangement.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-06 Various (Jake)	***ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts***	**14 Agenda item**	**Agree with Rejection**	**IP - 9**

Summary:

During the Spring National Meeting, the Working Group exposed revisions to update U.S. GAAP references in the Preamble and reject *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts* for statutory accounting. With the exposure comments were requested on whether new disclosure reconciliations of liabilities should be captured.

Interested Parties' Comments:

Interested parties agree that the ASU should be rejected for statutory purposes and both paragraph 20 of the Preamble and the applicable SSAPs should be adjusted accordingly. More specifically, interested parties agree with the objectives of statutory accounting that stress the ability to pay claims in the future by intentionally establishing conservative reserves that also emphasize the long-term nature of the liabilities.

U.S. GAAP serves different needs. "Market consistent" approaches are not suited for regulatory purposes due to the negative effects the unhelpful volatility they introduce can have on the ability of insurance companies to provide long-term insurance products critically relied upon by millions of Americans.

In a market consistent approach, such as with the ASU, a rollforward of balance sheet items (i.e., future policy benefits, policyholder account balances, and market risk benefits) can offer insights into the changes related to those balances. For entities not preparing their balance sheet on a market consistent basis, such as with statutory accounting, the rollforward of extraneous balances (i.e., non-balance sheet items) does not provide meaningful information to the users of the statutory financial statements. As such, interested parties recommend the NAIC reject the U.S. GAAP disclosures for statutory accounting for the following reasons:

1) Such a rollforward of extraneous balances (i.e., non-balance sheet balances) does not provide additional meaningful information to the users of statutory financial statements,

2) Such rollforwards would be prohibitively resource extensive (i.e., expensive) for preparers of statutory financial statements who are not required to prepare financial statements in accordance with U.S. GAAP (i.e., mutual companies, foreign private issuers and small companies), and

3) The NAIC is ahead of the FASB by currently requiring the rollforward of balance sheet reserve balances as required in the "Analysis of Increase in Reserves During the Year" for the balance sheet account of Aggregate Reserve for Life Contracts and in "Exhibit 7 – Deposit Type Contracts" for the balance sheet account of Liability for Deposit-Type Contracts. As such, rollforwards already exist that offer insights into the changes related to balance sheet reserve balances.

Additionally, we note that the list of SSAPs for which the guidance is to be rejected should include SSAP No. 54R, *Individual and Group Accident and Health Contracts*, and SSAP No. 55, *Unpaid Claims, Losses and Loss Adjustment Expenses*, as there is guidance in these SSAPs that is applicable to some health contracts that are considered long-duration.

Should regulators decide to "tweak" the existing NAIC rollforward disclosures, after their review of the disclosures in the ASU, the NAIC should reject the ASU in totality and start a separate disclosure project in that regards. While interested parties do not believe new disclosures are necessary, such an approach would ensure any OCBOA issues do not arise with auditors (i.e., where the auditing standards require auditors to enforce US GAAP disclosures for which companies may not be able to comply).

Recommended Action:

NAIC staff recommends adopting the exposed revisions to the Preamble (to update U.S. GAAP references) and to identify the rejection of ASU 2018-12 in the following SSAPs: *SSAP No. 50—Classifications of Insurance or Managed Care Contracts, SSAP No. 51R—Life Contracts, SSAP No. 52—Deposit-Type Contracts, SSAP No. 54—Individual and Group Accident and Health Contracts, SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses, SSAP No. 56—Separate Accounts, SSAP No. 71—Policy Acquisition Costs and Commissions, and SSAP No. 86—Derivatives.* ***(NAIC staff highlights that SSAP No. 54 and SSAP No. 55 were added based on interested parties' comments.)***

NAIC staff has not duplicated the proposed language to reject the ASU in all the noted SSAPs (as most were noted in the exposure), but has included the paragraphs for SSAP No. 54 and SSAP No. 55 below:

SSAP No. 54—Individual and Group Accident and Health Contracts

41. This statement rejects *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts* and *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises* relating to accounting and reporting for individual and group accident and health contracts.

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

20. This statement also rejects *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts, AICPA Statement of Position 92-4, Auditing Insurance Entities' Loss Reserves* and *ASU 2015-09, Disclosures about Short-Duration Contracts.* Although the disclosures in ASU 2015-09 are similar to existing statutory accounting disclosures on claims development, the U.S. GAAP disclosures would reflect consolidated information, with potential for different aggregations than what is used for a legal entity basis under statutory accounting. As such, ASU 2015-09 is rejected for statutory accounting, and reporting entities shall follow the established statutory accounting disclosures

NAIC staff is not advocating for new disclosures in response to ASU 2018-12, but the exposure requested feedback on whether new or revised disclosures are necessary. This inquiry was intended to capture whether additional disclosures will be required by the AICPA in accordance with Generally Accepted Auditing Standards (GAAS), and if it would be most appropriate to capture those disclosure requirements in SAP. **At this time, as there is no proposal to incorporate revised disclosures, NAIC staff agrees with interested parties that this agenda item would be finalized if the Working Groups determines to reject the ASU (including the disclosures).**

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-08 SSAP No. 51 SSAP No. 52 (Julie)	**Reporting Deposit-Type Contracts**	**15 Agenda Item**	**Comments Received**	**IP - 11**

Summary:

During the Spring National Meeting, the Working Group exposed this agenda item with a request for comments on why guaranteed investment contracts, or other deposit-type contracts, are reported in Exhibit 5 – Aggregate Reserves for Life Contracts or Exhibit 6 – Aggregate Reserves for Accident and Health Contracts instead of Exhibit 7 – Deposit-Type Contracts.

Interested Parties' Comments:

Interested parties note that generally, deposit-type contracts such as GICs and supplemental contracts are reported in Exhibit 7 – Deposit Type Contracts. However, certain contracts (which have similar characteristics to deposit-type contracts) incorporate mortality or morbidity risk components which qualify those contracts to be reported in Exhibit 5 – Life Contracts or Exhibit 6 – Accident and Health Contracts. A common example is a supplemental contract which provides for a life-contingent payout. Because the contract was life-contingent at issue, it is reported in Exhibit 5 and remains in Exhibit 5 after the death of the annuitant as remaining guaranteed payments continue to the beneficiary. Additionally, state insurance departments have the discretion to approve or require a contract to be classified as a life / A&H insurance contract.

For further clarification as to why certain contracts are reported in Exhibit 5 due to mortality or morbidity risk, we want to note that the guidance in paragraph 44 of SSAP 50 is generally what is used to infer guidance around the classification of these contracts. This paragraph includes the below definition of what is a Deposit Type Contract (i.e. Exhibit 7) [emphasis added]:

"Funding Agreements **without** well-defined class-based (e.g. age, gender) annuity purchase rates defining either specific or maximum purchase rate guarantees (see SSAP No. 15, paragraph 19, paragraph 20 of this statement and SSAP No. 52—Deposit-Type Contracts, paragraph 20.)"

While the above definition does not explicitly define where contracts with these features (i.e. well-defined class-based annuity purchase rates defining specific or maximum purchase rate guarantees) should be classified, it is clear that they should not be included in Exhibit 7. Therefore, another supportable classification is to include them within Exhibit 5 due to the mortality and morbidity risk components within these features.

Recommended Action:

NAIC staff recommends that the Working Group direct NAIC staff to consider whether statutory accounting revisions are necessary to ensure consistency and clarity in reporting. Particularly, questions have arisen from the following components noted in the interested parties' comments. NAIC staff suggests re-exposure of the agenda item, with inclusion of the items / questions noted below, with a request for additional comments from industry and regulators and specific request for comments from the Financial Stability (EX) Task Force and the Life Actuarial (A) Task Force.

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

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

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

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

3. **Annuity Guidance** – The interested parties cited existing annuity guidance in paragraph 20 of *SSAP No. 50—Classifications of Insurance or Managed Care Contracts.* Per this guidance, contracts containing well-defined class-based (e.g., age / gender) annuity purchase rates used in defining either a specific or

maximum purchase rate guarantee would constitute an annuity contract containing a life contingency that would require it to be classified as a life contract.

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

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

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

Excerpt from SSAP No. 50, paragraph 20:

1. An annuity contract is an arrangement whereby an annuitant is guaranteed to receive a series of stipulated amounts commencing either immediately or at some future date. The contract shall be issued to or for the benefit of an identifiable individual or group of individuals. **<u>Such a contract containing well-defined class-based (e.g. age, gender) annuity purchase rates used in defining either a specific or maximum purchase rate guarantee would constitute an annuity contract containing a life contingency that would require it to be classified as a life contract.</u>** Some examples of contracts issued for the benefit of a group of individuals include pension plan sponsors purchasing contracts for the benefit of their plan participants, employers or associations purchasing contracts for the benefit of their employees or members, and collective trusts purchasing contracts for the benefit of participating pension plans and their plan participants. **<u>The main types of annuity contracts with life contingencies are discussed below.</u>**

   a. A deferred annuity provides for the accumulation of funds to be applied at some future period designated by the policyholder. Premium payments can be made in a lump sum amount (single premium deferred annuity), or periodically (flexible or fixed premium deferred annuity) as allowed by the policy contract. At the end of the accumulation period, the policyholder may elect to receive a lump sum distribution or may elect to receive periodic payments for life, or over a specific period, or some combination thereof;

   b. A variable annuity is an annuity which includes a provision for benefit payments which vary in accordance with the rate of return of the underlying investment portfolio selected by the policyholder. The considerations for a variable annuity are usually invested in a separate account in which the value of the contract share varies according to the performance of the separate account before the commencement of annuity payments as well as after. Premium payments can be made in lump sum amounts or periodically as allowed by the policy contract. A minimum death benefit is often guaranteed during the annuity consideration accumulation period and these contracts are, therefore, classified as life contracts;

   c. A straight-life annuity provides for periodic payments to the annuitant as long as the annuitant lives. Death of the annuitant constitutes completion of the contract and no further payments are made by the insurance company;

   d. A life annuity with a period certain works essentially the same way as the straight-life annuity as the annuitant receives periodic payments for as long as the annuitant lives. However, if the annuitant dies before the end of the specified "certain" period, payments are continued to a beneficiary until the specified number of "certain" payments (i.e., the specified period in the contract) is completed;

e. A refund annuity is similar to the life annuity with a period certain in which the annuitant receives periodic payments for as long as the annuitant lives. There are two variants of this type of annuity. Under the cash refund annuity, a lump-sum payment is made at the death of the annuitant equal to the excess, if any, of the purchase price of the annuity over the sum of the annuity payments made to date of death. The installment refund annuity provides that annuity payments are to continue to a beneficiary after the death of the annuitant until the sum of all payments made equals the purchase price;

f. A joint and survivorship annuity provides for the continuation of payments after the death of one of the annuitants during the lifetime of the surviving annuitant.

REVIEW of COMMENTS on EXPOSED ITEMS

1. Ref #2018-26: SCA Loss-Tracking Accounting Guidance
2. Ref #2018-38: Prepayments to Service and Claims Adjusting Providers
3. Ref #2019-09: SSAP No. 101 – Q/A Updates – TCJA
4. Ref #2019-10: SSAP No. 101 – Q/A Updates – DTA/DTL Offset
5. Ref #2019-12: *ASU 2014-17, Business Combinations – Pushdown Accounting*
6. Ref #2019-13: Clarification of a Look-Through Approach
7. Ref #2019-14: Attribution of Goodwill
8. Ref #2019-18: "Other" Derivatives

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2018-26 SSAP No. 97 (Fatima/Julie)	**SCA Loss-Tracking Accounting Guidance**	**16 Agenda Item**	**Comments Received**	**IP - 6**

Summary:
During the Spring National Meeting, the Working Group exposed revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to update the existing reporting requirements for when a reporting entity has a negative equity value in an SCA investment and has provided a financial guarantee or commitment. With the exposed revisions, if the entire SCA equity loss is recognized under *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* (under the guarantee guidance), then the obligation to provide further commitments does not need to be recognized under SSAP No. 97. However, if there is a guarantee or commitment, and the entire loss is not recognized under SSAP No. 5R, the reporting entity shall not stop at zero in valuing the SCA and shall recognize a negative value for the SCA. The revisions also provide a more detailed reference to *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investors Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses*, with inclusion of the INT 00-24 exhibit into SSAP No. 97.

Interested Parties' Comments:
The proposed revisions to SSAP No. 97 paragraph 13e include the following: "If the entire loss is recognized under SSAP No. 5R, it does not also need to be recognized under SSAP No. 97. However, if there is a guarantee or commitment, and the entire loss is not recognized under SSAP No. 5R, the reporting entity shall not stop at zero, and shall recognize <u>the amount of loss, including losses that result in </u>a negative value of the SCA." It appears the proposed wording is intended to provide for a potential loss under a guarantee that is exempted from the initial liability recognition guidance of paragraph 18f of SSAP No. 5R (i.e., guarantees made to/or on behalf of directly or indirectly wholly-owned insurance or non-insurance subsidiaries). If that is the case, then the term "entire loss" used in the context of the proposed wording appears to be inconsistent with the SSAP No. 5R loss recognition guidance for guarantees. As such, we recommend the following revisions:

"If the ~~entire loss~~ guaranteed obligation is recognized under SSAP No. 5R, it does not also need to be recognized under SSAP No. 97. However, if there is a guarantee or commitment, and the ~~entire loss~~ guaranteed obligation is not recognized under SSAP No. 5R, the reporting entity ~~shall not stop at zero, and~~ shall recognize a liability for the guaranteed obligation measured in accordance with SSAP No. 5R paragraph 20 (i.e., fair value). This includes guarantees made to/or on behalf of directly or indirectly wholly-owned insurance or non-insurance subsidiaries that would otherwise be exempted from initial liability recognition guidance under paragraph 18f of SSAP No. 5R ~~negative value of the SCA~~."

Recommended Action:

NAIC staff highlights that the guarantee guidance in SSAP No. 5R includes two key elements:

1) Liability recognition at the inception of a guarantee at an amount that represents the greater of a) the fair value of the guarantee or b) the contingent liability. (At inception of the guarantee, it would be unusual for the contingent liability (which has a probable threshold for recognition) to be greater than the fair value of the guarantee. This is because most guarantees are not provided when there is a probable likelihood that the guarantor will have to act on the guarantee.)

2) Subsequent recognition of the guarantee liability. Pursuant to the guidance in SSAP No. 5R, this guidance is not specific, but it generally entails the reduction of the initial liability, because the guidance identified that the entity is typically removed from risk over time. (This guidance identifies that a release from risk could occur as the "fair value of the guarantee changes.") The guidance identifies that the noncontingent liability would be eliminated with the recognition of a contingent liability if the criteria is met (probable / reasonably estimable). The guidance also identifies that if there is a recognition of a contingent liability, which is settled, then the reporting entity would need to reassess any remaining guarantee for re-recognition as a noncontingent liability.

The proposed revisions from interested parties have focused on the SSAP No. 5R initial liability recognition of a guarantee (at the fair value of the guarantee), whereas the situations being addressed in SSAP No. 97 are scenarios in which the SCA has incurred losses that have resulted in a negative equity value of the SCA by the insurance reporting entity. These incurred losses, resulting in a negative equity value, are anticipated to only occur after initial recognition of the SCA relationship and after the initial fair value recognition of the guarantee. As such, in these scenarios, the subsequent "guarantee risk" is greater than what existed at initial recognition.

Although it is possible that the "probable" threshold made not be met for full recognition of the guarantee as a contingent liability, **it is NAIC staff's recommendation that when there is a guarantee / financial commitment and the SCA has incurred losses resulting in a negative equity value, the noncontingent liability should be adjusted so, at a minimum, it reflects the reporting entity's negative equity value. (This would be consistent with historical guidance in SSAP No. 97.)** NAIC staff agrees that the liability should not be double recognized (both under SSAP No. 5R and SSAP No. 97), but disagrees that the "initial noncontingent liability" recognized at inception of the guarantee is sufficient when the reporting entity's share of losses in the investee has subsequently resulted in a negative equity value. Rather, the noncontingent liability should be updated to reflect the enhanced guarantee risk – at least to the extent of the negative equity value – to ensure that the balance sheet is not understated on the commitment to provide future financial support to an SCA.

In order to prevent confusion with having guidance in both SSAP No. 5R and SSAP No. 97, **NAIC staff suggests that new language be added to SSAP No. 5R to clarify that the noncontingent liability of a guarantee in these situations shall be the greater of the premium that would be expected to cover the guarantee in a stand-alone transaction (e.g., fair value), or losses that exceed an insurance reporting entity's initial investment in an SCA (negative equity position). Additionally, NAIC staff recommends removing the guidance from SSAP No. 97 and pointing to the provisions of SSAP No. 5R.** The SSAP No. 97 revisions also propose a slight disclosure change to the SCA Loss-Tracking disclosure to capture the guarantee and not the reported value of the SCA. (With the proposed edits, the SCA will be reported at zero.)

NAIC staff recommends that the Working Group expose the following proposed revisions to SSAP No. 5R and SSAP No. 97 for comment:

Proposed Revisions to SSAP No. 5R: (Only relevant paragraphs included).

8. An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations if both of the following conditions are met:

a. Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the statutory financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and

b. The amount of loss can be reasonably estimated.

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

a. Guarantee that is accounted for as a derivative instrument, other than credit derivatives within SSAP No. 86;

b. Guarantee for which the underlying is related to the performance of nonfinancial assets that are owned by the guaranteed party, including product warranties;

c. Guarantee issued in a business combination that represents contingent consideration;

d. Guarantee in which the guarantor's obligation would be reported as an equity item;

e. Guarantee by an original lessee that has become secondarily liable under a new lease that relieved the original lessee from being the primary obligator;

f. Guarantees (as defined in paragraph 16) made to/or on behalf of directly or indirectly wholly-owned insurance or non-insurance subsidiaries[1]; and

g. Intercompany and related party guarantees that are considered "unlimited" (e.g., typically in response to a rating agency's requirement to provide a commitment to support).

19. With the exception of the provision for guarantees made to/or on behalf of a wholly-owned subsidiaries in paragraph 18.f. and "unlimited" guarantees in 18.g., this guidance does not exclude guarantees issued as intercompany transactions or between related parties from the initial liability recognition requirement. Thus, unless the guarantee is provided on behalf of a wholly-owned subsidiary or considered "unlimited," guarantees issued between the following parties are subject to the initial recognition and disclosure requirements:

a. Guarantee issued either between parents and their subsidiaries or between corporations under common control;

b. A parent's guarantee of its subsidiary's debt to a third party; and

c. A subsidiary's guarantee of the debt owed to a third party by either its parent or another subsidiary of that parent.

[1] The exclusion for wholly-owned subsidiaries includes guarantees from a parent to, or on behalf of, a direct wholly-owned insurance or non-insurance subsidiary as well as guarantees made from a parent to, or on behalf of, an indirect wholly-owned insurance or non-insurance subsidiary. The "wholly-owned" exclusion in paragraph 18.f. does not include guarantees issued from one subsidiary to another subsidiary, regardless if both subsidiaries are wholly-owned (directly or indirectly) by a parent company.

20. At the inception of a guarantee, the guarantor shall recognize in its statement of financial position a liability for that guarantee. Except as indicated in paragraph 22, the objective of the initial measurement of the liability is the fair value[2] of the guarantee at its inception.

> Footnote: As practical expedients, when a guarantee is issued in a standalone arm's-length transaction, the liability recognized at the inception of the guarantee should be the premium received or receivable by the guarantor. When a guarantee is issued as part of a transaction with multiple elements, the liability recognized at the inception of the guarantee should be an estimate of the guarantee's fair value. In that circumstance, guarantors should consider what premium would be required by the guarantor to issue the same guarantee in a standalone arm's-length transaction.

21. The issuance of a guarantee obligates the guarantor (the issuer) in two respects: (a) the guarantor undertakes an obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur (the noncontingent aspect) and (b) the guarantor undertakes a contingent obligation to make future payments if those triggering events or conditions occur (the contingent aspect). Because the issuance of a guarantee imposes a noncontingent obligation to stand ready to perform in the event that the specified triggering event occurs, the provisions of paragraph 8 should not be interpreted as prohibiting the guarantor from initially recognizing a liability for that guarantee even though it is not probable that payments will be required under that guarantee.

22. In the event that, at the inception of the guarantee, the guarantor is required to recognize a liability under paragraph 8 for the related contingent loss, the liability to be initially recognized for that guarantee shall be the greater of (a) the amount the satisfies the fair value objective as discussed in paragraph 20 or (b) the contingent liability amount required to be recognized at inception of the guarantee by paragraph 8. For many guarantors, it would be unusual for the contingent liability under (b) to exceed the amount that satisfies the fair value objective at the inception of the guarantee.

23. The offsetting entry pursuant to the liability recognition at the inception of the guarantee depends on the circumstances in which the guarantee was issued. Examples include:

a. If the guarantee was issued in a standalone transaction for a premium, the offsetting entry would the consideration received.

b. If the guarantee was issued in conjunction with the sale of assets, a product, or a business, the overall proceeds would be allocated between the consideration being remitted to the guarantor for issuing the guarantee and the proceeds from that sale. That allocation would affect the calculation of the gain or loss on the sale transaction.

c. If a residual value guarantee were provided by a lessee-guarantor when entering into an operating lease, the offsetting entry would be reflected as prepaid rent, which would be nonadmitted under SSAP No. 29.

d. If a guarantee were issued to an unrelated or related party for no consideration on a standalone basis, the offsetting entry would be to expense.

24. Except for the measurement and recognition of continued guarantee obligations after the settlement of a contingent guarantee liability described in paragraph 25, and the provisions for SCAs detailed in paragraph 24a, this standard does not describe in detail how the guarantor's liability for its obligations under the guarantee would be measured subsequent to initial recognition. The liability that the guarantor initially recognized in accordance with paragraph 20 would typically be reduced (as a credit to income) as the guarantor is released from risk under the guarantee. Depending on the nature of the guarantee, the guarantor's release from risk has typically been recognized over the term of the guarantee (a) only upon either expiration or settlement of the guarantee, (b) by a systematic and rational amortization method, or (c) as the fair value of the guarantee changes (for example, guarantees accounted for as derivatives). The reduction of liability does not encompass the recognition and subsequent adjustment of the contingent liability recognized under paragraph 8 related to the contingent loss for the guarantee. If the guarantor is required to

subsequently recognize a contingent liability for the guarantee, the guarantor shall eliminate any remaining noncontingent liability for that guarantee and recognize a contingent liability in accordance with paragraph 8.

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

25. After recognition and settlement of a contingent guarantee liability in accordance with paragraph 8, a guarantor shall assess whether remaining potential obligations exist under the guarantee agreement. If the guarantor still has potential obligations under the guarantee contract, the guarantor shall recognize the remaining noncontingent guarantee that represents the current fair value of the potential obligation remaining under the guarantee agreement. This noncontingent guarantee liability shall be released in accordance with paragraph 24.

Proposed Revisions to SSAP No. 97: (Only relevant paragraphs included – revisions from Spring shaded).

13. On at least a quarterly basis, the procedures set forth below shall be followed by a reporting entity in applying an equity method of accounting (as described in paragraphs 8.b.i. through 8.b.iv.), as applicable, to investments in SCA entities:

e. For entities subject to 8.b.i., 8.b.ii., 8.b.iii. and 8.b.iv. a reporting entity's share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by an equity method plus advances made by the investor. The reporting entity shall discontinue applying an equity method when the investment (including advances) is reduced to zero[3] and shall not provide for additional losses, while still continuing to track the amount of unreported equity method losses, until any future equity method income can be reported. If the ~~unless the~~ reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee, the provisions ~~such as (guaranteed obligations meeting the definition of liabilities in~~of *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* shall be followed. ~~(SSAP No. 5R), they shall be recorded as liabilities). If~~As the entire equity method loss (subject to the financial guarantee / commitment) shall be ~~is~~ recognized under SSAP No. 5R, it does not also need to be recognized under SSAP No. 97. If the investee subsequently reports net income, the reporting entity shall resume applying an equity method only after its share of that net income equals the share of net losses not recognized during the period that an equity method was suspended;

Footnote 2: Although the SCA is reported at zero in the investment schedule, a guarantee liability (either contingent or noncontingent) may be required to be reported under SSAP No. 5R. Additionally, ~~R~~refer to the ~~additional~~ guidance related to discontinuance of an equity method in paragraphs 15-17 and *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee* and *EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses*. As detailed in INT 00-24, a reporting entity's share of losses in an SCA shall be applied to other investments held in the SCA once the SCA (common stock) investment has been reduced to zero.

35. All SCA investments within the scope of this statement (except paragraph 8.b.i. entities) shall include disclosure of the SCA balance sheet value (admitted and nonadmitted) as well as information received from the NAIC in response to the SCA filing (e.g., date and type of filing, NAIC valuation amount, whether resubmission of filing is required). This disclosure shall include an aggregate total of all SCAs (except paragraph 8.b.i. entities) with detail of the aggregate gross value under this statement with the admitted and nonadmitted amounts reflected on the balance sheet. (As noted in paragraph 4, joint ventures, partnerships and limited liability companies are accounted for under the guidance in SSAP No. 48. As such, those entities are not subject to the disclosures in this statement, unless specifically directed by SSAP No. 48.)

a. For all periods presented, a reporting entity whose shares of losses in an SCA exceeds its investment in the SCA shall disclose its share of losses. (This is required regardless of a guarantee or commitment of future financial support to the SCA.) This disclosure shall include the following:

i. The reporting entity's accumulated share of the SCA losses not recognized during the period that the equity method was suspended;

ii. The reporting entity's share of the SCA's equity, including negative equity;

iii. Whether a guaranteed obligation or commitment for financial support exists; and

iv. ~~The SCA's reported value~~The amount of the recognized guarantee under SSAP No. 5R .

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2018-38 SSAP No. 55 (Robin)	**Prepayments to Service and Claims Adjusting Providers**	**17 Agenda Item**	**Comments Received**	**IP - 7**

Summary:

During the Spring National Meeting, the Working Group exposed revisions to *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses* to provide guidance regarding prepayments to providers of claims and adjusting services. This proposal strengthens the existing guidance which provides that prepayments to third parties do not reduce the reporting entity's liabilities for unpaid claims/ losses or claims/ loss adjusting expenses, but are recognized as nonadmitted prepaid expenses. This exposure does not change the reporting of incurred losses and loss adjusting expenses which are expensed as incurred. Additionally, guidance was exposed regarding flat fee bundled payments.

Interested Parties' Comments:

This proposal is intended to clarify that prepayments to providers of claims and adjusting services are recognized as non-admitted prepaid expenses and guidance regarding flat fee bundled payments. Interested parties previously commented recommending that the Working Group include qualifying language in SSAP No. 55 to exclude capitation payments since the guidance in SSAP No. 84 already addresses health contracts. Since health carriers expense loss adjustment expenses when claims are incurred, it is not necessary to establish an asset. The *Accounting Practices and Procedures Manual* already has rules that cover advances to providers that should not be overruled by the proposed guidance. Additionally, "miscellaneous underwriting expenses" is not a recognized expense category for health insurance. Therefore, interested parties recommend that qualifying language be included to exclude all payments under managed care contracts. Health carriers are concerned that the proposal changes how claims adjustment expenses are being recorded and do not believe the intent of the proposal is to add significant administrative burden to health carriers by requiring the recording of a non-admitted prepaid asset initially when claims are incurred and then expense the amounts when claims are adjudicated and/or paid. Following are suggested revisions to the proposed guidance.

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

   a. All prepayments (i.e., variable, fixed or bundled amounts) to third party administrators, management companies or other entities for unpaid claims, losses and losses/claims adjustment expenses, except for capitated payments for managed care contracts, shall not reduce losses/claims and shall be initially reported as a prepaid asset and nonadmitted in accordance with SSAP No. 29—*Prepaid Expenses*. When the benefit has been provided to the policyholder or claimant, the claims prepayments to third party administrators, management companies or other entities (except for capitated payments for managed care contracts), are reclassified proportionately from the prepaid nonadmitted asset to claims, losses or loss/claim expenses paid based on the amount of losses/claims cost incurred to provide the benefit. <u>However, this guidance does not apply to health insurance and managed care contracts with respect to loans and advances to providers, which are addressed in another statement. This guidance also does not apply to loss/claim adjustment expenses for health insurance and managed care contracts, which are expensed when the corresponding losses/claims are incurred, not when they are paid.</u>

   b. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as miscellaneous underwriting expenses for property and casualty contracts and as general administrative expenses for health insurance and managed care contracts.

   c. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related

5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims adjustment expenses on non-capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third-party administrators, etc. The liability for claims adjustment expenses on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers.

   a. When the prepaid benefit as described in paragraph 4 has been provided to the policyholder or the claimant, the associated prepayments to third party administrators, management companies or other entities (except for capitated payments for managed care contracts) are reclassified proportionately from the prepaid nonadmitted asset to paid loss /claim adjusting expenses based on the amount of losses/claims cost incurred to provide the benefit. <u>However, the foregoing is not applicable to health insurance and managed care contracts.</u> Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as miscellaneous underwriting expenses<u> for property and casualty contracts and as general administrative expenses for health insurance and managed care contracts</u>.

<u>*Recommended Action:*</u>

NAIC Staff recommends exposure with NAIC staff revisions to reflect edits in response to some of the interested parties' concerns that some of the exposed text was perceived as changing the timing of claims and claims adjusting expense recognition for health entities (the current guidance that claims and claims

adjustment expense is expensed as incurred is unchanged). The proposed modifications are reflected as shaded text in paragraphs 4 and 5 of SSAP No. 55 below. The revisions are summarized as follows:

- o Language which mirrors existing guidance in paragraph 5, ;liabilities are established regardless of payments to third parties.

- o The existing guidance which provides that the claims and loss adjustment expense (LAE) are expensed as incurred is unchanged. Additional wording has been added to make this clearer.

- o In response to the comment that "miscellaneous underwriting expenses" is not a recognized expense category for health insurance, additional annual statement line references in paragraphs 4 and 5 have been recommended.

- o Added a reference to SSAP No. 84 regarding prepayments to providers, etc.

Revisions have not been recommended for the following interested parties' comments:

1. Interested parties previously commented recommending that the Working Group include qualifying language in SSAP No. 55 to exclude capitation payments since the guidance in SSAP No. 84 already addresses health contracts.

   a. **NAIC Staff note:** Capitation payments under managed care contracts were previously and continue to be excluded from the prepayment of LAE guidance, paragraph 5 as reflected in the first sentence of existing paragraph 5. Revisions exposed in the Spring for paragraph 4. a. already includes a carve out for capitated payments

2. Interested parties commented that "Since health carriers expense loss adjustment expenses when claims are incurred, it is not necessary to establish an asset. Therefore, interested parties recommend that qualifying language be included to exclude all payments under managed care contracts." Health carriers are concerned that the proposal changes how claims adjustment expenses are being recorded and do not believe the intent of the proposal is to add significant administrative burden to health carriers by requiring the recording of a non-admitted prepaid asset initially when claims are incurred and then expense the amounts when claims are adjudicated and/or paid.

   a. **NAIC Staff note:** All claims and losses and loss or claim adjustment expenses are already recognized as expenses when incurred, per SSAP No. 55, paragraph 4. This proposal does not change that treatment.

2019 Spring National Meeting exposure with shaded new edits for Summer 2019 discussion:

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

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

   a. The liability for unpaid losses and claims shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims on non-capitated payments under managed care contracts shall be established in an amount necessary to pay the losses/ claims irrespective of payments made to third-party administrators, etc. The liability for claims on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers. As loss or claims payments occur, from the third-party administrators, management companies or other entities, to the policyholder or claimant, (except for capitated payments for managed care contracts) paid claims, losses or paid loss/paid claim adjusting liabilities are reduced. Note that guidance regarding the admissibility of loans and advances to providers which apply to health insurance and managed care contracts are addressed in *SSAP No. 84—Health Care and Government Insured Plan Receivables.*

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

c. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related

5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims adjustment expenses on non-capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third-party administrators, etc. The liability for claims adjustment expenses on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers.

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

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-09 SSAP No. 101 (Robin/Julie)	SSAP No. 101 – Q/A Updates - TCJA	18 Combined Q&A	Comments Received	IP -12 AICPA - 19

Summary:
During the Spring National Meeting, the Working Group exposed revisions to the *SSAP No. 101—Income Taxes* Implementation Q&A to update the guidance in response to the federal Tax Cuts and Jobs Act.

Interested Parties' Comments:
Ref #2019-09 includes modifications to the Q&A for TCJA tax law changes such as reduction in the corporate tax rate (and elimination of the graduated corporate tax rates), repeal of the corporate alternative minimum tax, repeal of the small life insurance company deduction, and elimination of the operating loss carryback for life insurance

companies (but allowance of an unlimited carryforward period). Interested Parties agree with the Q&A revisions exposed in Ref #2019-09, and we have no further comments with respect to that exposure.

NAIC AICPA Task Force Comments:*

The Task Force's only comment for these two exposures is to request that transition guidance be provided (for example, the guidance is to be applied as of December 31, 2019 as a change in accounting principle). We believe this is necessary as the proposed guidance may be a change in interpretation of the current guidance by companies and auditors.

** The NAIC AICPA Task Force is not an NAIC group. It is not the NAIC/AICPA Working Group.*

Recommended Action:

The SSAP No. 101 and the QA have been updated to incorporate the tracked revisions from agenda items 2019-09 and 2019-10 into one combined document reflected in Attachment 18. NAIC staff recommends:

1. **Adopting the exposed revisions to SSAP No. 101 with the clarification that a reporting entity shall apply the changes as a change in accounting principle for financial accounting years ending Dec. 31, 2019. Proposed effective date language which could apply to both agenda item 2019-09 and 2019-10 is illustrated below.**

   Effective Date and Transition

   37. This statement shall be effective for years beginning January 1, 2012. 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*. Revisions adopted in August 2019 to the Implementation Questions and Answers in Exhibit A which update the exhibit in response to changes from the federal Tax Cuts and Jobs Act and to clarify deferred tax asset and deferred tax liability offsetting under paragraph 11.c., are effective for financial accounting years ending December 31, 2019. Any change in income tax balances resulting from the August 2019 revisions are accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

   Proposed updates to the QA effective date language:

   The National Association of Insurance Commissioners issued *SSAP No. 101—Income Taxes* (SSAP No. 101) with an effective date of January 1, 2012.

   This Q&A is effective for reporting periods ending on or after January 1, 2012. Note: Minor revisions were adopted in May 2018 in response to the federal income tax law changes enacted December 22, 2017. These revisions have been limited to updating the post-2017 ordinary loss carryback provisions for entities taxed as life insurance companies. Further nonsubstantive revisions ~~are necessary~~were developed to update the Q&A for the revised corporate federal income tax rate and certain other federal tax law changes primarily under the Tax Cuts and Jobs Act enacted in December 2017 and to clarify deferred tax asset and deferred tax liability offsetting under SSAP No. 101, paragraph 11.c. These revisions to the implementation guidance are effective for financial accounting years ending December 31, 2019. Any change in income tax balances resulting from the August 2019 revisions are accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. ~~will be completed as a separate project of the Statutory Accounting Principles (E) Working Group.~~

2. **In addition, NAIC staff recommends adoption of some very minor typographical edits (such as changing "is" to "its") noted by Interested Parties' technical representatives. These revisions are shown as tracked revisions in the attachment and listed on the cover page of the attachment.**

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-10 (Robin/Julie)	**SSAP No. 101 – Q/A Updates – DTA/DTL Offset**	**18 Combined Q&A**	**Comments Received**	**IP – 12 AICPA – 19**

Summary:
During the Spring National Meeting, the Working Group exposed revisions to SSAP No. 101—Income Taxes Implementation Q&A to clarify the application of the deferred tax admittance calculation, particularly with regards to offsetting deferred tax liabilities. The guidance in paragraph 11.c. indicates that the reporting entity shall consider the reversal patterns of temporary differences; however, this consideration does not require scheduling beyond what is required in paragraph 7.e. in determining the valuation allowance for gross DTAs. The interested parties' proposed revisions explicitly state that consideration of reversal patterns in paragraph 11.c. is not required unless the reversal patterns of temporary differences were considered in assessing a statutory valuation allowance. For these entities, the paragraph 11.c. admissibility will be a mechanical calculation.

Interested Parties' Comments:
As previously noted, Ref #2019-10 is directed toward eliminating inconsistent application among reporting entities of the SSAP No. 101 paragraph 11.c. DTA admission test. Interested parties agree with the Q&A revisions exposed in Ref #2019-10, but we have one suggestion for an additional clarification in paragraph 4.13 of the Q&A, which deals specifically with the SSAP No. 101 DTA paragraph 11.c. DTA admission test. As exposed, paragraph 4.13 includes some of interested parties originally recommended revisions, plus some pre-exposure modifications made by NAIC staff and/or Interested Parties representatives.

Interested parties propose one other change to the modifications to paragraph 4.13 which we believe will further support Ref #2019-10's objective of clarification and elimination of inconsistent treatment - that being, addition of the following sentence after the first sentence in the footnote to Q&A paragraph 4.13:

> Thus, for example, if a reporting entity had considered the reversal patterns of $100 of existing DTLs in the determination of any statutory valuation allowance adjustment, it shall consider the reversal patterns of that same $100 of existing DTLs in the paragraph 11.c. DTA admission test but shall not be required to do further scheduling.

NAIC AICPA Task Force Comments*:
The Task Force's only comment for these two exposures is to request that transition guidance be provided (for example, the guidance is to be applied as of December 31, 2019 as a change in accounting principle). We believe this is necessary as the proposed guidance may be a change in interpretation of the current guidance by companies and auditors.

** The NAIC AICPA Task Force is not an NAIC group. It is not the NAIC/AICPA Working Group.*

Recommended Action:
NAIC staff recommends the adoption of the exposed material with the transition guidance noted below. NAIC staff does not recommend the adoption of the additional language proposed by interested parties as it is more specific than the current guidance in the statement; however, if the Working Group is interested in pursuing this further, NAIC would recommend exposure of the proposed language. The SSAP No. 101 and the QA have been updated to incorporate the tracked revisions from agenda items 2019-09 and 2019-10 into one combined document reflected in Attachment 18.

1. **Adopting the exposed revisions to SSAP No. 101 with the clarification that a reporting entity shall apply the changes as a change in accounting principle for financial accounting years ending Dec. 31,**

2019. Proposed effective date language which could apply to both agenda item 2019-09 and 2019-10 is illustrated below.

Effective Date and Transition

37. This statement shall be effective for years beginning January 1, 2012. 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*. Revisions adopted in August 2019 to the Implementation Questions and Answers in Exhibit A which update the exhibit in response to changes from the federal Tax Cuts and Jobs Act and to clarify deferred tax asset and deferred tax liability offsetting under paragraph 11.c., are effective for financial accounting years ending December 31, 2019. Any change in income tax balances resulting from the August 2019 revisions are accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

Proposed updates to the QA effective date language:

The National Association of Insurance Commissioners issued *SSAP No. 101—Income Taxes* (SSAP No. 101) with an effective date of January 1, 2012.

This Q&A is effective for reporting periods ending on or after January 1, 2012. Note: Minor revisions were adopted in May 2018 in response to the federal income tax law changes enacted December 22, 2017. These revisions have been limited to updating the post-2017 ordinary loss carryback provisions for entities taxed as life insurance companies. Further nonsubstantive revisions ~~are necessary~~were developed to update the Q&A for the revised corporate federal income tax rate and certain other federal tax law changes primarily under the Tax Cuts and Jobs Act enacted in December 2017 and to clarify deferred tax asset and deferred tax liability offsetting under SSAP No. 101, paragraph 11.c. These revisions to the implementation guidance are effective for financial accounting years ending December 31, 2019. Any change in income tax balances resulting from the August 2019 revisions are accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. ~~will be completed as a separate project of the Statutory Accounting Principles (E) Working Group.~~

2. **NAIC staff does not recommend the modifications suggested by interested parties to the QA paragraph 4.13 footnote as the proposed example illustrates a specific identification of reversal patterns which staff believes is not required by the guidance in SSAP No. 101, paragraphs 7e and 11c. Staff believes the other recommended modifications to QA paragraph 4.13 address the issue of inconsistent treatment previously raised by interested parties.**

Proposed interested parties' language for footnote to QA 4.13

Thus, for example, if a reporting entity had considered the reversal patterns of $100 of existing DTLs in the determination of any statutory valuation allowance adjustment, it shall consider the reversal patterns **of that same $100** of existing DTLs in the paragraph 11.c. DTA admission test but shall not be required to do further scheduling.

The current guidance in SSAP No. 101, paragraph 11.c. reads as follows:

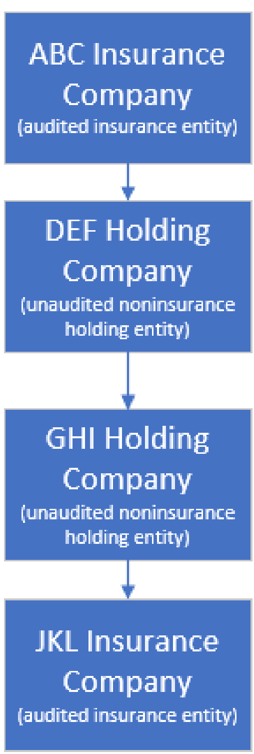
11c……Additionally, for purposes of this component, the reporting entity shall consider the reversal patterns of temporary differences; however, this consideration does not require scheduling beyond that required in paragraph 7.e.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-12 SSAP No. 68 SSAP No. 97 (Fatima/Julie)	***ASU 2014-17, Business Combinations – Pushdown Accounting***	**19 Agenda Item**	**Comments Received**	**IP – 13 AICPA - 19**

<u>*Summary:*</u>
During the Spring National Meeting, the Working Group exposed revisions to *SSAP No. 68—Business Combinations* to reject *ASU 2014-17, Business Combinations – Pushdown Accounting*, for statutory accounting. The exposed revisions also explicitly prohibit pushdown accounting in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* for SCAs reported under audited U.S. GAAP.

<u>*Interested Parties' Comments:*</u>
Interested parties have concerns about the proposal to reject pushdown accounting in determining the valuation of a subsidiary of an insurance entity that uses GAAP as its basis of accounting. Overall, interested parties disagree with the approach to addressing goodwill in the suite of proposals as the proposed changes would cause a significant number of insurers to change their accounting for subsidiaries and incur additional audit costs. We believe there are more direct approaches to addressing the concerns about goodwill that would be less confusing to preparers and auditors. Additionally, depending on the approach used, it may be necessary for the new guidance to be applied prospectively so that companies can make the necessary changes without having to restate previous year's valuations. We welcome the opportunity to discuss alternative approaches with staff.
Due to the complexities of applying SSAP No. 97 and the interrelationship of the three issues, we recommend that these proposals be deliberated "one-at-a-time" and in a logical sequence. We believe the logical sequence is to first address Ref #2019-12, *Business Combinations – Pushdown Accounting*, followed by Ref #2019-14, *Attribution of Goodwill*, and finally Ref #2019-13, *Clarification of a Look-Through Approach*.

- Ref #2019-12 proposes the rejection of pushdown accounting in the underlying GAAP-basis financial statements of acquired subsidiary, controlled and affiliated entities (SCAs) for purposes of statutory accounting reporting.



- The changes recommended to SSAP No. 97 in Ref #2019-12 are far-reaching, would be difficult to operationalize and costly to implement and maintain, and raise several audit questions/issues that will need to be addressed by the public accounting firms. Without knowing how widespread the issue is, it is unclear what, if any, changes should be made until additional clarity is provided around the issues and quantification of the targeted goodwill is obtained.

Interested parties believe that the spirit of the "look through" guidance in SSAP No. 97 is to avoid unnecessary audits and related audit fees by providing reporting entities the ability to admit audited SCA entities that happen to be owned by unaudited downstream noninsurance holding companies that are immaterial to the reporting entity. This concept is unaffected by a multiple holding company structure. Consider the following example.

Per SSAP No. 97 paragraph 26(b) and 26(c), Holding Company DEF and GHI do not have material GAAP assets or liabilities, the ultimate value of these companies is equal to the underlying audited statutory surplus of Insurance Company JKL. Therefore, none of the assets or liabilities subject to the GAAP audit of Holding Company DEF or GHI would be reflected in the investment in subsidiary. Thus, an audit of Holding Company DEF or GHI would be an audit of no material balances other than the assets and liabilities of JKL, which are already audited, and therefore, would be an inefficient use of policyholder surplus. Further, audits of Holding Company DEF or GHI would provide neither transparency nor additional meaningful, comparable financial information to policyholders or regulators. We do not believe requiring an audit of these immaterial noninsurance subsidiaries solely for admittance to be in the spirit of the SSAP No. 97 "look through" guidance or an efficient use of policyholder surplus.

For the reasons stated above, interested parties believe that the "double look through" approach applied to immaterial downstream noninsurance holding companies is an appropriate interpretation of SSAP No. 97 and consistent with the spirit of the guidance, which is to eliminate unnecessary costly audits that would not yield any additional assurance on investment valuation.

Interested parties recommend that the scope of the issue be identified prior to proposing any changes to SSAP No. 97. This should include the number of SCAs in which pushdown accounting is used, the amount of goodwill and other intangibles that are included in the pushdown basis, and the types of entities which have been acquired at values that materially exceeded the respective book values.

Once the scope and magnitude is identified, a decision can be made whether the targeted issue is widespread or limited to a few companies and whether there is a cost/benefit to requiring a complicated/costly approach or whether more targeted guidance would be more effective.

Once an approach is decided upon for Ref #2019-12, the next logical step would then be to address how goodwill should be attributed to legal entities in an ownership chain and finally, how the look-through approach should be applied.

<u>*NAIC AICPA Task Force* Comments:*</u>
The Task Force believes the proposed revisions could be a significant change to current SAP and requests clarification of the following: we request that the working group clarify what is meant by "audited reconciliation" and "audited support" in the proposed new paragraph 20 of SSAP 97. Would this be similar to adjustments made to the audited U.S. GAAP carrying value for par. 8.b.ii and 8.b.iv entities? For these adjustments, there is no "audited reconciliation" included in any financial statements. An insurance entity prepares a schedule to determine the required adjustments for purposes of its carrying value of the SCA, which is subject to audit procedures in relation to the insurer's financial statements taken as a whole, but there is no reconciliation included in the audited financial statements of the SCA.

We also request that the working group clarify, for companies that receive approval from their domiciliary commissioner to continue to admit the existing goodwill that has been pushed down on or before December 31, 2019, whether this goodwill is subject to amortization and the 10% of surplus limitation. In addition, we request that specific transition guidance be added for companies that do not obtain approval from their domiciliary regulator to continue to admit goodwill pushed down from acquisitions prior to January 1, 2020.

** The NAIC AICPA Task Force is not an NAIC group. It is not the NAIC/AICPA (E) Working Group.*

<u>*Recommended Action:*</u>
Although NAIC staff agrees that the SSAP No. 97 agenda items could be perceived to be related, they are different issues, with little overlap. Although NAIC staff would not be opposed to delaying discussions periodically, <u>**NAIC staff does not agree with halting the consideration of each separate issue until final resolution is made on a particular topic**</u>. NAIC staff highlights that the items presented are current issues that have been raised as part of the SCA filings or from inquiries with regulators or auditors, and clarity on the noted issues is deemed necessary to ensure both consistency in reporting and compliance with existing Statutory Accounting Principles. NAIC staff has captured current recommendations for all items for discussion at the Summer National Meeting.

Prior to the 2019 Summer National Meeting, information was shared noting that the SEC no longer requires pushdown accounting for SEC reporting. Previously, pushdown accounting was required for SEC purposes if an entity acquired 95% or more ownership of a subsidiary and was permitted if an entity acquired ownership between 80-95% of a subsidiary. If less than 80% was acquired, pushdown was prohibited. With the SEC reporting revisions, entities are permitted to elect pushdown with any acquisition of ownership.

NAIC staff believes that the historical guidance permitting pushdown for statutory filers was intended to allow companies that were required to use pushdown to mirror this approach. With the elimination of the SEC requirements and restrictions, NAIC staff is requesting Working Group direction on whether pushdown should continue to be permitted. **<u>The options for Working Group consideration include:</u>**

1) **<u>Complete rejection of pushdown accounting</u>**. As pushdown is now an election for SEC / U.S. GAAP filers, reporting entities can avoid use of pushdown if prohibited for statutory accounting. (NAIC staff would propose a prospective effective date if electing this option to avoid restatement of those entities that have previously elected pushdown.)

2) **<u>Permission to use pushdown for all non-insurance entities.</u>** This option would increase optionality into the statutory financial statements. If permitted, this approach would result in different SCA values and goodwill calculations for those that follow the guidance in SSAP No. 68 and those that utilize pushdown. Under SSAP No. 68, acquired SCAs do not write-up their assets or liabilities to fair value and goodwill is calculated as the difference between purchase price and book value. Under U.S. GAAP pushdown, acquired SCAs write-up their assets and liabilities to fair value, and goodwill is calculated as the difference between the purchase price and the fair value of the acquired entity. With pushdown, the goodwill is reported at the SCA level. As such, goodwill will be an indefinite asset unless it is identified as impaired. (Under U.S. GAAP, private entities and not-for-profit entities can elect to amortize goodwill over a 10-year period, but this is not an election for public entities.) **<u>If this option is supported, NAIC staff would recommend that the goodwill admittance limitation capture goodwill from an insurance entity's acquisition of an SCA that is reported on the SCA financial statements.</u>** (This option would not permit pushdown for insurance SCAs (8.b.i entities).

   (If this option is considered, NAIC staff would propose restrictions on the use of pushdown that differ from U.S. GAAP. For example, under U.S. GAAP, a reporting entity could subsequent elect pushdown accounting in any reporting period after original acquisition. If pushdown was permitted, NAIC staff would propose to require the election at original acquisition and not allow subsequent elections.)

3) **<u>Permit pushdown if elected by SEC Registrants, excluding non-insurance entities</u>**. Although this option would introduce different accounting by type of reporting entity, it is consistent with when pushdown would have been applied under prior statutory accounting guidance. (Under the old SEC provisions, pushdown was only permitted when meeting certain SEC requirements.) This would seemingly allow the companies that have historically utilized pushdown under the SEC rules to continue acquisitions under that prior approach. **<u>If this option is supported, NAIC staff would recommend that the goodwill admittance limitation capture goodwill from the acquisition of an SCA that is reported on the SCA financial statements.</u>** <u>*(Also, NAIC staff would propose restrictions to the provisions to ensure the election is made at the time of original acquisition.)*</u> (This option would not permit pushdown for insurance SCAs (8.b.i entities).

   <u>NAIC staff recommends that the Working Group expose the agenda item with a request for comments on the three options above. Additionally, to ensure that goodwill resulting from an insurance reporting entity's acquisition of an SCA when pushdown is applied is captured within the goodwill admittance limitation, the exposure includes limited revisions to reference this goodwill in SSAP No. 68, paragraph 9.</u> With exposure, NAIC staff will work with industry on alternative approaches. Comments are specifically requested on the extent that pushdown accounting has been applied, particularly with non-SEC filers.

Revisions Proposed in Accordance with 2019 Summer National Meeting Recommendation:

SSAP No. 68—Business Combinations and Goodwill

3. For those acquired SCA entities accounted for in accordance with paragraph 8.b.i. of SSAP No. 97 under the statutory purchase method, the historical bases of the acquired entity shall continue to be used in preparing its statutory financial statements. Therefore, pushdown accounting is not permitted.

7. Positive goodwill recorded under the statutory purchase method of accounting shall be admitted subject to the following limitation: Positive goodwill from all sources, including life, accident and health, and deposit-type assumption reinsurance and goodwill resulting from the acquisition of an SCA by the insurance reporting entity that is reported on the SCA's financial statements (resulting from the application of pushdown accounting), is limited in the aggregate to 10% of the acquiring[4] 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[5]. 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)]

With the exposure, NAIC staff will continue to work with industry on alternative approaches. Comments are specifically requested on the extent that pushdown accounting has been applied, particularly with non-SEC filers.

To assist with discussion on pushdown, the following items are included in the Hearing Agenda:

1) Comparison of SAP and GAAP guidance, including pushdown.
2) Preliminary information from discussions with AICPA and Industry representations
3) History of SAP guidance regarding pushdown accounting.

Comparison of SAP / GAAP Goodwill Guidance, including GAAP Pushdown:

SCA Acquisition	Purchase Price: $300	Asset Book Value: $90	Asset Fair Value: $150
Standard SAP Accounting:	Investment in SCA: $90 Goodwill: $210	The combined $300 is reported as the investment in SCA, but the goodwill is separately reported and is subject to the SSAP No. 68 admittance restrictions and the 10-year amortization.	
U.S. GAAP Standard:	Investment in SCA: $150 Goodwill: $150	When pushdown is not elected, under U.S. GAAP, goodwill is calculated on the difference between fair value and the purchase price. This is different than SAP where goodwill is calculated based on the difference between book value and the purchase price.	

[4] The "acquiring" entity is intended to reflect the insurance reporting entity that reports the investment resulting in goodwill. The goodwill limitation test shall be completed at the individual reporting company level.

[5] This includes, but is not limited to, situations in which the investment is nonadmitted as the audited financial statements for the SCA, joint venture, partnership or limited liability company includes substantial doubt on the entity's ability to continue as a going concern, or on the basis/contents of the audit opinion pursuant to paragraph 20 of SSAP No. 97.

U.S. GAAP Pushdown:	*Parent Reporting:* Investment in SCA: $300	With pushdown, the reported value at the reporting entity level simply reflects the purchase price.
	SCA Reporting: Assets: $150 Goodwill: $150	With pushdown, the acquired SCA increases the book value of their assets to fair value, and reports goodwill on their F/S for any remaining difference.

<u>Preliminary information from discussions with AICPA and Industry representations</u>

- Insurance reporting entities that were SEC filers have historically used pushdown when acquiring SCAs. This is because pushdown accounting was required for SEC filers and US GAAP allowed pushdown to prevent differences between the SEC and US GAAP.

- With ASU 2014-17, the US GAAP guidance became an election for all reporting entities. As such, more entities may have elected to use pushdown, **<u>but no information is known as to the extent pushdown accounting has been applied.</u>**

- **<u>For the SEC registrants that used pushdown, the U.S. GAAP guidance was followed</u>**. As such, at acquisition the assets and liabilities of the SCA were adjusted to fair value, and the goodwill calculated was the difference between the purchase price and the fair value of the SCA. (This is different from the goodwill calculation required under SSAP No. 68.) The goodwill was then recognized as an asset on the SCA books (and not at the insurance reporting entity level). This goodwill was subject to the U.S. GAAP impairment calculation, which requires annual testing of impairment, but was not subject to the admittance or amortization requirements of SSAP No. 68.

- **<u>For non-SEC registrants that have elected pushdown under the new GAAP provisions, it is uncertain how goodwill was calculated prior to the pushdown</u>**. (Whether it was calculated under the guidance in SSAP No. 68 or under U.S. GAAP.)

- Although U.S. GAAP now permits pushdown beyond SEC filers, pushdown is prohibited under IFRS.

- Per the discussion with interested parties' representatives, **<u>the acquisition of a new SCA from a non-related party is considered to be an economic transaction under SSAP No. 25</u>**. However, if the acquisition of an SCA was from a related party, the it would not be considered an economic transaction. With classification as an economic transaction, the interested parties noted that increase of the SCA to represent fair value is consistent under SSAP No. 25.

<u>Historical SAP Guidance:</u>

The original Issue Paper No. 68 noted that pushdown should be prohibited in all SCA acquisitions. Issue Papers are not authoritative, and this guidance was not what was adopted in the original SSAP No. 68. There is no discussion in the original Issue Paper on the expansion that permitted pushdown for the "7.b.iii" entities in the issued SSAP No. 46. The expansion on the use of pushdown to all SCA entities except insurance SCA entities "8.b.i" was then reflected as a modification to SSAP No. 68 from the 2004 adoption of *SSAP No. 88—Investments in Subsidiary, Controlled and Affiliated Entities, A Replacement of SSAP No. 46.* (This revision expanded the ability to use pushdown accounting to noninsurance entities that engage in insurance "activities" and meet the revenue test under 8.b.ii.) There was no discussion in the corresponding Issue Paper (No. 118) regarding the expansion to all entities except insurance SCAs. NAIC staff suspects that as pushdown was limited to only SEC registrants under U.S. GAAP, the expansion to all entities that could use audited U.S. GAAP was not concerning as it would be applied only in the SEC-qualifying situations. This aspect of SSAP No. 68 has not been modified since the adoption of SSAP No. 88.

Original Codification of AP&P Manual – Effective Jan. 1, 2001:

Issue Paper No. 68—Business Combinations and Goodwill:

8. Under the statutory purchase method the historical bases of the acquired entity shall continue to be used in preparing its statutory financial statements except in those instances provided for in paragraph **8.b. of Issue Paper No. 46**. **Therefore, pushdown accounting is not permitted.**

Issue Paper No. 46—Accounting for Investments in Subsidiary, Controlled or Affiliated Entities:

8b. If a SCA investment does not meet the requirements for the market valuation approach in paragraph 7.a. or, if the requirements are met, but a reporting entity elects not to use that approach, investments in SCAs shall be recorded as follows:

i. Investments in insurance SCA entities shall be recorded based on the underlying statutory equity of the respective entity's financial statements, adjusted for unamortized goodwill as provided for in Issue Paper No. 68—Business Combinations and Goodwill (Issue Paper No. 68);

ii. Investments in noninsurance SCA entities that have no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, shall be recorded based on the underlying equity of the respective entity's financial statements adjusted to a statutory basis of accounting and the resultant proportionate share of the subsidiary's adjusted surplus, adjusted for unamortized goodwill as provided for in Issue Paper No. 68. Examples include but are not limited to: 1) an insurer and a SCA entity that leases autos, furniture, office equipment, or computer equipment to the insurer, 2) an insurer and a SCA entity that owns real estate property that is leased to the insurer for office space, and 3) an insurer and an SCA entity which holds investments which an insurer could acquire directly (i.e., "look through" investment subsidiary);

iii. Investments in noninsurance SCA entities that have significant ongoing operations beyond the holding of assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, shall be recorded based on the audited GAAP equity of the investee. Examples include but are not limited to: 1) a property-casualty or life insurer and a SCA entity that is an oil and gas venture, and 2) a property-casualty or life insurer and a SCA manufacturer.

SSAP No. 68—Business Combinations and Goodwill

8. Under the statutory purchase method the historical bases of the acquired entity shall continue to be used in preparing its statutory financial statements except in those instances provided for in paragraph **7.b.iii of SSAP No. 46**. Therefore, pushdown accounting is not permitted.

SSAP No. 46—Investments in Subsidiary, Controlled and Affiliated Entities:

7.b.iii. Investments in noninsurance SCA entities that have significant ongoing operations beyond the holding of assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, shall be recorded based on the audited GAAP equity of the investee. Examples include but are not limited to: (i) a property-casualty or life insurer and a SCA entity that is an oil and gas venture, and (ii) a property-casualty or life insurer and a SCA manufacturer.

AP&P Manual – As of March 2005:

SSAP No. 88—Investments in Subsidiary, Controlled and Affiliated Entities, A Replacement of SSAP No. 46 detailed the amendments adopted to SSAP No. 68:

26. This statement supersedes paragraphs 4-6 of SSAP No. 68—Business Combinations and Goodwill

as follows:

4. For those acquired SCA entities accounted for in accordance with paragraphs 8.b.i., 8.b.ii., 8.b.iii. or 8.b.iv. of SSAP No. 88, goodwill is defined as the difference between the cost of acquiring the entity and the reporting entity's share of the book value of the acquired entity. When the cost of the acquired entity is greater than the reporting entity's share of the book value, positive goodwill exists. When the cost of the acquired entity is less than the reporting entity's share of the book value, negative goodwill exists. Goodwill resulting from assumption reinsurance shall be recorded as a separate write-in for other-than-invested assets. All other goodwill shall be reported in the carrying value of the investment.

5. A business combination accounted for under the statutory purchase method and in which the acquired entity is valued in accordance with paragraphs 8.b.ii., 8.b.iii. or, 8.b.iv. of SSAP No. 88 shall determine the amount of positive goodwill or negative goodwill created by the combination using the reporting entity's share of the GAAP net book value of the acquired entity. Business combinations accounted for under the statutory purchase method and in which the acquired entity is valued in accordance with, 8 b. i. SSAP No. 88 shall determine the amount of positive or negative goodwill created by the business combination using the insurer's share of the statutory book value of the acquired entity.

6. **<u>For those acquired SCA entities accounted for in accordance with paragraph 8.b.i. under the statutory purchase method the historical bases of the acquired entity shall continue to be used in preparing its statutory financial statements. Therefore, pushdown accounting is not permitted</u>**.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-13 SSAP No. 97 (Fatima/Julie)	**Clarification of a Look-Through Approach**	**20 Agenda Item**	**Comments Received**	**IP – 13 AICPA - 19**

<u>Summary:</u>
During the Spring National Meeting, the Working Group exposed revisions to clarify the guidance for look-through entities. These revisions specify that goodwill may be admitted only if its value has been supported by an audit report and that the look-through provision only applies to the downstream level directly below the noninsurance holding company. With the exposure, comments were requested on multiple-level shell holding companies for specific consideration.

<u>Interested Parties' Comments:</u>
Full comments under Ref # 2019-12 – Excerpt of comments related to this agenda item are shown below:

Per SSAP No. 97 paragraph 26(b) and 26(c), Holding Company DEF and GHI do not have material GAAP assets or liabilities, the ultimate value of these companies is equal to the underlying audited statutory surplus of Insurance Company JKL. Therefore, none of the assets or liabilities subject to the GAAP audit of Holding Company DEF or GHI would be reflected in the investment in subsidiary. Thus, an audit of Holding Company DEF or GHI would be an audit of no material balances other than the assets and liabilities of JKL, which are already audited, and therefore, would be an inefficient use of policyholder surplus. Further, audits of Holding Company DEF or GHI would provide neither transparency nor additional meaningful, comparable financial information to policyholders or regulators. We do not believe requiring an audit of these immaterial noninsurance subsidiaries solely for admittance to be in the spirit of the SSAP No. 97 "look through" guidance or an efficient use of policyholder surplus.

For the reasons stated above, interested parties believe that the "double look through" approach applied to immaterial downstream noninsurance holding companies is an appropriate interpretation of SSAP No. 97 and (consistent with the spirit of the guidance, which is to eliminate unnecessary costly audits that would not yield any additional assurance on investment valuation.

NAIC AICPA Task Force Comments:
This Form A is classified as non-substantive, which would result in adopted revisions being effective upon adoption unless otherwise noted. The Task Force suggests the proposal include specific transition guidance.

Recommended Action:
NAIC staff recommends that this agenda item be disposed. NAIC staff agrees that the existing guidance in SSAP No. 97 only permits the look-through approach when an unaudited downstream holding company is an 8.b.iii entity without any material assets or liabilities other than the audited / unaudited SCAs / SSAP No. 48 entities that are held by the downstream holding company. **As such, a more-than-one look-through is not concerning when the look-through entities comply with the existing provisions of SSAP No. 97. NAIC staff highlights that information when there is a more-than-one look through is proposed to be captured in the disclosure enhancements being considered under agenda item 2019-14.**

If preferred, the Working Group could elect not to dispose this item, and instead defer this item for review after considering the discussion that occurs on agenda item 2019-12 and 2019-14.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-14 SSAP No. 68 SSAP No. 97 (Fatima/Julie)	**Attribution of Goodwill**	**21 Agenda Item**	**Comments Received**	**IP – 13 AICPA - 19**

Summary:
During the Spring National Meeting, the Working Group exposed revisions to SSAP No. 68—Business Combinations and SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities to clarify that the acquisition of a holding company requires the purchase price and goodwill to be attributed to the downstream entities that the holding company directly owns. (This attribution is a documentation exercise and is not "pushdown accounting.") By attributing the goodwill to the downstream entities at acquisition, when a downstream entity is sold or nonadmitted, the reporting entity has documentation to support the amount of goodwill that is eliminated or nonadmitted accordingly.

Interested Parties' Comments:
See comments under Ref # 2019-12

NAIC AICPA Task Force Comments:*
The Task Force requests clarification of the method or methods that should be used to attribute goodwill to the acquired downstream entities. Different methods could include attribution based on the relative percentage of net book value, fair value, or another amount applicable to the individual entities at the acquisition date.

This Form A is also classified as non-substantive; we suggest this proposal include specific transition guidance.

** The NAIC AICPA Task Force is not an NAIC group. It is not the NAIC/AICPA (E) Working Group.*

Recommended Action:
Although the interested parties have included reference to Agenda Item 2019-14 in their overall comments, NAIC staff has noted that there are no specific comments on this item captured in their comment letter. As background, this agenda item proposes a reporting requirement for reporting entities to identify the goodwill that is attributed to underlying entities when acquiring a down-stream holding company. This is necessary to ensure that goodwill

is properly nonadmitted or eliminated when the look-through entities under a downstream holding companies are nonadmitted, sold or need to be assessed for impairment assessments.

NAIC staff notes that the allocation of goodwill is not a new concept, and U.S. GAAP (in ASC 350-20-35-41 through 44) requires goodwill acquired to be assigned to "reporting units" as of the acquisition date. The U.S. GAAP guidance notes that the methodology used to determine the amount of goodwill to assign to a reporting unit shall be reasonable and supportable and shall be applied in a consistent manner. The U.S. GAAP guidance identifies that, in concept, the amount of goodwill assigned to a reporting unity would be determined in a manner similar to how the amount of goodwill recognized is determined. (The U.S. GAAP guidance references the use of fair value in determining the assignment of goodwill as the fair value of assets and liabilities is used under U.S. GAAP to determine the amount of goodwill.) The FASB guidance also identified that the "assigned" goodwill does not need to be reflected in the entity's reported segments, but again, is captured as part of that "segment" when testing for impairment.

For SAP purposes, the allocation (or "assignment") of goodwill is needed to ensure proper reporting when a reporting entity conducts a look-through of downstream holding companies. Although comments were received requesting the calculation method for the "assignment" of goodwill, NAIC staff purposely did not originally propose to specify a calculation as NAIC staff was under the initial impression that the goodwill should be assigned to the downstream reporting entities in a manner in which the reporting entity believes the goodwill is supported. NAIC staff agrees that all of the options suggested by the NAIC AICPA Task Force could be viable options:

> "Different methods could include attribution based on the relative percentage of net book value, fair value, or another amount applicable to the individual entities at the acquisition date."

For purposes of the Summer National Meeting, NAIC staff recommends that the Working Group expose revisions to SSAP No. 97, clarifying that the "assignment" of goodwill is a disclosure element, with revisions to the disclosure requirements for downstream holding companies. The revisions also reflect a change in terminology from "allocation" to "assignment." NAIC staff has also included language indicating that the SSAP does not specify a particular method for the assignment of goodwill, and that goodwill should be assigned in accordance with the assessment of the reporting entity at acquisition. However, the expanded disclosures do require disclosure of the method or approach used to assign goodwill.

Proposed Revisions to SSAP No. 97:

5. A business combination accounted for under the statutory purchase method and in which the acquired entity is valued in accordance with paragraphs 8.b.ii., 8.b.iii. or, 8.b.iv. of SSAP No. 97 shall determine the amount of positive goodwill or negative goodwill created by the combination using the reporting entity's share of the GAAP net book value of the acquired entity, adjusted to a statutory basis of accounting in accordance with paragraph 9 of SSAP No. 97 in the case of acquired entities valued in accordance with paragraphs 8.b.ii. or 8.b.iv. of SSAP No. 97. If the acquired entity is a holding company, the purchase price and goodwill shall be calculated to determine the amount of goodwill that should be assigned ~~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.~~)~~ Information on the assigned goodwill shall be captured in the initial Sub 1 filing to the NAIC for all holding company acquisitions and disclosed in accordance with paragraph 42 if the reporting entity utilizes the look-through approach. Business combinations accounted for under the statutory purchase method and in which the acquired entity is valued in accordance with, paragraph 8.b.i. of SSAP No. 97 shall determine the amount of positive or negative goodwill created by the business combination using the insurer's share of the statutory book value of the acquired entity.

41. If a reporting entity holds an investment in a downstream noninsurance holding company, the reporting entity may look-through the downstream noninsurance holding company to the value of (i) SCA

entities having audited financial statements and/or (ii) joint ventures, partnerships, and/or limited liability companies having audited financial statements in which the downstream noninsurance holding company has a minor ownership interest or otherwise lacks control, i.e., ownership interest is less than 10% in lieu of obtaining an audit of the financial statements of the downstream noninsurance holding company (provided the limited exception to the audited financial statements requirement contained in paragraphs 26-27 applies).

42. If a reporting entity utilizes the look-through approach for the valuation of the downstream noninsurance holding company instead of obtaining audited financial statements of the downstream noninsurance holding company, the financial statements of the reporting entity shall include the following disclosures for each noninsurance holding company in which the look-through approach is utilized:

a. Information that details t~~T~~he name of the downstream noninsurance holding company (including whether the reporting entity has looked-through more-than-one holding companies) along with details on the carrying value, goodwill and admitted value of the holding company.

~~a.~~b. Information on the entities held by the noninsurance holding company that includes their carrying value, assignment of goodwill (and how this assignment was determined), whether audited financial statements were obtained, and the ultimate admitted value. ~~;~~

~~b. The carrying value of the investment in the downstream non insurance holding company;~~

c. The fact that the financial statements of the downstream noninsurance company are not audited;

d. 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;

e. The fact that all liabilities, commitments, contingencies, guarantees or obligations of the downstream noninsurance holding company, which are required to be recorded as liabilities, commitments, contingencies, guarantees or obligations under applicable accounting guidance, are reflected in the reporting entity's determination of the carrying value of the investment in the downstream noninsurance holding company, if not already recorded in the financial statements of the downstream noninsurance holding company.

Example Disclosure for Inclusion in the A/S Illustrations:
(NAIC staff is not proposing to data-capture this information.)

For the year-end 2018 financial statements, the reporting entity reported the value of a downstream holding company using the look-through approach permitted in SSAP No. 97 as the downstream holding company was not supported by audited financial statements. Pursuant to the provisions in SSAP No. 97, the look-through approach is only permitted when the downstream noninsurance entity is an 8.b.iii entity, and the downstream holding company does not own any other assets which are material to the downstream holding company other than the audited/non-audited entities held by the downstream holding company. Additionally, the downstream noninsurance holding company is not subject to liabilities, commitments, contingencies, guarantees or obligations which are materials to the downstream holding company.

In accordance with the provisions of SSAP No. 97, the investment of the downstream holding company has been limited to the value contained in the audited financial statements, including adjustments required by SSAP No. 97, of the SCA entities (and SSAP No. 48 entities) owned by the downstream noninsurance holding company pursuant to the valuation requirements detailed in SSAP No. 97, paragraphs 22-25. Detail of how the reported investment of the downstream holding company was determined using the look-through approach is shown below:

Downstream Holding Company Look-Through						
Downstream Holding Company:		Carrying Value	Goodwill	Total Admitted Value	SSAP No. 97 Adjustments	Total Nonadmitted
ABC Downstream**		$3,000,000	$250,000	$2,712,500	$0	$287,500
Name of Look-Through Entity	Audited F/S (Yes / No)	Carrying Value	Assigned Goodwill %*	Assigned Goodwill	SSAP No. 97 Adjustments	Admitted Value
XYZ Entity	Yes	2,500,000	85%	$212,500	$0	$2,712,500
QRS Entity	No	400,000	10%	$25,000	$0	$0
MNO Entity	No	100,000	5%	$12,500	$0	$0
Total		$3,000,000	100%	$250,000	$0	2,712,500

* Goodwill assignment occurred at original acquisition of the downstream holding company on the basis of the percentage of the carrying value of each look-through entity to the total carrying value.

** ABC Downstream holding company is owned by DEF nonaudited downstream holding company. The reporting entity has conducted a "more-than-one" holding company look-through as both downstream companies qualify for look-through under SSAP No. 97 as they are 8.b.iii entities holding no materials assets or liabilities in accordance with SSAP No. 97, paragraphs 26-27.

Exhibit A – SCA Reporting Process:

Initial Reporting of SCA Investments

53. Reporting the acquisition or formation of a new investment is accomplished by submitting a completed Sub 1 form for each investment, disclosing (i) the valuation reported or to be reported by the insurance company on its latest or next quarterly financial statement blank, (ii) which method of those described in paragraph 8 was used to arrive at the valuation, (iii) the factual context of the transaction and (iv) economic and business motivations for the transaction. If the acquired investment was a downstream noninsurance holding company, the reporting entity shall also detail the entities held by the downstream holding company and assign goodwill percentages to each of the entities held by the holding company. The submission will be processed by the NAIC only if the NAIC determines it has been provided with all material information with respect to all SCA companies of the reporting insurance company that require valuation.

54. The purpose of a Sub 1 filing is to determine whether the value claimed is reasonable. If the NAIC determines that the reported transaction meets the tests specified, it will complete the filing in the VISION database. If the NAIC determines that the transaction does not meet the tests specified, it shall not complete the filing in the VISION database and instead notifies the reporting insurance company and the state of domicile in writing of its determination.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-18 SSAP No. 86 (Julie)	**Other Derivatives**	**22 Agenda Item**	**Comments Received**	**IP - 21**

Summary:
On May 29, 2019, the Working Group exposed revisions to *SSAP No. 86—Derivatives* to incorporate guidance for "other" derivatives. This guidance proposes to recognize these derivatives at fair value, but specifies that the derivatives are nonadmitted. Derivatives that are classified as "other" would be subject to state investment law, and if permitted under state laws, would be admitted under a prescribed practice.

Current guidance in SSAP No. 86 only addresses derivatives involved in hedging, income generation or replication transactions. As such, the nonadmittance classification of derivatives not addressed in SSAP No. 86 is consistent with the current guidance that would occur under *SSAP No. 4—Assets and Nonadmitted Assets*. Pursuant to paragraph 3.b. of SSAP No. 4, nonadmitted assets include items that are not specifically identified as admitted assets within the *Accounting Practices and Procedures Manual*.

Interested Parties' Comments:
Interested parties were surprised by three aspects of this proposal:

1) The structured notes definition within SSAP No. 86 was not amended to conform to the adopted definition within SSAP No. 26R as agreed to by interested parties, NAIC staff and regulators,

2) This proposal attempts to address derivative items, beyond the scope of structured notes, which were not the impetus for this exposure, and

3) This proposal suggests that structured notes would be non-admitted assets which is inconsistent with the interested party understanding upon adoption of agenda item 2018-08.

First, interested parties have always been concerned about the unintended consequences of having to mark to market, and report as derivatives, bonds that have an embedded derivative as highlighted in the definition of structured notes. Specifically, the potential to have a derivative that is clearly minor, but nonetheless meets the structured note definition, whereby the whole bond is required to be marked to market as a derivative. Therefore, interested parties believe the definition within SSAP No. 86 (as noted in our February 15, 2019 comment letter) should be aligned with the definition in SSAP No. 26R or, maybe more appropriately, just reference the definition in SSAP No. 26R. Interested parties believe having the exact same definition in both SSAPs, will help prevent any potential confusion surrounding the scope of structured notes, which is important given the cliff effect penalty of marking them to market as derivatives. This concern takes on further added importance as the SVO is currently exposing a definition of structured notes to be included in their P&P Manual, based upon the definition currently proposed for SSAP No. 86. Having two, or possibly three, different definitions (however trivial the difference may appear to be) serves no purpose and has potential unintended consequences. All three definitions should be the same (exactly) to help eliminate any further potential confusion on a very technical area.

Second, the exposure attempts to address structured notes within the broader context of a new category of "other" derivatives. It is quite possible (and likely, given the exposure draft) that interested parties, NAIC staff and/or regulators have differing opinions on the treatment of structured notes versus "other" derivatives. This is (in part) related to the interested party concern, expressed in our February 15, 2019 comment letter of the items needing to be addressed to make the structured notes proposal viable. More specifically, that structured notes need to be addressed holistically and not on a piecemeal basis. The remainder of the interested party comments will address structured notes, within the context of SSAP No. 86. Interested parties believe that if NAIC staff want to address "other" derivatives that is best addressed separately.

Third, and closely related to our second concern expressed above, interested parties do not support the proposed language in SSAP No. 86 stating that structured notes are non-admitted assets. This was not understood to be part of the proposal, for which interested parties agreed with the adoption of agenda item 2018-08. Further, this is a substantive change and significantly risks, because statutory accounting does not bifurcate derivatives, the non-admission of potentially billions of dollars of bonds with minor embedded derivatives that technically do (or could in the future) meet the definition of structured notes but are not in substance similar to the examples NAIC staff included in the Ref #2018-08 proposal. Therefore, the interested party comments below reflect the incorporation of structured notes (only) within SSAP No. 86 under the assumption they are admitted assets. After reviewing these suggested changes, should NAIC staff or regulators continue to believe structured notes should be non-admitted, interested parties request that agenda item 2018-08 be reopened so minor embedded derivates can be addressed given evolving markets and the real potential for future unintended consequences and/or disruption of capital markets. Interested parties' suggested amendments to the NAIC staff proposed changes are shown below as additions or ~~deletions~~.

Interested Party Proposed Revisions to SSAP No. 86—Derivatives:

3. This statement addresses the recognition of derivatives and measurement of derivatives used in (or that are):

a. Hedging transactions;

b. Income generation transactions; ~~and~~

c. Replication (synthetic asset) transactions~~.~~; and

d. Structured notes. ~~Other Derivatives – (Derivatives that are not used in hedging, income generation or replication transactions.)~~

Impairment

17. This statement adopts the impairment guidelines established by SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5R) for the underlying financial assets or liabilities.

Recognition of Derivatives

18. Derivative instruments represent rights or obligations that meet the definitions of assets (SSAP No. 4—Assets and Nonadmitted Assets) or liabilities (SSAP No. 5R) and shall be reported in financial statements. In addition, derivative instruments also meet the definition of financial instruments as defined in SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures (SSAP No. 27). Should the cost basis of the derivative instrument be undefined (i.e., no premium is paid), the instrument shall be disclosed in accordance with paragraphs 44-48 of SSAP No. 100R—Fair Value (SSAP No. 100R). Derivative instruments ~~used in hedging, income generation or replication (synthetic asset) transactions shall be recognized and measured in accordance with the specific provisions within this statement and~~ are admitted assets to the extent they conform to the requirements of this statement.

19. ~~Derivative instruments that are not used in hedging, income generation or replication (synthetic asset) transactions shall be considered "Other" derivatives. These derivatives~~ Structured notes shall be accounted for at fair value and the changes in fair value shall be recorded as unrealized gains or losses. These derivatives ~~do not~~ qualify as admitted assets.

Derivatives Used in Hedging Transactions

20. Derivative instruments used in hedging transactions that meet the criteria of a highly effective hedge shall be considered an effective hedge and are permitted to be valued and reported in a manner that is consistent with the hedged asset or liability (referred to as hedge accounting). For instance, assume an

entity has a financial instrument on which it is currently receiving income at a variable rate but wishes to receive income at a fixed rate and thus enters into a swap agreement to exchange the cash flows. If the transaction qualifies as an effective hedge and a financial instrument on a statutory basis is valued and reported at amortized cost, then the swap would also be valued and reported at amortized cost. Derivative instruments used in hedging transactions that do not meet or no longer meet the criteria of an effective hedge, or that meet the required criteria but the entity has chosen not to apply hedge accounting, shall be accounted for at fair value and the changes in the fair value shall be recorded as unrealized gains or unrealized losses (referred to as fair value accounting).

Derivatives Used in Income Generation Transactions

General

44. Income generation transactions are defined as derivatives written or sold to generate additional income or return to the reporting entity. They include covered options, caps, and floors (e.g., a reporting entity writes an equity call option on stock that it already owns).

Derivatives Used in Replication (Synthetic Asset) Transactions

54. Replication (Synthetic Asset) transaction means a derivative transaction entered into in conjunction with other investments in order to reproduce the investment characteristics of otherwise permissible investments. A derivative transaction entered into by an insurer as a hedging or income generation transaction shall not be considered a replication (synthetic asset) transaction.

Lastly, also as noted in our February 15, 2019 comment letter, interested parties believe future referrals to the Blanks and Investment RBC Working Groups will be necessary to establish the appropriate classification for these derivatives as well as any related impacts to AVR. As agenda item 2018-08 is currently perceived as a non-substantive change, which is effective immediately upon adoption, these changes will need to occur prior to year-end. Otherwise, agenda item 2018-08 will need to be changed to substantive with an appropriate effective date. Interested parties believe getting this done right is more important than getting this done quickly. Interested parties further note that a separate line item for structured notes within the Schedule DB reporting schedule for derivatives would be beneficial so it is clear to regulators the number and magnitude of structured notes, if any, which take on very different risk characteristics amongst bonds (structured notes), due to varying significance of such embedded derivatives, as well as other derivatives that are not structured notes.

Recommended Actions:

NAIC staff recommends that the Working Group adopt the exposed revisions to SSAP No. 86. These revisions will include a reference to "other derivatives," specify that they shall be reported at fair value and that they do not qualify as admitted assets.

(Revisions to consider a reference to the SSAP No. 26R definition for a structured note in SSAP No. 86 is captured in agenda item 2019-27EP. This should address the comments received on the definition differences.)

The interested parties' comments are not proposed to be reflected for the following reasons:

1) The guidance in SSAP No. 86 prescribes accounting guidance for derivative transactions. The comments, and proposed edits from interested parties would prescribe specific accounting treatment for a particular type of derivative instrument. The proposal to capture guidance for a particular type of derivative instrument is inherently different from the current focus and approach of SSAP No. 86.

2) The guidance in SSAP No. 86 does not currently provide accounting guidance for derivative instruments that are not used in hedging, income generating or replication transactions. (Derivatives not captured in these transactions are considered "other derivatives.") Without specific identification as admitted assets, under *SSAP No. 4—Assets and Nonadmitted Assets*, these instruments shall currently be nonadmitted

unless allowed under state investment law. The proposed revisions to clarify this treatment is not a change from current SAP treatment.

3) As existing state investment laws may restrict use of "other derivatives" (such as speculative derivatives), the admittance of structured notes (as "other derivatives") shall be governed by state investment law. If these investments are allowed under state investment law, they can be admitted with disclosure as a prescribed practice.

Previous information received from interested parties have noted that structured note transactions are not widely held. This prior information seems to be conflict with the current comments that the proposed edits will have "significant" impact to the financial statements. **<u>If preferred by the Working Group, NAIC staff can develop a separate agenda item to capture information on structured notes reported as other derivatives.</u>**

With regards to the interested parties' comments on embedded derivatives, NAIC staff notes that the specific guidance for embedded derivatives in SSAP No. 86 was primarily incorporated to address situations in which <u>insurance contracts</u> could have embedded derivatives, to prevent the separation of <u>insurance contract</u> components. **<u>NAIC staff believes that the guidance in SSAP No. 86 preventing separation of embedded derivatives was not intended to allow structures that are in substance derivative transactions (such as structured notes) to be captured as non-derivative (e.g., bond) investments.</u>**

<u>NAIC staff provides the following additional information to assist with discussion:</u>

1) **"Other Derivatives"** – The direction to consider new guidance in SSAP No. 86 was taken in direct response to the interested parties' Feb. 15, 2019 comments:

> **<u>Interested parties do not believe structured notes will generally meet the requirements of a hedging transaction, income generation transaction, or replication transaction, as currently defined</u>**. Accordingly, SSAP No. 86 will need to be amended to either broaden the definition of income generation, to include structured notes, or a new category will need to be created.

Although the current (June 30th) interested parties' comments disagree with the proposed guidance for "other derivatives" and are requesting specific "structured note" guidance, NAIC staff highlights the following:

a. **An "other derivative" is a derivative that is not captured as hedging, income generation or replication. (This is an existing definition in the Annual Statement Instructions.) As such, if the derivative is not used in the noted transactions, under existing provisions, it would be considered an "other derivative."** Although the original interested party comment letter noted that structured notes will not generally meet the requirements of a hedging, income generation or replication derivative transactions, each derivative instrument should be reported based on how it is used. There are no other provisions that specify how certain derivative instruments should be reported. This is because if the instrument was used as a hedging transaction, then it would be classified as hedging. **(Specifying guidance for a structured note – as a certain derivative instrument – would be different approach than what is used for all other derivative instruments.)**

> **<u>A/S Instructions Definitions - "Other":</u>** A derivative transaction written or sold by the reporting entity used for means other than (1) Hedging Effective; (2) Hedging Other; (3) Replication; or (4) Income Generation (definitions listed above or referenced in *SSAP No. 86—Derivatives*.) When this subcategory is used, a description of the use should be included in the footnotes to the financial statements.

b. **The proposed guidance to nonadmit "other derivatives" is consistent with how such transactions would be captured under the provisions of *SSAP No. 4—Assets and Nonadmitted Assets*.** Pursuant to SSAP No. 4, a nonadmitted asset includes assets that are not specifically identified as admitted assets within the *Accounting Practices and Procedures Manual*. **<u>As detailed within SSAP No. 86, that</u>**

statement only addresses the recognition of derivatives and measurement of derivatives used in hedging transactions, income generation transactions; and replication (synthetic asset) transactions. SSAP No. 86 also indicates that derivative instruments are admitted assets to the extent they conform to the requirements of SSAP No. 86.

c. **The existing guidance in SSAP No. 86 is based on the premise that state investment law does not generally permit speculative derivatives. A structured note is generally a speculative derivative that is wrapped in a debt structure. In these structures, the investment amount could be lost based on the performance of an underlying variable. To illustrate, the following are example prospectuses (which were included in agenda item 2018-18) detail the risks of structured notes:**

Example 1:

These "Securities" are unsecured and unsubordinated debt securities issued by ABC (NAIC 1) and fully and unconditionally guaranteed by ABC with returns linked to the performance of the EURO XX Index (the "Underlying"). If the Underlying Return is greater than zero, ABC will pay the Principal Amount at maturity plus a return equal to the product of (i) the Principal Amount multiplied by (ii) the Underlying Return multiplied by (iii) the Upside Gearing of 2.75. If the Underlying Return is less than or equal to zero, ABC will either pay the full Principal Amount at maturity, or, if the Final Level is less than the Downside Threshold, ABC will pay significantly less than the full Principal Amount at maturity, if anything, resulting in a loss of principal that is proportionate to the negative Underlying Return. These long-dated Securities are for investors who seek an equity index-based return and who are willing to risk a loss on their principal and forgo current income in exchange for the Upside Gearing feature and the contingent repayment of principal, which applies only if the Final Level is not less than the Downside Threshold, each as applicable at maturity. Investing in the Securities involves significant risks. You will not receive interest or dividend payments during the term of the Securities. You may lose some or all of your Principal Amount. The contingent repayment of principal applies only if you hold the Securities to maturity.

The securities are significantly riskier than conventional debt instruments. The terms of the securities may not obligate us to repay the full principal amount of the securities. The securities can have downside market risk similar to the underlying, which can result in a loss of a significant portion or all of your investment at maturity. This market risk is in addition to the credit risk inherent in purchasing our debt obligations.

Example 2:

A $1,000 investment in the Notes will pay $1,000 at maturity unless: (a) the final price of the linked share is lower than the initial price of the linked share; and (b) between the initial valuation date and the final valuation date, inclusive, the closing price of the linked share on any day is below the protection price.

If the conditions described in (a) and (b) are both true, at maturity you will receive, at our election, instead of the full principal amount of your Notes, either (i) the physical delivery amount (fractional shares to be paid in cash in an amount equal to the fractional shares multiplied by the final price), or (ii) a cash amount equal to the principal amount of your Notes reduced by the percentage decrease in the price of the linked share from the initial price to the final price.

If you receive shares of the linked share in lieu of the principal amount of your Notes at maturity, the value of your investment will approximately equal the market value of the shares of the linked share you receive, which could be substantially less than the value of your original investment. *You may lose some or all of your principal if you invest in the Notes*.

Also, as additional background information, the following information is from the SEC on structured notes. (This information was also contained in agenda item 2018-18.)

<u>SEC Excerpts – Structured Note</u>:

- Structured Notes are securities issued by financial institutions whose returns are based on, among other things, equity indexes, a single equity security, a basket of equity securities, interest rates, commodities, and/or foreign currencies. Thus, the return is "linked" to the performance of a reference asset or index. Structured notes have a fixed maturity and include two components – a bond component and an embedded derivative.

- Some structured notes provide for the repayment of principal at maturity, which is often referred to as "principal protection." (Such protection may be limited to a portion of the original principal (e.g., 10%) and may be contingent on specific factors.) Many structured notes do not offer this feature. **<u>For structured notes that do not offer full principal protection, the performance of the linked asset or index may cause the holder to lose some, or all, of their principal.</u>** *(Note: Principal protection focuses on the risk of principal loss from the embedded derivative and not risk of loss from default by the issuer.)*

- Ability to trade structured notes in a secondary market is often very limited as structured notes (other than exchange-traded notes known as ETNs) are not listed for trading on securities exchanges. As a result, the only potential buyer may be the issuing financial institution's broker-dealer affiliate or the broker-dealer distributor of the structured note. In addition, issuers often specifically disclaim their intent to repurchase or make markets in the notes they issue. Holders should be prepared to hold a structured note to its maturity date or risk selling the note at a discount to its value at the time of sale.

- Structured notes have complicated payoff structures that can make it difficult to accurately assess the value, risk and potential for growth through the term of the structured note. Determining the performance of the note can be complex and the calculation can vary significantly from note to note. Payoff structures can be leveraged, inverse, or inverse-leveraged, which may result in larger returns or losses for the holder. For example, the payoff on structured notes can depend on:

    - Participation Rates: Some structured notes provide a minimum payoff of the principal invested plus an additional payoff based on multiplying any increase in the reference asset or index by a fixed percentage. This percentage is called the participation rate. For example, if the participation rate is 50 percent, and the reference asset or index increased 20 percent, then the return paid would be 10 percent (50% of 20%).

    - Capped Maximum Returns: Some structured notes may provide payments linked to a reference asset or index with a leveraged or enhanced participation rate, but only up to a capped, maximum amount. Once the maximum payoff is reached, the holder does not participate in any additional increases in the reference asset or index.

    - Knock-in Feature: Some structured notes may specify that if the reference asset or index falls below a pre-specified level during the term of the note, the holder may lose some or all of the principal investment at maturity and also could lose coupon payments scheduled throughout the term of the note. This pre-specified level may be called a barrier, trigger or knock-in. When this level is breached, the payout return changes on the note. For example, if the reference asset or index falls below the knock-in level and its value is lower than on the date of issuance, instead of receiving a return of principal, the holder may receive an amount that reflects the decline in value of the reference asset or index. For certain types of structured notes, the holder may actually receive the reference asset that has declined in value during the term of the note.

- In addition to risk of the underlying variable, structured notes are unsecured debt obligations. Hence, they are also subject to the risk of issuer default.

- Some structured notes have "call provisions" that allow the issuer, at its sole discretion, to redeem the note before it matures at a price that may be above, below or equal to the face value of the structured note.

With regards to the comments on definition differences between SSAP No. 26R and SSAP No. 86, the revisions to the structured note definition to SSAP No. 26R adopted at the Spring National Meeting reflected the edits suggested by interested parties. The revisions captured in SSAP No. 26R and SSAP No. 86 are inherently different, as the guidance excludes structured notes from SSAP No. 26R, and the guidance captures these instruments in scope of SSAP No. 86. **The provisions that detail the "specific instruments" addressed in both statements are almost identical, and NAIC staff has found just two small edits that would make the definitions identical. Although NAIC staff does not believe there would have been any mischaracterization of structured notes based on these limited edits, NAIC staff does not oppose incorporating these changes as editorial edits to SSAP No. 86, or simply referring to the definition in SSAP No. 26R. This item has been captured in the proposed editorial agenda item (Ref # 2019-27EP) for exposure.** (NAIC staff highlights that the examples were different between the two standards. For example, the notation that RSATs are excluded from structured notes in SSAP No. 26R is not necessary in SSAP No. 86 as that standard has specific guidance for the accounting of RSATs.)

The comment letters are included in Attachment 23 (25 pages).

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Draft: 6/24/19

Statutory Accounting Principles (E) Working Group
Conference Call
May 29, 2019

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met via conference call May 29, 2019. The following Working Group members participated: Dale Bruggeman, Chair (OH); Jim Armstrong and Carrie Mears, Vice Chairs (IA); Sean Duke (AL); Kim Hudson (CA); William Arfanis (CT); Rylynn Brown (DE); Jeff Jackson (IL); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett and Patricia Gosselin (NH); Joe DiMemmo (PA); Jamie Walker (TX); Doug Stolte (VA); and Amy Malm (WI).

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

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

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

a. Agenda Item 2018-32

Mr. Bruggeman directed the Working Group to agenda item 2018-32: SSAP No. 26R – Prepayment Penalties. Julie Gann (NAIC) stated that the Working Group had exposed revisions during the Spring National Meeting to provide guidance for determining the prepayment penalty for called bonds in scope of *SSAP No. 26R—Bonds* when consideration received is less than par (Attachment One-B). She stated that the current exposure would require separate recognition to investment income for the prepayment penalty when the reporting entity has a process in place to identify prepayment penalties. Otherwise, the entire difference between the consideration received and the book/adjusted carrying value (BACV) would be recognized as a realized gain. Ms. Gann stated that if consideration received is less than the BACV, then the entire difference would be recognized through investment income as that is how it would be recognized under the yield-to-worst concept. She stated that the interested parties' comments stated support for the revisions recommended by NAIC staff.

b. Agenda Item 2019-05

Mr. Bruggeman directed the Working Group to agenda item 2019-05: Repurchase Disclosures. Ms. Gann stated that the Working Group had exposed revisions during the Spring National Meeting to reduce the disclosure requirements for repurchase and reverse repurchase transactions in *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (Attachment One-C). She stated that the exposure eliminated the "minimum" and "average daily balance" disclosures, as well as information on counterparties. She noted that information on defaults would no longer be captured in the data template, and it would only be disclosed in the narrative if a default was to occur. Ms. Gann stated that interested parties' comments noted appreciation for the reduction in disclosures.

c. Agenda Item 2019-07

Mr. Bruggeman directed the Working Group to agenda item 2019-07: Bonds Received as Property Dividends or Capital Contributions. Ms. Gann stated that the Working Group had exposed revisions to direct the initial reported value for a bond received as a property dividend or as a capital contribution in SSAP No. 26R and *SSAP No. 72—Surplus and Quasi-Reorganizations* (Attachment One-D). She stated that the exposed guidance refers to *SSAP No. 25—Affiliates and Other Related Parties* in determining the initial reported value. Ms. Gann stated that the interested parties' comments stated support for the proposed revisions.

2. Exposed Agenda Item 2019-18

Mr. Bruggeman directed the Working Group to agenda item 2019-18: Accounting for Other Derivatives. Ms. Gann stated that during the Spring National Meeting, the Working Group adopted revisions under agenda item 2018-18: Structured Notes. In accordance with the adopted revisions, structured notes are not bonds, and those instruments shall be captured as derivatives within *SSAP No. 86—Derivatives*. With the adoption of agenda item 2018-18, comments from interested parties noted that the existing guidance in SSAP No. 86 only addresses derivatives involved in hedging, income generation and replication transactions. The interested parties requested guidance in SSAP No. 86 to address “other” derivatives that do not qualify within the existing categories. In response to these comments, the Working Group directed NAIC staff to proceed with a separate agenda item to address “other derivatives.” Ms. Gann stated that the agenda item was drafted pursuant to the Working Group direction. She stated that the agenda item proposes to use a fair value measurement method for “other” derivatives, and it specifies that such derivatives shall be nonadmitted. If a state’s investment law permits these derivatives, a reporting entity would report the derivatives as admitted assets in accordance with a prescribed practice. Mr. Bruggeman stated that admittance of these derivatives should be determined in accordance with the domiciliary state investment law. He noted that if the state investment law “allows” these derivatives, it may be perceived to be consistent with an “admitted” provision, and he requested additional information on this terminology. Michael Reis (Northwestern Mutual) and Michael M. Monahan (American Council of Life Insurers—ACLI), representing interested parties, stated that they were expecting the fair value measurement method, but they were not expecting a nonadmitted classification for these derivatives. They indicated that more detailed comments would be submitted during the exposure period.

Ms. Mears made a motion, seconded by Mr. Hudson, to expose agenda item 2019-18 for a public comment period ending June 28. The motion passed unanimously.

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

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Draft Pending Adoption

Draft: 4/16/19

Statutory Accounting Principles (E) Working Group
Orlando, Florida
April 6, 2019

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met in Orlando, FL, April 6, 2019. The following Working Group members participated: Dale Bruggeman, Chair (OH); Carrie Mears, Vice Chair (IA); Richard Ford (AL); Kim Hudson and Susan Bernard (CA); Kathy Belfi and William Arfanis (CT); Rylynn Brown (DE); Eric Moser (IL); Stewart Guerin and Caroline Fletcher (LA); Judy Weaver (MI); Doug Bartlett (NH); Stephen Wiest (NY); Joe DiMemmo, Kimberly Rankin and Melissa Greiner (PA); Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI).

1. Adopted its Feb. 6, 2019; Jan. 17, 2019; Dec. 12, 2018; and 2018 Fall National Meeting Minutes

Ms. Walker made a motion, seconded by Mr. Ford, to adopt the Working Group's Feb. 6 (Attachment One-A), Jan. 17, 2019 (Attachment One-B), Dec. 12, 2018 (Attachment One-C) and Nov. 15, 2018 (*see NAIC Proceedings – Fall 2018, Accounting Practices and Procedures (E) Task Force, Attachment One*) minutes. The motion passed unanimously.

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

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

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

a. Agenda Item 2018-17

Mr. Bruggeman directed the Working Group to agenda item 2018-17: Structured Settlements. Julie Gann (NAIC) stated that the Working Group previously exposed *Issue Paper No. 160—Structured Settlements* (Attachment One-E) to document the adopted substantive revisions to *Statement of Statutory Accounting Principles (SSAP) No. 21R—Other Admitted Assets*. Ms. Gann stated that interested parties had no comment on the exposure and noted that the adopted revisions to SSAP No. 21R were effective for year-end 2018.

b. Agenda Item 2018-35

Mr. Bruggeman directed the Working Group to agenda item 2018-35: *Accounting Standards Update (ASU) 2018-07, Improvements to Nonemployee Share-Based Payment Accounting*. Ms. Gann stated that the Working Group previously exposed this agenda item (Attachment One-F) with nonsubstantive revisions to *SSAP No. 95—Nonmonetary Transactions* along with nonsubstantive revisions to *SSAP No. 104R—Share-Based Payments* (Attachment One-G) to adopt with modification ASU 2018-07. Ms. Gann stated that the revisions to SSAP No. 104R eliminate the specific section for nonemployee awards and include guidance for nonemployees with the share-based payment guidance for employees. She stated that no comments were received from interested parties.

c. Agenda Item 2018-36

Mr. Bruggeman directed the Working Group to agenda item 2018-36: *ASU 2018-13, Changes to the Disclosure Requirements for Fair Value*. Ms. Gann stated that this agenda item (Attachment One-H) adopts with modification ASU 2018-13 and incorporates revised disclosures in *SSAP No. 100R—Fair Value*. Ms. Gann stated that as a nonsubstantive item, the deleted disclosures will not be required in the 2019 statutory financial statements, which will be in advance of the Jan. 1, 2020, effective date of the ASU. She noted that the ASU permits early adoption, and no concern was noted on the effective date. She stated that interested parties indicated support for the revisions.

d. Agenda Item 2018-40

Mr. Bruggeman directed the Working Group to agenda item 2018-40: *ASU 2018-15, Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract*. Ms. Gann stated that this agenda item (Attachment One-I) adopts with modification ASU 2018-15 and clarifies the guidance previously adopted from *ASU 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement* in *SSAP No. 16R—Electronic Data Processing Equipment and Software*. Ms. Gann stated that the nonsubstantive changes clarify accounting based on the contract:

- Reporting Entities with Hosting Arrangements That Are Service Contracts – The reporting entity shall capitalize implementation costs of the hosting arrangement (the costs incurred to implement the cloud hosting service contract) as nonoperating system software. The capitalized costs shall be consistent with the costs that are permitted to be capitalized for internal use software and shall be reported as a nonadmitted asset. These implementation costs shall be recognized as each module or component of the hosting arrangement is ready for its intended use. The implementation costs shall be amortized over the lesser of the term of the hosting arrangement, or five years.

- Reporting Entities with Hosting Arrangements That Are Not Service Contracts – The reporting entity shall recognize an operating or nonoperating system software asset for the costs incurred for the software license in accordance with SSAP No. 16R. If the reporting entity has a hosting arrangement that includes both the acquisition of a software asset and an ongoing hosting arrangement, the reporting entity shall allocate the costs of the arrangement to the different elements. Costs for the ongoing hosting arrangement shall be accounted for in accordance with *SSAP No. 22—Leases*.

Ms. Gann stated that the adoption with modification of ASU 2018-15 is effective Jan. 1, 2020, with early adoption permitted, which is consistent with U.S. generally accepted accounting principles (GAAP). She stated that interested parties had no comment on this item.

e. Agenda Item 2018-46

Mr. Bruggeman directed the Working Group to agenda item 2018-46: Benchmark Interest Rates. Ms. Gann stated that this agenda item (Attachment One-J) revises *SSAP No. 86—Derivatives* to incorporate benchmark interest rates as reflected in *ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities* and *ASU 2018-16, Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as Benchmark Interest Rate for Hedge Accounting Purposes*. Ms. Gann stated that interested parties had no comment on this nonsubstantive item, and with adoption, all of the following will be considered U.S. benchmark interest rates under SSAP No. 86:

- Interest rates on direct U.S. Department of the Treasury obligations of the U.S. government
- London Interbank Offered Rate (LIBOR) swap rate
- Fed funds effective rate overnight index swap (OIS) rate
- Securities Industry and Financial Markets Association (SIFMA) municipal swap rate
- SOFR OIS rate

f. Agenda Item 2018-47EP

Mr. Bruggeman directed the Working Group to agenda item 2018-47EP: Editorial and Maintenance Update. Ms. Gann stated that this agenda item (Attachment One-K) incorporates nonsubstantive revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to clarify that investments in scope of *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* are not subject to the disclosures of SSAP No. 97 unless specifically directed to complete disclosures under SSAP No. 48. Ms. Gann stated that interested parties had no comment on this item.

3. Adopted Statutory Accounting Interpretations During its Public Hearing

Mr. Hudson made a motion, seconded by Mr. Wiest, to adopt the statutory accounting interpretations detailed below. Mr. Bruggeman stated that the motion passed unanimously, satisfying the two-thirds voting requirement for the adoption of interpretations that override specific elements of existing statutory accounting principles.

Draft Pending Adoption

a. INT 19-01

Mr. Bruggeman directed the Working Group to *Interpretation (INT) 19-01: Extension of Ninety-Day Rule for the Impact of California Camp Fire, Hill Fire and Woolsey Fire*. Robin Marcotte (NAIC) stated that this INT (Attachment One-L) provides a 60-day extension from the 90-day rule captured in *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due from Agents and Brokers* for policies from the four counties directly affected by the noted California fires. She stated that the temporary extension is consistent with similar extensions that have been provided for other major disasters. Ms. Marcotte stated that the extension provides a total of 150 days, which should not extend past April 24, 2019, and that the INT 19-01 will be automatically nullified on April 25, 2019. Ms. Marcotte stated that the interested parties supported the proposed extension. She noted that because of the short-term nature of the extension, INT 19-01 will be publicly posted on the NAIC website.

b. INT 19-02

Mr. Bruggeman directed the Working Group to *INT 19-02: Single Security Initiative*. Ms. Gann stated that INT 19-02 (Attachment One-M) incorporates a limited-scope exception to securities exchanged as part of the Freddie Mac Single Security Initiative. She stated that the exception requires continuation of the amortized cost basis of the security surrendered to the new security received in the exchange. This is an exception to the guidance in *SSAP No. 26R—Bonds* that requires fair value of the surrendered security to become the cost basis for the received security, unless the fair value of the security received is more clearly evident. Ms. Gann stated that by continuing the amortized cost basis, the reporting entity shall not recognize any gains or losses as a result of the exchange. She stated that this is considered appropriate as most of the elements of the security held after the exchange will exactly match the security surrendered. Additionally, the cash flows of the new securities will ultimately be backed by the same loans as the original security. Ms. Gann stated that the INT also permits reporting entities to adjust the security's basis for the float compensation received, noting that this treatment is consistent with how Freddie Mac will treat the compensation payment.

Ms. Gann stated that interested parties' comments noted that the INT provided reference to SSAP No. 26R, but she noted that these securities are accounted for under *SSAP No. 43R—Loan-Backed and Structured Securities*. She stated that SSAP No. 43R does not include specific exchange guidance, but the INT should also reference SSAP No. 43R. Ms. Gann stated that edits to reference SSAP No. 43R had been proposed for inclusion in INT 19-02. John Bauer (Prudential), representing interested parties, stated agreement with the proposed edits and with moving forward with adoption of the interpretation. Ms. Gann stated that the Freddie Mac Single Security Initiative will be monitored, as nullification of INT 19-02 will occur at the conclusion of the exchange program.

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

Mr. Ford made a motion, seconded by Ms. Walker, to revise *Appendix D—Nonapplicable GAAP Pronouncements* to reject the U.S. GAAP standards noted below as not applicable. The motion passed unanimously.

- *ASU 2017-13, Amendments to SEC Paragraphs Pursuant to the Staff Announcement at the July 20, 2017 EITF Meeting and Rescission of Prior SEC Staff Announcements and Observer Comments* (Agenda Item 2018-41 – Attachment One-N)

- *ASU 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income* (Agenda Item 2018-42 – Attachment One-O)

- *ASU 2018-04, Investments—Debt Securities (Topic 320) and Regulated Operations (Topic 980), Amendments to SEC Paragraphs* (Agenda Item 2018-43 – Attachment One-P)

- *ASU 2018-05, Income Taxes (Topic 740), Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118* (Agenda Item 2018-44 – Attachment One-Q)

- *ASU 2018-06, Codification Improvements to Topic 942, Financial Services—Depository and Lending* (Agenda Item 2018-45 - Attachment One-R)

Draft Pending Adoption

5. Reviewed Comments and Considered Action on Exposed Substantive Items

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

a. Agenda Item 2018-18

Mr. Bruggeman directed the Working Group to agenda item 2018-08: Structured Notes. Ms. Gann stated that during the 2018 Fall National Meeting, the Working Group exposed nonsubstantive revisions to require structured notes, except for mortgage referenced securities, for which the contractual principal amount to be paid at maturity is at risk for other than the borrower to pay the contractual amount due, to be reported as derivatives under SSAP No. 86. She stated that the exposed revisions also clarified that derivatives shall never be reported as cash equivalents or short-term instruments regardless of maturity date, and that mortgage-referenced securities shall be in scope of SSAP No. 43R. With the re-exposure of the agenda item, a comparison of reporting structured notes as derivatives or mandatory convertibles was also exposed.

Ms. Gann stated that comments were received from interested parties on the exposure. She stated that these comments proposed technical edits to the definition of the structured note definition and requested consideration of guidance in SSAP No. 86 for these items as they would not be captured in the existing provisions for hedging derivatives, income generation derivatives or replication derivations. She stated that the interested parties' comments also requested referrals to other groups to consider reporting changes and asset valuation reserve (AVR) and risk-based capital (RBC) implications.

Ms. Gann stated that revisions to the exposure were drafted to incorporate the interested parties' technical edits, and to incorporate a Dec. 31, 2019, effective date to allow for corresponding blank revisions to be adopted. Mike Reis (Northwestern Mutual) and Joshua Bean (Transamerica Capital Strategy) stated support for the direction reflected in the proposed edits and the NAIC staff recommendation.

Ms. Mears made a motion, seconded by Mr. Bartlett, to adopt revisions to statutory accounting (Attachment One-S), with an effective date of Dec. 31, 2019, as follows:

- *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments*: Revisions clarify that derivative instruments shall not be reported as cash equivalents or short-term instruments regardless of their maturity date and shall be reported as derivatives regardless of maturity.

- SSAP No. 26R: Revisions, as modified with the interested parties' edits, remove securities from the bond definition when the contractual amount of the instrument to be paid at maturity is at risk for other than the failure of the borrower to pay the contractual amount due. This guidance identifies that the instrument may be in the form of a debt instrument, but the issuer obligation to return principal is contingent on the performance of an underlying variable. The revisions also remove the structured note disclosure.

- SSAP No. 43R: Revisions capture mortgage-referenced securities in scope. This inclusion is an explicit exception to the loan-backed and structured security definition as the items do not qualify as "loan-backed securities" as the pool of mortgages are not held in trust, and the amount due under the investment are not backed by the referenced mortgages.

- SSAP No. 86: Revisions, as modified with the interested parties' edits, explicitly capture structured notes in scope when there is a risk of principal loss based on the terms of the agreement.

With the motion to adopt the statutory accounting revisions, the Working Group also directed an annual statement blanks proposal to the Blanks (E) Working Group and a referral to the Capital Adequacy (E) Task Force to consider blanks reporting revisions and AVR and RBC revisions for structured notes. The Working Group also directed a referral to the Valuation of Securities (E) Task Force to revise the definition in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to mirror (or reference) the definition of structured notes adopted under statutory accounting. Lastly, with the motion, the Working Group directed NAIC staff to prepare a separate agenda item to consider inclusion of fair value accounting guidance in SSAP No. 86 for "other" derivatives when the reporting entity's domiciliary state permits admittance under the state investment laws. The motion passed unanimously.

b. Agenda Item 2018-22

Mr. Bruggeman directed the Working Group to agenda item 2018-22: Participation Agreement in a Mortgage Loan. Ms. Gann stated that during the 2018 Fall National Meeting, the Working Group exposed revisions to *SSAP No. 37—Mortgage Loans* to clarify that mortgage loans acquired through a participation agreement are limited to single mortgage loan agreements and exclude "bundled" mortgage loans. Ms. Gann stated that during the exposure period, interested parties submitted technical edits and suggested clarifications that a "bundled" mortgage loan would not include a "bulk purchase" where the reporting entity was acquiring multiple single mortgage loan agreements in a single transaction. Ms. Gann also stated that informal regulator comments were also received to revise the definition of a "participation agreement" to clarify that ownership through a participation agreement should provide the same rights and obligations as a mortgage loan acquired directly.

Mr. Wiest made a motion, seconded by Ms. Weaver, to expose revisions to SSAP No. 37, reflecting both the interested parties' and the informal regulator proposed edits, for comment. The motion passed unanimously.

c. Agenda Item 2018-32

Mr. Bruggeman directed the Working Group to agenda item 2018-32: Prepayment Penalties. Ms. Gann stated that during the 2018 Fall National Meeting, the Working Group exposed revisions to SSAP No. 26R to provide guidance in determining prepayment penalties or acceleration when bonds are called with consideration less than par. This original exposure proposed guidance to require each bond to be reviewed individually to determine if there was a prepayment penalty or acceleration fee.

Ms. Gann stated that comments received from interested parties suggested to eliminate the individual bond assessment, as that guidance would incorporate manual processes that would be unduly burdensome for the limited circumstances when these bonds are called. The interested parties' proposed guidance would require assessment if the entity had processes in place to identify prepayment penalties for these situations. Ms. Gann stated that NAIC staff agreed with the proposal by interested parties, with the inclusion of additional language to clarify that a reporting entity would have to consistently apply its process. These additional edits also clarify that if a bond is called with consideration less than book/adjusted carrying value (BACV), the entire difference shall be reported to investment income. She stated that under the yield-to-worst concept in SSAP No. 26R, bonds shall be amortized to the call or maturity date that produces the lowest asset value. If the yield-to-worst concept had been followed, then the amortization would have been recorded through investment income.

Ms. Walker made a motion, seconded by Ms. Malm, to expose revisions to SSAP No. 26R, reflecting the interested parties' and NAIC staff's suggested edits. Mr. Bruggeman stated that this agenda item would be exposed with a shortened comment deadline of May 10, 2019, to allow adoption consideration prior to the review of the concurrent annual statement blanks revisions. Colin Newberry (Protective Life Corporation) stated support for the exposure with the shortened comment deadline.

d. Agenda Item 2018-33

Mr. Bruggeman directed the Working Group to agenda item 2018-33: Pledges to FHLBs. Ms. Gann stated that during the 2018 Fall National Meeting, the Working Group exposed revisions to *SSAP No. 30R—Unaffiliated Common Stock* to clarify that assets pledged to a Federal Home Loan Bank (FHLB) on behalf of an affiliate shall be nonadmitted pursuant to *SSAP No. 4—Assets and Nonadmitted Assets*. The revisions also clarify that any transaction entered into on behalf of an affiliate but is completed in a manner to exclude the affiliate involvement (e.g., pledging assets directly to the FHLB on behalf of the affiliate) shall be considered a related party transaction under *SSAP No. 25—Affiliates and Other Related Parties*. She stated that with the exposure, comments were requested on other group or affiliate activities that occur with FHLBs. Ms. Gann stated that no comments were received from interested parties on this item, and responses to the exposure questions were received from the FHLBs. She stated that with the information received, NAIC staff have not recommended consideration of additional revisions to the FHLB guidance in SSAP No. 30R.

Mr. Hudson made a motion, seconded by Mr. Bartlett, to adopt the exposed nonsubstantive revisions to SSAP No. 30R (Attachment One-T). The motion passed unanimously.

e. Agenda Item 2018-34

Mr. Bruggeman directed the Working Group to agenda item 2018-34: Foreign Mutual Funds. Ms. Gann stated that during the 2018 Fall National Meeting, the Working Group exposed revisions to SSAP No. 30R to include foreign mutual funds in scope.

She stated that with the prior adoption of substantive revisions, the language was revised to reference "U.S. SEC registered investment companies," and this language inadvertently excluded registered foreign mutual funds that had previously been captured in scope of SSAP No. 30. Ms. Gann stated that the proposed effective date for revisions is Jan. 1, 2019. She noted that this date mirrors the effective date of the substantive revisions to SSAP No. 30R and would prevent companies from having to derecognize foreign mutual funds from the common stock schedule, and then reinstating those investments on that schedule. Ms. Gann stated that the exposure to include foreign mutual funds in scope also included a request for comments on how the foreign mutual funds (including Canadian funds) should be reported on the common stock schedule, and requested comments on whether funds diversified in accordance with the federal Investment Company Act of 1940 should be excluded from the "ten largest exposures to a single issuer/borrower/investment" captured in Line 2 of the Supplemental Investment Risk Interrogatory (SIRI).

Ms. Gann stated that interested parties provided comments on the exposure, recommending: 1) a technical edit to the proposed language in SSAP No. 30R; 2) use of a new code to identify foreign mutual funds in the common stock schedule; and 3) support for an approach that would exclude all mutual funds (foreign and domestic) from Line 2 of SIRI if the fund is diversified within the meaning of the federal Investment Company Act of 1940. Ms. Gann stated that BlackRock Solutions also provided comments suggesting that exchange-traded funds (ETFs) that are diversified within the meaning of the federal Investment Company Act of 1940 also be excluded from Line 2 of the SIRI.

Ms. Gann stated that NAIC staff support excluding all diversified funds from Line 2 of the SIRI, as the insurance reporting entity does not have actual exposure to a fund manager, but rather to investments held within funds. If the fund is diversified within the meaning of the federal Investment Company Act of 1940, then NAIC staff do not believe a look-through to the underlying funds is necessary to determine investment exposure. However, if the fund is not diversified within the meaning of the federal Investment Company Act of 1940, a reporting entity should not exclude investments from being reported as large exposures to a particular issuer simply because the investments have been aggregated within a non-diversified fund. For investments held in non-diversified funds, a reporting entity should look-through the fund to aggregate the holdings with other investments directly held for reporting, as appropriate, on the listing of the 10 largest exposures. Ms. Gann stated that an additional disclosure has also been proposed to report the investments in fund managers with allocation of the total investments divided between diversified and non-diversified funds. She stated that this disclosure would provide information on large fund manager investments, particularly as the revisions to Line 2 would exclude diversified fund investments from the disclosure of the 10 largest exposures. Ms. Gann also stated that a review of Line 13 of SIRI (10 largest equity interests) is recommended to determine the extent investments in diversified or non-diversified equity funds shall be reported. She stated that NAIC staff had presented two options in the materials, with recommendation for determining what is captured in Line 13 to also be based on whether the equity funds were diversified or non-diversified. She stated that a review of Line 13, and the options presented, is proposed to be considered separately in a new agenda item.

Mr. Bruggeman inquired if there were any general concerns from regulators or industry with the SIRI revisions proposed by NAIC staff. No comments were received in response to this inquiry. Alana Thomson (New York Life) stated support for the quickness in which the SSAP No. 30R scope issue was addressed, and the Jan. 1, 2019, effective date. She stated that a review of the proposed blank changes, and SIRI revisions currently being proposed, will occur with the exposure at the Blanks (E) Working Group.

Ms. Mears made a motion, seconded by Mr. Ford, to adopt the exposed revisions to SSAP No. 30R, modified with the interested parties' proposed edits, with a Jan. 1, 2019, effective date (Attachment One-U), and to sponsor annual statement blanks proposals to: 1) capture a new code on the common stock schedule to identify foreign mutual funds; and 2) incorporate revisions to the SIRI to clarify what should be captured in Line 2 (10 largest exposures) and capture a new disclosure on diversified and non-diversified investments with fund managers. With the action, the Working Group also directed NAIC staff to develop a new agenda item to consider Line 13 of SIRI and to clarify what should be captured in the disclosure of the 10 largest equity interests. The motion passed unanimously.

f. Agenda Item 2018-37

Mr. Bruggeman directed the Working Group to agenda item 2018-37: *ASU 2018-14, Changes to the Disclosure Requirements for Defined Benefit Plans*. Ms. Gann stated that during the 2018 Fall National Meeting, the Working Group exposed nonsubstantive revisions to *SSAP No. 92—Postretirement Benefits Other Than Pensions* and *SSAP No. 102—Pensions* to adopt with modification the disclosure amendments reflected in ASU 2018-14. Ms. Gann stated that the proposed revisions predominantly reflect the deletion of prior disclosures, with a few edits to existing disclosures consistent with U.S. GAAP.

Ms. Gann stated that interested parties did not have any comments on this item, but informal comments received during the exposure identified a slight edit was needed to reinstate a word inadvertently deleted in the exposed language.

Ms. Malm made a motion, seconded by Mr. Hudson, to adopt revisions to SSAP No. 92 and SSAP No. 102 to adopt with modification ASU 2018-14, modified with the slight edit discussed during the meeting (Attachment One-V). The motion passed unanimously.

g. Agenda Item 2018-38

Mr. Bruggeman directed the Working Group to agenda item 2018-38: Prepayments to Service and Claims Adjusting Providers. Ms. Marcotte stated that during the 2018 Fall National Meeting, the Working Group exposed nonsubstantive revisions to *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses* to provide guidance clarifying that prepayments to providers of losses and loss adjusting services shall be recognized as miscellaneous underwriting expenses, with guidance for reclassification as loss expense or loss adjustment expense (LAE), as applicable, as losses are paid. She stated that the example in the agenda item was an uncommon situation in which a flat fee was paid upfront to a roadside assistance provider. She stated that during the 2018 Fall National Meeting Working Group discussion, it was highlighted that the proposed treatment is different from recognizing a nonadmitted prepaid asset. Ms. Marcotte stated that comments were requested on this difference and if the amounts are expected to be material.

Ms. Marcotte noted that interested parties' comments noted a preference to "nonadmit a prepaid asset" for prepaid losses and LAE. She noted that these comments are consistent with existing guidance, instead of the previously exposed "expense and reclassify as amounts are paid" approach. The interested parties' proposed revisions will require nonadmission of prepaid amounts for losses and LAE and allocation to expense categories as benefits or services are rendered. She stated that NAIC staff worked with interested parties to revise their proposed language to further address flat fee prepayments to require immediate recognition of miscellaneous expenses that are not for losses or loss adjusting. She stated that an additional modification to the interested parties' proposed language removes the reference to *SSAP No. 84—Health Care and Government Insured Plan Receivables* as that statement is not currently referenced in SSAP No. 55.

Ms. Weaver made a motion, seconded by Ms. Mears, to expose the nonsubstantive revisions to SSAP No. 55 as modified with the interested parties' input. The motion passed unanimously.

h. Agenda Item 2018-39

Mr. Bruggeman directed the Working Group to agenda item 2018-39: Interest on Claims. Ms. Marcotte stated that during the 2018 Fall National Meeting, the Working Group, exposed nonsubstantive revisions to SSAP No. 55 to clarify the reporting of interest on accident and health (A&H) claims. Ms. Marcotte stated the revised guidance would record interest paid to claimants as Other Claim Adjustment Expenses and interest paid to regulatory authorities as Regulatory Fines and Fees. She noted that this item will establish consistent accounting as insurers are recording interest on (A&H) claims in a variety of ways.

Ms. Marcotte noted that the interested parties' comments were not opposed to the revised accounting, but noted a concern that any changes will take some time to implement. She stated that interested parties requested a Jan. 1, 2020, effective date to allow sufficient time for health insurers to make the necessary changes to their claims processing systems. Ms. Marcotte stated that based on informal input from Working Group members, because of the variety of current reporting, NAIC staff were recommending that early adoption be permitted with prospective application.

Ms. Weaver made a motion, seconded by Ms. Malm, to adopt the nonsubstantive revisions to SSAP No. 55 with a Jan. 1, 2020, effective date with early adoption permitted (Attachment One-W). The motion passed unanimously.

i. Agenda Item 2018-06

Mr. Bruggeman directed the Working Group to agenda item 2018-06: Regulatory Transactions – Referral from Reinsurance (E) Task Force. Ms. Gann stated that this agenda item was drafted to consider accounting and reporting revisions for "regulatory transactions" as defined in the P&P Manual. She stated that with the provisions of the P&P Manual, "regulatory transactions" should not be reported as filing exempt (FE), with NAIC designations or self-assigned as 5GI securities. She stated that with the current restrictions, and as there are no specific instructions for the reporting of these investments, reporting entities do not have any available reporting options when designations are required on investment schedules. Ms. Gann stated that original revisions exposed considered changes to SSAP No. 4, but the current proposal by NAIC staff is to dispose the agenda item without statutory accounting revisions and send a referral to the Valuation of Securities (E) Task Force to add new reporting codes for investments that are regulatory transactions. Ms. Gann stated that this approach would address the reporting void that currently exists, as well as address concerns on the accounting revisions raised from the last exposure by interested parties.

Ms. Gann stated that the proposed referral would recommend two reporting codes. The first code, “RTS,” would be used in situations where the domiciliary state has received assistance from the Securities Valuation Office (SVO) in reviewing a regulatory transaction. This code would be accompanied by the SVO analytical value assigned after the SVO completed its review. The second code, “RT,” would be used for all other regulatory transactions and those in which the SVO was not able to determine an analytical value. These investments would be reported as an NAIC 6 for measurement and RBC assessments.

Mr. Reis, representing interested parties, agreed with the recommended action, noting that it achieves the regulatory objectives without concern for unintended consequences noted from the previously exposed statutory accounting revisions.

Mr. Hudson made a motion, seconded by Ms. Walker, to dispose the agenda item without statutory accounting revisions and to send a referral to the Valuation of Securities (E) Task Force to incorporate new reporting codes as discussed during the meeting. The motion passed unanimously.

6. Considered Maintenance Agenda—Pending Listing—Exposures

Mr. Hudson made a motion, seconded by Ms. Weaver, to move agenda items 2019-03 through 2019-17 to the active listing, and expose all items for comment, with distinction of each item as either substantive or nonsubstantive, and with corresponding referrals as recommended by NAIC staff. The motion passed unanimously.

a. Agenda Item 2019-03

Mr. Bruggeman directed the Working Group to agenda item 2019-03: Affiliated Transactions. Ms. Gann stated that this nonsubstantive agenda item had been drafted to consider revisions to statutory accounting principles to clarify “affiliate” reporting when underlying investments continue to reflect an affiliated transaction. She stated that the agenda item proposes revisions to SSAP No. 25 to incorporate principal concepts that focus on the substance of the transaction and the parties whose actions or performance materially affect the insurance reporting entity under the transaction. Ms. Gann stated that revisions are also proposed to SSAP No. 26R, *SSAP No. 32—Preferred Stock*, SSAP No. 43R, and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, to identify that investment transactions are subject to the principles of related party transactions in SSAP No. 25. In summarizing the edits, Ms. Gann stated that the revisions identify that it is erroneous to conclude that the inclusion of a non-related intermediary or the presence of non-related assets in a transaction predominantly comprised of related party investments eliminates the requirement to assess and properly identify related party transactions. In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

b. Agenda Item 2019-04

Mr. Bruggeman directed the Working Group to agenda item 2019-04: Investment Classification Project – Preferred Stock. Ms. Gann stated that this substantive agenda item had been drafted to consider revisions to SSAP No. 32 in accordance with the initiative of the Investment Classification Project. Ms. Gann stated that the agenda item identifies the following areas where revisions are recommended to SSAP No. 32:

- Review existing definitions and assess whether definitions should be retained or revised.
- Consider clarifications to existing accounting and valuation guidance.
- Assess guidance for dividends and the impact of dividends on impairment assessments.
- Clarify the application of SSAP No. 32 in conjunction with SSAP No. 48 and SSAP No. 97.

Ms. Gann stated that the original NAIC staff recommendation was to expose the concept agenda with a request for comments. However, after receiving initial feedback on the proposal, she recommended that the Working Group direct NAIC staff to draft substantive revisions to SSAP No. 32 in accordance with the concepts noted in the agenda item for subsequent exposure. She stated that this approach would allow earlier review of the actual tracked changes being considered. In response to an inquiry from Mr. Bruggeman, no objection was noted to directing NAIC staff to draft these revisions.

c. Agenda Item 2019-05

Mr. Bruggeman directed the Working Group to agenda item 2019-05: Repurchase Disclosures. Ms. Gann stated that this agenda item was drafted as a nonsubstantive change to eliminate some of the repurchase and reverse repurchase disclosures required under *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. She stated that the proposed revisions would: 1) remove the counterparty information from the disclosure; 2) remove the default disclosure from the data-captured template (requiring narrative disclosure only if a default was to occur); and 3) remove the "minimum" and "average daily balance" disclosures on repo activity. She stated that with the revisions, a reporting entity would need to report the maximum balance and reporting period ending balance for each quarter, with the overall maximum activity and year-end balance in the annual financial statement if a reporting entity engages in repo activities. Mr. Bruggeman clarified that this disclosure is consistent with other disclosures and should reflect first-quarter activity in the March 31 quarterly filing, second-quarter activity in the June 30 quarterly filing and third-quarter activity in the Sept. 30 quarterly filing, with the year-end financial statements representing the maximum activity that occurred throughout the entire year.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure. Mr. Bruggeman stated that this agenda item would be exposed with a shortened comment deadline of May 10 to allow adoption consideration prior to the review of concurrent annual statement blanks revisions.

d. Agenda Item 2019-06

Mr. Bruggeman directed the Working Group to agenda item 2019-06: *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts*. Ms. Gann stated that this nonsubstantive agenda item considers ASU 2018-12 for statutory accounting, with recommended action to reject ASU 2018-12 in several SSAPs and update the preamble to update referenced U.S. GAAP guidance that was revised in the ASU. She stated that the proposal to reject the ASU is consistent with prior actions when reviewing U.S. GAAP guidance on insurance accounting. Ms. Gann stated that the exposure requests comments on whether new statutory accounting reconciliation disclosures for life contracts should be considered. She stated that if new disclosures are incorporated, such disclosures would likely not be effective until the ASU is effective. Mr. Bruggeman requested consideration of the new principles-based reserving (PBR) reconciliations in assessing new disclosures under the ASU.

Mike Monahan (American Council of Life Insurers—ACLI), stated that representatives of the life insurance industry will be meeting with the Financial Accounting Standards Board (FASB) to request an extension of the implementation date of ASU 2018-12. Mr. Monahan stated that industry will not be requesting FASB to open the ASU for revisions, even though there are technical edits that could be considered.

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

e. Agenda Item 2019-07

Mr. Bruggeman directed the Working Group to agenda item 2019-07: Bonds Received as Property Dividends or Capital Contributions. Ms. Gann stated that this agenda item proposes nonsubstantive revisions to clarify statutory accounting and reporting guidance for bonds received as property dividends or capital contributions. She stated that the agenda item specifically proposes revisions to clarify that the "actual cost" initially reported for a bond received as a property dividend or capital contribution shall reflect the initial reported value of the bond (either fair value or amortized cost) determined in accordance with SSAP No. 25. She stated that an annual statement blanks proposal is recommended to clarify the reporting instructions.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure. Mr. Bruggeman stated that this item will be exposed with a shortened comment period ending May 10, 2019, to allow for consideration of adoption prior to the review of concurrent annual financial statement blanks revisions.

f. Agenda Item 2019-08

Mr. Bruggeman directed the Working Group to agenda item 2019-08: Reporting Deposit-Type Contracts. Ms. Gann stated that this nonsubstantive agenda item had been drafted in response to questions identified by the Financial Stability (EX) Task Force when developing liquidity disclosures to the 2019 life blank. She stated that the Task Force noted an inability to fully identify deposit-type contracts, particularly guaranteed investment contracts (GICs) within the statutory financial statements, as in some instances those contracts are being reported on Exhibit 5 – Aggregate Reserves for Life Contracts or Exhibit 6 – Aggregate Reserves for Accident and Health Contracts, instead of Exhibit 7 – Deposit-Type Contracts. Ms. Gann stated that this agenda item does not currently propose any revisions, but instead solicits information regarding the reporting of GICs and other deposit-type-contracts. Once the information is received, consideration of revisions may occur to ensure proper aggregation and assessment of liquidity risks. Ms. Gann stated that this agenda item also recommends a referral to the Life Actuarial (A) Task Force to inform it of the inquiry and request its comments. Mr. Bruggeman requested those companies that complete U.S. GAAP disclosures to provide comments on whether similar disclosures could be provided for statutory accounting.

In response to an inquiry from Mr. Bruggeman, there was no objection to exposure or the recommended referral.

g. Agenda Item 2019-09

Mr. Bruggeman directed the Working Group to agenda item 2019-09: SSAP No. 101 – Q&A Updates – TCJA. Ms. Marcotte stated that this agenda item has been drafted to consider nonsubstantive revisions to Exhibit A – Implementation Questions and Answers (SSAP No. 101 Q&A) in *SSAP No. 101—Income Taxes*. She noted that the previously adopted revisions to SSAP No. 101 in response to the federal Tax Cuts and Jobs Act (TCJA) only included limited revisions. She stated that when adopting the prior revisions, it was identified that a detailed project would be needed to update the SSAP No. 101 Q&A and representatives from industry volunteered to undertake this extensive project. Ms. Marcotte noted that the interested parties had submitted a large amount of detailed work in their comment letter (Attachment One-X). Ms. Marcotte stated that the proposed revisions are presented in a separate file. She noted that readers should be aware that some of the revisions to paragraph 4.18, paragraph 4.21 and paragraph 4.24 will also be affected by agenda item 2019-10. She noted that agenda item 2019-09 could be characterized as a detailed update to the SSAP No. 101 Q&A to address the changes in the TCJA and that agenda item 2019-10 addresses a specific item related to offsetting of deferred tax assets (DTAs) and deferred tax liabilities (DTLs) that relate to paragraph 11.c. of SSAP No. 101.

Mr. Bruggeman noted his appreciation for the extensive work by interested parties to update the SSAP No. 101 Q&A, especially Art Schneider (consulting for ACLI). In response to an inquiry from Mr. Bruggeman, there was no objection to exposure.

h. Agenda Item 2019-10

Mr. Bruggeman directed the Working Group to agenda item 2019-10: SSAP No. 101 – Q&A Updates – DTA/DTL Offset. Ms. Marcotte stated that this agenda item has been drafted to consider interested parties' proposed nonsubstantive revisions provided in a December 2018 comment letter (Attachment One-Y) related to the application of paragraph 11.c. of SSAP No. 101. She said that paragraph 11.c. is the third component of the DTA admittance calculation. She stated that under paragraph 11.c., admittance is permitted for adjusted gross DTAs (after application of paragraph 11.a. and paragraph 11.b.) that can be offset against existing gross DTLs. Ms. Marcotte said that the interested parties have indicated that their proposed revisions are to consolidate the guidance on what information needs to be considered for the third step of the admissibility calculation (paragraph 11.c.). She stated that the proposed revisions would be more explicit that consideration of reversal patterns in paragraph 11.c is not required unless the reversal of temporary differences was considered in assessing for a statutory valuation allowance. She noted that the interested parties' proposal is to revise the guidance in the SSAP No. 101 Q&A Exhibit and that no revisions are proposed to paragraph 11.c SSAP No. 101.

Ms. Marcotte noted that NAIC staff worked with interested parties' technical representatives to incorporate the majority of the interested parties' proposed revisions and to also ensure internal consistency in the SSAP No. 101 Q&A. She said that the agenda item includes an overview of the interested parties' proposed revisions and NAIC staff's proposed modifications. She noted that if there is a variation in the agenda item from the interested parties' proposed language, the recommendation is to expose NAIC staff's modifications, noting that these modifications were discussed with industry technical representatives and NAIC staff believe there may only be a few limited issues in which there is continued differences on the proposed language. She stated that the proposed revisions include the primary recommendation made by interested parties, which was to clarify that consideration of reversals is not required in paragraph 11.c. if reversals were not considered in determining the need for a statutory valuation allowance under paragraph 7.e.

Ms. Marcotte recommended that the Working Group move this item to the nonsubstantive active listing and expose revisions to SSAP No. 101 using NAIC staff's and/or interested parties' technical representatives' modifications summarized and detailed in the agenda item. She noted that there is one modification to materials provided related to paragraph 4.2. She said that the intent was not to delete an existing sentence that was initially proposed for deletion. She stated that the exposure would be modified accordingly. She noted that some of the revisions to paragraph 4.18, paragraph 4.21 and paragraph 4.24 will also be affected by TCJA updates in agenda item 2019-09. However, the final revisions related to the offsetting concept issues will be based on the revisions on this agenda item.

Mr. Bruggeman noted that the changes from the TCJA eliminated the use of ordinary net operating loss tax carrybacks for life entities, which affected the 11.a. portion of the calculation, but also allowed unlimited carryforwards, which affected the 11.b. and could impact the 11.c. portions of the admissibility calculation. He noted that prior to the TCJA, carryforwards for life entities expired after 15 years. Mr. Bruggeman stated it is important to go through this issue thoughtfully.

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

i. Agenda Item 2019-11

Mr. Bruggeman directed the Working Group to agenda item 2019-11: SSAP No. 62R Effective Date. Ms. Marcotte stated the nonsubstantive agenda item has been drafted to further clarify the effective date guidance regarding the substantive updates to *SSAP No. 62R—Property and Casualty Reinsurance*, which was adopted at the 2018 Fall Meeting in agenda item 2017-28: Reinsurance Credit. She stated that the previously adopted revisions clarify the determination of reinsurance credit and incorporate language from *EITF 93-6, Accounting for Multi-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises* and *EITF Topic D-35, FASB Staff Views on Issue No. 93-6*, with a Jan. 1, 2019, effective date. She noted that when the revisions were exposed at the 2018 Summer National Meeting, comments were requested on the effective date, and no comments were received.

Ms. Marcotte stated that subsequent to the November 2018 adoption, NAIC staff received inquiries asking if the adopted revisions were to be applied to reinsurance contracts in effect as of Jan. 1, 2019, or reinsurance contracts entered into or amended on or after Jan. 1, 2019. She noted that the adopted revisions primarily incorporated GAAP guidance that was previously adopted by reference. She stated that the proposed revisions in this new agenda item were to be clear that the guidance applies to contracts in effect as of Jan. 1. 2019, and that there is no grandfathering of existing contracts.

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

j. Agenda Item 2019-12

Mr. Bruggeman directed the Working Group to agenda item 2019-12: *ASU 2014-17, Business Combinations – Pushdown Accounting*. Ms. Gann stated that this agenda item proposes nonsubstantive revisions to reject ASU 2014-17 for statutory accounting with additional revisions to prohibit pushdown accounting for statutory accounting. She noted that historically, U.S. GAAP required SEC filers to use pushdown accounting, but ASU 2014-17 incorporated changes that permit entities to elect pushdown accounting. Ms. Gann stated that pushdown accounting increases the acquired entity's basis by the amount of "overpayment" from the book value instead of recognizing goodwill from the acquisition. She stated that statutory accounting principles have restrictions on the admittance and amortization of goodwill, and the use of pushdown accounting would circumvent these statutory accounting restrictions.

Ms. Gann stated that current guidance in SSAP No. 97 prohibits pushdown accounting specifically for U.S. insurance subsidiary, controlled and affiliated (SCA) entities, but this agenda item would prohibit the use of pushdown accounting for all reported SCAs, including those that use U.S. audited GAAP financial statements. She stated that if a reporting entity had an SCA that used pushdown accounting, the proposed revisions would require an audited adjustment to its U.S. GAAP financial statements to remove the effects of pushdown accounting. Consistent with existing statutory accounting principles, the difference between the purchase price and the net book value of the entity would be recognized as goodwill in accordance with the admittance and amortization requirements of *SSAP No. 68—Business Combinations and Goodwill*.

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

k. Agenda Item 2019-13

Mr. Bruggeman directed the Working Group to agenda item 2019-13: Clarification of a Look-Through Approach. Ms. Gann stated that the agenda item proposes nonsubstantive revisions to clarify the application of the look-through approach in SSAP No. 97. Particularly, the revisions clarify that the look-through is intended for companies directly below the holding company. Ms. Gann stated that comments are requested on the prevalence of multiple shell holding companies, noting there is limited concern for true shell holding companies, but there is concern when reporting entities request a look-through of multiple levels in an organization, particularly when there are material assets at the holding companies that are included in the valuation of the SCA. Ms. Gann stated that SSAP No. 97 prohibits the look-through approach when the holding company owns other material assets. Ms. Gann stated that the revisions also clarify that goodwill can only be admitted for an entity that has an audit report. She stated that in instances in which there are multiple shell companies in an organization, only goodwill from the purchase of the entity whose value is substantiated with an audit report can be admitted. As an example, she stated that if the entity acquired goodwill from the acquisition of a holding company, and the entity looked-through the holding company to an underlying audited SCA, the goodwill from the acquisition of the unaudited holding company would not be admitted. Ms. Gann also stated that companies may only report SCAs that are owned directly by the insurance reporting entity. If there is indirect control through the holding company structure, perhaps through a sister organization, the insurance reporting entity cannot look through to that entity unless there is a direct line of control.

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

l. Agenda Item 2019-14

Mr. Bruggeman directed the Working Group to agenda item 2019-14: Attribution of Goodwill. Ms. Gann stated that this agenda item proposes nonsubstantive revisions to clarify that when a holding company with underlying entities is acquired and goodwill is generated as part of the transaction, the goodwill should be attributed to the SCA's underlying entities. She noted that this attribution is needed to determine the extent goodwill should be eliminated when an underlying SCA is sold, or in determining admittance when a look-through is performed to an underlying entity. She stated that only goodwill attributed to the admitted SCA would be permitted to be admitted if completing a look-through.

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

m. Agenda Item 2019-15EP

Mr. Bruggeman directed the Working Group to agenda item 2019-15: Editorial Update. Jake Stultz (NAIC) stated that this agenda item proposes nonsubstantive editorial revisions to update paragraph or schedule references, delete duplicated paragraphs, eliminate "proposed" language from final guidance and update a footnote based on previously adopted guidance.

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

n. Agenda Item 2019-16

Mr. Bruggeman directed the Working Group to agenda item 2019-16: *ASU 2015-08, Business Combinations – Pushdown Accounting – SEC Paragraphs.* Mr. Stultz stated that this agenda item proposes nonsubstantive revisions to reject ASU 2015-08 for statutory accounting. He stated that this ASU removes historical SEC guidance from the FASB Codification and is not applicable for statutory accounting.

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

o. Agenda Item 2019-17

Mr. Bruggeman directed the Working Group to agenda item 2019-17: *ASU 2019-02, Entertainment, Improvements for Accounting for Costs of Films and License Agreements for Program Materials, a consensus of the FASB Emerging Issues Task Force*. Mr. Stultz stated that this agenda item proposes nonsubstantive revisions to reject ASU 2019-12 for statutory accounting. He stated that this ASU addresses the capitalization of costs, primarily for episodic television series, and is not applicable for statutory accounting.

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

7. Considered Maintenance Agenda—Active Listing

a. Agenda Item 2016-02 and 2015-03

Mr. Bruggeman directed the Working Group to agenda item 2016-02: Leases. Mr. Stultz stated that in 2016, the Working Group directed NAIC staff to review and incorporate the language from *ASU 2016-02, Leases (Topic 842)* while retaining the operating lease treatment for statutory accounting. Mr. Stultz stated that on Aug. 6, 2017, and on Aug. 4, 2018, the Working Group exposed substantive revisions to SSAP No. 22. As a result of the comments received, the Working Group directed NAIC staff to work with interested parties and revise the documents for exposure. Mr. Stultz stated that the draft revisions focus on sale-leaseback guidance for real estate and include editorial updates to enhance the readability of the SSAP.

Mr. Stultz stated that four additional ASUs have been included with this agenda item, which had been issued by the FASB to clarify the original guidance in ASU 2016-02:

- *ASU 2018-10, Codification Improvements to Topic 842, Leases.*
- *ASU 2018-11, Leases (Topic 842), Targeted Improvement.*
- *ASU 2018-20, Leases (Topic 842), Narrow-Scope Improvements for Lessors*. Mr. Stultz noted that guidance from ASU 2018-20 modifies paragraph 842-10-15-40 from ASC Topic 842. Mr. Stultz stated that this language has been incorporated into paragraph 29 of SSAP No. 22R, which was included in the meeting materials.
- *ASU 2019-01, Leases (Topic 842), Codification Improvements.*

Mr. Stultz recommended disposal of agenda item 2015-03: Sale-Leasebacks with Nonadmitted Assets. He noted that this item was to address some questions regarding sale-leaseback transactions involving nonadmitted assets with unrelated parties and that the agenda item had been on hold since 2015 waiting to be addressed with the major revisions from ASU 2016-02.

Mr. Ford made a motion, seconded by Mr. Hudson, to expose the Issue Paper and the substantive revisions to SSAP No. 22. The motion passed unanimously.

b. Agenda Item 2017-28

Mr. Bruggeman directed the Working Group to agenda item 2017-28: Reinsurance Credit. Ms. Marcotte noted that on Nov. 15, 2018, the Working Group adopted substantive revisions to SSAP No. 62R that clarify the determination of reinsurance credit with a Jan. 1, 2019, effective date. She stated that the Working Group directed NAIC staff to draft an issue paper documenting the substantive revisions for historical documentation, and *Issue Paper 16X—Property and Casualty Reinsurance Credit* has been prepared for consideration.

Mr. Moser made a motion, seconded by Mr. Bartlett, to expose the substantive *Issue Paper 16X—Property and Casualty Reinsurance Credit.* The motion passed unanimously.

c. Agenda Item 2018-03

Mr. Bruggeman directed the Working Group to agenda item 2018-03: Reporting NAIC Designations as Weighted Averages. Ms. Gann stated that this agenda item was originally drafted to propose nonsubstantive revisions to clarify accounting and reporting guidance for securities acquired in lots under SSAP No. 43R. She stated that this agenda item was previously deferred to allow the Working Group time to consider elimination of the modified filing exempt (MFE) approach from SSAP No. 43R. She stated with the removal of MFE, which was effective March 31, 2019, this agenda item has been brought back before the Working Group. She stated that the revisions are consistent with the prior proposal, but the impact is expected to be significantly less as only securities that are financially modeled under SSAP No. 43R could potentially have differing NAIC designations by lot. Ms. Gann stated that if there are differing NAIC designations by lot, the revisions would require the reporting entity to either report the entire security at the lowest (worst) NAIC designation or split the reporting of the security into separate reporting lines by differing NAIC designations. She stated that the proposed revisions are consistent with existing annual statement instructions that require reporting at the lowest level to prevent inaccurate information and that it has been noted that investment software systems can report these securities separately.

Ms. Mears made a motion, seconded by Mr. Ford, to expose the nonsubstantive revisions. The motion passed unanimously.

d. Agenda Item 2018-04

Mr. Bruggeman directed the Working Group to agenda item 2018-04: Bank Loan Referral. Ms. Gann stated that this agenda item was drafted to consider a 2016 referral from the Valuation of Securities (E) Task Force regarding the guidance for bank loans in the P&P Manual. Although consideration of the bank loan guidance is still pending, nonsubstantive revisions have been drafted to clarify the application of the collateral loan guidance in SSAP No. 21R. She stated that the proposed revisions would clarify that if a security is in scope of another SSAP, but the security has additional protection with collateral, the security does not get reclassified as a collateral loan in scope of SSAP No. 21 with admittance of the security dependent on the quality of the collateral. For example, if a security is considered a bond in scope of SSAP No. 26, and the bond has an additional collateral protection, the security continues to be in scope of SSAP No. 26R. Ms. Gann stated that NAIC staff are continuing to work with the SVO to address the overall bank loan referral.

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

e. Agenda Item 2018-26

Mr. Bruggeman directed the Working Group to agenda item 2018-26: SCA Loss Tracking. Ms. Gann stated that this agenda item was originally drafted to clarify the requirements when a reporting entity has a negative valuation in an SCA investment. She stated that prior revisions incorporated new disclosures, and the current focus of the agenda item is to consider revising the accounting and reporting provisions in SSAP No. 97. Ms. Gann stated that this agenda item was not exposed at the 2018 Fall National Meeting, but comments were received from interested parties and included as part of the combined comment letters. She stated that the existing language in SSAP No. 97 requires negative value reporting when there is a financial guarantee or commitment by the reporting entity to the SCA. However, Ms. Gann stated that NAIC staff agree with interested parties that the guidance should not result with a double-counting of the liability. She stated that if there is a financial guarantee or commitment and the entire loss has been recognized under *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*, the negative value of the SCA should not be reported under SSAP No. 97. Ms. Gann stated that questions have recently been received regarding the application of SCA losses to other investments held from the SCA, and she noted that *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses* addresses these scenarios. She stated that the proposed revisions to SSAP No. 97 would also bring the exhibit from INT 00-24 into SSAP No. 97 with additional reference to the existing guidance to ensure proper application.

Ms. Brown made a motion, seconded by Ms. Weaver, to expose the nonsubstantive revisions. The motion passed unanimously.

8. Discussed Other Matters

a. Disclosures for *SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees*

Ms. Gann stated that the Working Group adopted SSAP No. 108 during the 2018 Fall National Meeting with a Jan. 1, 2020, effective date, with early application permitted as of Jan. 1, 2019. At the time of adoption, the disclosure templates and notes to the financial statements for the adopted disclosures were not finalized. Ms. Gann stated that NAIC staff have worked with industry representatives in preparing reporting templates and instructions and that an annual statement blanks proposal will be considered for exposure by the Blanks (E) Working Group during this Spring National Meeting. Ms. Gann stated that the intent is to have the disclosure templates adopted during the Blanks (E) Working Group's June 2019 conference call to allow the them to be in place for the 2019 year-end financial statements for the early-adopters. Mr. Bruggeman stated that no action is needed on this item.

b. Agenda Item 2018-07: Surplus Note Accounting – Referral from the Reinsurance (E) Task Force

Ms. Gann stated that this agenda item was drafted to review surplus notes in situations where the cash flows from a surplus note and another instrument are linked. These dynamics were noted to include situations in which terms negate or reduce cash flow exchanges and/or when amounts payable under a surplus note and an amount receivable under an other agreement or asset can be netted or offset (partially or in full), eliminating or reducing the exchange of cash or assets that would normally occur throughout the duration or at maturity of the surplus note or linked asset. She stated that this agenda item, with proposed revisions to *SSAP No. 41R—Surplus Notes*, had been exposed during the 2018 Summer National Meeting for a public comment period ending Nov. 30, 2018. She stated that the comments have been included in the comment letter packet, but consideration of this agenda item has been deferred while NAIC staff collect information from reporting entities, and their domiciliary states, for situations in which "linked surplus note" transactions have occurred. Ms. Gann stated that after the information has been received, it is anticipated that a regulator-to-regulator conference call will occur to discuss the company-specific information pursuant to the provisions permitted under the NAIC Policy Statement on Open Meetings. Ms. Gann stated that after the regulator-to-regulator conference call occurs, this agenda item will be included on the Hearing agenda for public discussion of the comments and proposed revisions. She also requested that reporting entities that have issued linked surplus notes provide information to NAIC staff. Mr. Bruggeman stated that no action is needed on this item.

c. Agenda Item 2016-20: Credit Losses

Ms. Gann stated that the Working Group has had several discussions and exposures regarding ASU 2016-13: Credit Losses. She stated that since the last exposure during the 2018 Summer National Meeting, and the receipt of comment letters in November 2018, the FASB has undertaken additional projects to clarify the guidance and improve transition. Additionally, there was discussion by the U.S. House Committee on Financial Services on Dec. 11, 2018. Ms. Gann stated that with the discussions that are ongoing, this agenda item has been put on perpetual deferral, with NAIC staff monitoring the FASB discussions. She stated that recent FASB actions may result with this agenda item being brought back for discussion soon. However, it is not anticipated that further discussion will occur until the FASB has finalized guidance. Mr. Bruggeman stated this is a key issue as U.S. GAAP is used as a framework for statutory accounting, and the credit loss concept incorporates significant changes to the previously adopted framework and what is currently captured in statutory accounting. He stated that regardless of the actions of the Working Group, either to move towards the new U.S. GAAP approach or retain the prior approach (which would no longer be consistent with U.S. GAAP), there would be significant revisions necessary to statutory accounting.

Mr. Monahan stated that the ACLI is closely monitoring the work of the FASB and would be willing to provide updates to the Working Group on this issue. He stated that the ACLI does not believe the expected credit loss concept is applicable to statutory accounting and that it would provide further information supporting this position. Mr. Bruggeman stated that no action is needed on this item.

d. Informal Life and Health Drafting Group Update

Ms. Marcotte stated that at the 2018 Fall National Meeting, the Working Group heard comments on the exposure of revisions to *SSAP No. 61R—Life and Health Reinsurance* and to the *A-791 Life and Health Reinsurance* QA recommended by the informal life and health reinsurance drafting group. She stated that the Working Group directed the informal drafting group to expand their work to address group term life yearly renewable term (YRT) issues raised in comment letters from two states.

Ms. Marcotte stated that the informal drafting group updated the membership to address the YRT issues raised and has held four conference calls. She noted that the YRT issues related to group term life risk are complex. She stated that while the informal drafting group does not have a recommendation for exposure at this time, they are making steady progress and has active engagement from regulators and industry. She noted that the primary areas that are being considered for revisions are the A-791 QA guidance and to the YRT guidance in SSAP No. 61R, paragraph 19. She stated that the drafting group will continue to hold calls on this topic in the interim and intends to have something to recommend for exposure by the Summer National Meeting. Mr. Bruggeman noted that this issue is complex. He said the that guidance is a principles-based approach and that contracts should follow the spirit of the principles when applying the guidance.

e. Working Capital Finance Investments

Ms. Marcotte stated that the Valuation of Securities (E) Task Force has been discussing working capital finance investments (WCFI). She stated that the Task Force exposed a staff memorandum and an industry proposal on March 4. She noted that the industry proposal includes proposed revisions to *SSAP No. 105—Working Capital Finance Investments*. She stated that the Task Force is expected to send a referral to the Working Group after considering the results of the exposure at this Spring National Meeting. She said that NAIC staff will prepare recommendations for the Working Group's consideration once the referral is received.

f. Publication Update

Ms. Gann stated that the "as of March 2019" *Accounting Practices and Procedures Manual* (AP&P Manual) became available in printed and electronic versions on March 18, 2019. She stated that the new electronic product (BookShelf) is an online subscription service available with internet access that also provides each purchaser the ability to download the product to a total of four devices. Ms. Gann stated that the downloaded version has significantly more functionality and is encouraged to be the standard approach used by industry. Ms. Gann stated that purchasers that acquire the electronic product will no longer have to pre-purchase the subsequent year's manual to access the updates adopted throughout the year. Rather, these updates will be included as subsequent chapters to the AP&P Manual available directly in the electronic product. Purchasers of the printed AP&P Manual will still be required to pre-purchase it to receive updates adopted throughout the year. Mr. Bruggeman stated that regulators already have access to a free electronic portable document format (PDF) file of the AP&P Manual on StateNet. Therefore, the electronic product is not provided to regulators. However, he said the pdf available to regulators has been expanded to include the same bookmarks and updates captured in the electronic product.

g. U.S. GAAP Exposures

Mr. Stultz stated that NAIC staff have reviewed U.S. GAAP exposures and noted that comments during the exposure periods are not recommended, with a review once issued as final ASUs under the statutory maintenance process.

Ms. Bruggeman stated that agenda items 2018-32: Prepayment Penalties, 2019-05: Repurchase Disclosures, and 2019-07: Bonds Received as Property Dividends or Capital Contributions were exposed for a public comment period ending May 10. He stated that June 12 is the public comment deadline for all other exposures and the submission of new items.

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

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Exposure Draft
Issue Paper 16X—Property and Casualty Reinsurance Credit

Hearing Date: 2019 Summer National Meeting or Interim Conference Call

Location: 2019 Summer National Meeting or Interim Conference Call

Deadline for Written Notice of Intent to Speak: June 12, 2019

Deadline for Receipt of Written Comments: June 12, 2019

Notice of Public Hearing and Request for Written Comments

Basis for hearings. The Statutory Accounting Principles Working Group (SAPWG) will hold a public hearing to obtain information from and views of interested individuals and organizations about the standards proposed in this Exposure Draft. The SAPWG will conduct the hearing in accordance with the National Association of Insurance Commissioners (NAIC) policy statement on open meetings. An individual or organization desiring to speak must notify the NAIC in writing by **June 12, 2019.** Speakers will be notified as to the date, location, and other details of the hearings.

Oral presentation requirements. The intended speaker must submit a position paper, a detailed outline of a proposed presentation or comment letter addressing the standards proposed in the Exposure Draft by **June 12, 2019**. Individuals or organizations whose submission is not received by that date will only be granted permission to present at the discretion of the SAPWG chair. All submissions should be addressed to the NAIC staff at the address listed below.

Format of the hearings. Speakers will be allotted up to 10 minutes for their presentations to be followed by a period for answering questions from the SAPWG. Speakers should use their allotted time to provide information in addition to their already submitted written comments as those comments will have been read and analyzed by the SAPWG. Those submissions will be included in the public record and will be available at the hearings for inspection.

Copies. Exposure Drafts can be obtained on the Internet at the NAIC Home Page (http://www.naic.org). The documents can be downloaded using Microsoft Word.

Written comments. Participation at a public hearing is not a prerequisite to submitting written comments on this Exposure Draft. Written comments are given the same consideration as public hearing testimony.

The Statutory Accounting Principles Statement of Concepts was adopted by the Accounting Practices & Procedures (EX4) Task Force on September 20, 1994, in order to provide a foundation for the evaluation of alternative accounting treatments. All issues considered by the SAPWG will be evaluated in conjunction with the objectives of statutory reporting and the concepts set forth in the Statutory Accounting Principles Statement of Concepts. Whenever possible, establish a relationship between your comments and the principles defining statutory accounting.

The exposure period is not meant to measure support for, or opposition to, a particular accounting treatment but rather to accumulate an analysis of the issues from other perspectives and persuasive comments supporting them. Therefore, form letters and objections without valid support for their conclusions are not helpful in the deliberations of the working group. Comments should not simply register your agreement or disagreement without a detailed explanation, a description of the impact of the proposed guidelines, or possible alternative recommendations for accomplishing the regulatory objective.

Any individual or organization may send written comments addressed to the Working Group to the attention of Julie Gann at jgann@naic.org, Robin Marcotte at rmarcotte@naic.org, Fatima Sediqzad at fsediqzad@naic.org and Jake Stultz at jstultz@naic.org no later than **June 12, 2019**. Electronic submission is preferred **Robin Marcotte** is the NAIC Staff that is the project lead for this topic.

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Statutory Issue Paper No. 16X

Property and Casualty Reinsurance Credit

STATUS
Exposure Draft – April 2019

Original SSAP: 62R; Current Authoritative Guidance: SSAP No. 62R

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. This issue paper documents substantive revisions to *SSAP No. 62R—Property and Casualty Reinsurance* which were drafted to clarify the application of existing concepts in SSAP No. 62R.

2. The substantive revisions to SSAP No. 62R (illustrated in Exhibit A), are intended to clarify reinsurance risk-transfer requirements and that reinsurance accounting credit for contracts that pass risk transfer is only for the amount of risk ceded. The clarifications were primarily accomplished by incorporating U.S. generally accepted accounting principles (GAAP) guidance which was previously adopted by reference. The revisions included the following key elements:

a. Explicitly incorporate guidance from Financial Accounting Standards Board (FASB) *Emerging Issues Task Force No. 93-6, Accounting for Multi-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises* (EITF 93-6), which was adopted previously by reference.

b. Explicitly incorporate guidance from the EITF 93-6 related implementation guidance in *EITF Topic D-35, FASB Staff Views on Issue No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises*.

c. The revisions also moved some existing implementation guidance in SSAP No. 62R Exhibit A to be closer to the related topic. In some cases, the incorporated or moved guidance was also revised to better match the current U.S. GAAP presentation of guidance in accounting standards codification (ASC) topic 944-20.

DISCUSSION

3. This issue paper intends to provide historical information on the consideration of the revisions to SSAP No. 62R regarding reinsurance credit and more explicitly incorporating U.S. GAAP guidance.

Reasons for the Development of Revisions

4. The Financial Condition (E) Committee previously had a Risk-Limiting Contracts (E) Working Group which was charged with reviewing risk transfer guidance for property and casualty reinsurance. The Risk-Limiting Contracts (E) Working Group stopped work in 2016, because it was determined that needed accounting clarifications should be addressed by the Statutory Accounting Principles (E) Working Group.

5. At the 2016 Fall National Meeting, the chair of the Statutory Accounting Principles (E) Working Group, directed NAIC staff to research the application of reinsurance credit under *SSAP No. 61R—Life,*

Deposit-Type, and Accident and Health Reinsurance and *SSAP No. 62R—Property and Casualty Reinsurance* and develop materials for future discussion.

6. In April 2017, the Financial Analysis (E) Working Group (FAWG) provided a referral to the Statutory Accounting Principles (E) Working Group which noted concerns regarding risk-limiting features and the resulting application of reinsurance credit for property and casualty entities and for health contracts. In addition, the referral also requested that the Statutory Accounting Principles (E) Working Group develop life and health disclosures for inclusion in SSAP No. 61R.

7. The FAWG noted it had recently discussed a number of troubled and potentially troubled insurers that have participated in quota share/proportional reinsurance contracts with significant risk-limiting features. In many of these situations, the motivation for the contracts appeared to be surplus relief without a significant amount of insurance risk being transferred to the reinsurer. The contracts often utilize loss corridors, sliding scale commissions, or other risk-limiting features to significantly limit the risk transferred to the reinsurer. The FAWG noted that often these limitations result in a quota share reinsurance agreement operating more like an excess of loss reinsurance agreement, but the ceding insurer is accounting for the contract as if full, proportional reinsurance were in place. In certain cases, the ceding insurers have lost millions of dollars on certain blocks of business and even reached insolvency, while the reinsurers have continued to recognize profits on the contracts.

8. The FAWG referral further noted that while property and casualty insurers are required to disclose some of these features in the interrogatories, health insurers are not. The referral noted that the FAWG was surprised by the fact that U.S. GAAP seems to prevent some of these contracts from being recorded as meeting risk transfer requirements while statutory accounting principles may not. Although the number of property and casualty companies reporting these contracts differently between U.S. GAAP and statutory accounting principles reporting may be limited, the referral noted that they appear to be more prevalent in troubled company situations and are being offered by otherwise well-regarded reinsurers. Therefore, the FAWG referral suggested further changes to statutory accounting principles to prevent these situations.

Existing Statutory Accounting Guidance:

9. Existing statutory accounting guidance for property and casualty reinsurance is in SSAP No. 62R. The primary U.S. GAAP guidance which is adopted by reference is listed in paragraph 105 as follows:

> 105. This statement adopts with modification FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts (FAS 113) and FASB Emerging Issues Task Force No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises for the following:
>
> a. Reinsurance recoverables on unpaid case-basis and incurred but not reported losses and loss adjustment expenses shall be reported as a contra-liability netted against the liability for gross losses and loss adjustment expenses;
>
> b. Amounts paid for prospective reinsurance that meet the conditions for reinsurance accounting shall be reported as a reduction of unearned premiums;
>
> c. The gain created by a retroactive reinsurance agreement because the amount paid to the reinsurer is less than the gross liabilities for losses and loss adjustment expenses ceded to the reinsurer is reported in the statement of income as a write-in gain in other income by the ceding entity and a write-in loss by the assuming entity. The gain created by a retroactive reinsurance agreement is restricted as a

special surplus account until the actual retroactive reinsurance recovered is in excess of the consideration paid;

d. This statement requires that a liability (provision for reinsurance) be established through a provision reducing unassigned funds (surplus) for unsecured reinsurance recoverables from unauthorized or certified reinsurers and for certain overdue balances due from authorized reinsurers;

e. Some reinsurance agreements contain adjustable features that provide for adjustment of commission, premium or amount of coverage, based on loss experience. This statement requires that the asset or liability arising from the adjustable feature be computed based on experience to date under the agreement, and the impact of early termination may only be considered at the time the agreement has actually been terminated;

f. Structured settlements are addressed in SSAP No. 65—Property and Casualty Contracts. Statutory accounting and FAS 113 are consistent in accounting for structured settlement annuities where the reporting entity is the owner and payee and where the claimant is the payee and the reporting entity has been released from its obligation. FAS 113 distinguishes structured settlement annuities where the claimant is the payee and a legally enforceable release from the reporting entity's liability is obtained from those where the claimant is the payee but the reporting entity has not been released from its obligation. GAAP requires the deferral of any gain resulting from the purchase of a structured settlement annuity where the reporting entity has not been released from its obligation; and

g. This statement requires that reinsurance recoverables on unpaid losses and loss adjustment expenses be presented as a contra-liability. Requirements for offsetting and netting are addressed in SSAP No. 64.

10. From its original effective date, SSAP No. 62R has adopted with modification FAS 113. In reviewing the cross-reference of FAS 113 to current ASC topic 944-20, almost all of FAS 113 survives intact in the current ASC.

11. From its original effective date, SSAP No. 62R has also adopted with modification FASB *Emerging Issues Task Force No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises* (EITF 93-6). The primary statutory modification to EITF 93-6 relates to early termination considerations as SSAP No. 62R is consistent with EITF 93-6 regarding recognition of retrospective features based on experience to date.

12. The ASC topic 944-20 cross-reference to sources indicates it includes codified guidance from other standards than FAS 113 and EITF 93-6. Two of these other standards include FASB staff directed *EITF Topic D-34 Accounting for Reinsurance: Questions and Answers about FASB Statement No. 113* (EITF D-34) and *EITF Topic D-35, FASB Staff Views on Issue No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises* (EITF D-35). EITF D-34 is implementation guidance on FAS 113 and EITF D-35 is implementation guidance for EITF 93-6.

13. Prior to FASB Codification, FASB staff EITFs were lower in the GAAP hierarchy and were not automatically reviewed as part of the statutory accounting maintenance process. However, after incorporation within the FASB codification, all guidance carries the same authority.

14. SSAP No. 62R Exhibit A Implementation Questions and Answers was based on a *EITF Topic D-34 Accounting for Reinsurance: Questions and Answers about FASB Statement No. 113*, even though it is not named in the relevant literature of SSAP No. 62R.

15. SSAP No. 62R did not previously adopt *EITF Topic D-35, FASB Staff Views on Issue No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises,* however, it simply provides additional implementation guidance on EITF 93-6 guidance, which was adopted. As a FASB Staff EITF, it would not necessarily have been automatically reviewed for statutory accounting when the statutory accounting codification project was completed.

Development of Statutory Accounting Guidance:

16. On August 6, 2017, the Statutory Accounting Principles (E) Working Group exposed nonsubstantive revisions prepared by NAIC staff to *SSAP No. 62R—Property and Casualty Reinsurance.* The revisions were to clarify reinsurance risk transfer requirements and that reinsurance accounting credit for contracts that pass risk transfer is only for the amount of risk ceded. In addition, the Working Group also exposed updates to terminology and incorporated revisions and disclosures in *SSAP No. 61R—Life and Health Reinsurance* to assist in reviewing contracts, similar to existing disclosures in SSAP No. 62R. The exposure also included revisions to the QA guidance in Appendix A-791, Life and Health Reinsurance. Although agenda item 2017-28: Reinsurance Credit included revisions to SSAP No. 61R, A-791, and SSAP No. 62R, this issue paper was prepared to document the revisions adopted to SSAP No. 62R.

17. On November 6, 2017, the Statutory Accounting Principles (E) Working Group discussed comments from the interested parties and the ACLI (American Council of Life Insurers). The commenters expressed concerns that some of the revisions were substantive in nature and overly broad. The interested parties provided specific recommendations for the exposed SSAP No. 62R revisions. Both the interested parties and the ACLI indicated willingness to lend expertise to continue to assist the Working Group on this technical project. The Working Group provided the following directions for the next phase of project work:

a. NAIC staff were directed to work with Working Group and industry representatives to hold drafting calls to refine the exposure drafts for future Working Group consideration. The Working Group directed the formation of two drafting groups as follows 1) the informal property and casualty reinsurance drafting group; and 2) the informal life and health reinsurance drafting group.

b. The August 2017 exposed revisions to add the U.S. GAAP definitions of short-duration and long-duration contracts to the master glossary were directed to be removed, as the comments from the interested parties and the ACLI responded that the proposed additional definitions were not helpful.

c. NAIC staff was directed to use language proposed by interested parties for a replacement of the SSAP No. 62R, paragraph 29, exposure on nonproportional reinsurance credit as a starting point for the informal property and casualty reinsurance drafting group's future discussions. The proposed starting point language for SSAP No. 62R, paragraph 29, is as follows:

> 29. Reporting entities shall not record reinsurance credit for non-proportional reinsurance until such time as losses have been incurred on the underlying

business, which exceed the attachment point of the applicable reinsurance contract(s).

18. The revisions to SSAP No. 62R were developed in consultation with the informal property and casualty reinsurance drafting group (informal drafting group). Members of the drafting group included regulators, members of industry, representatives of the NAIC/ American Institute Certified Public Accountants (AICPA) (E) Working Group from the major CPA firms and industry trade representatives. The informal drafting group held approximately eight calls.

19. The informal drafting group discussions identified that the SSAP No. 62R guidance prior to the November 2018 updates was fairly consistent with the presentation of guidance in FAS 113. In researching this topic, it was identified that SSAP No. 62R was not consistent with how ASC topic 944-20 was arranged after FASB codification in 2009. This difference can confuse a casual reader, and the informal drafting group discussions identified that more explicitly incorporating guidance from EITF 93-6 and its related implementation guidance in EITF D-35, would be beneficial. Discussions from the informal drafting group members agreed that the intended application of SSAP No. 62R was intended to have very few differences from U.S. GAAP as reflected in originally in FAS 113 and EITF 93-6 and from the current text of ASC 944-20.

20. During the 2018 Summer National Meeting, the Statutory Accounting Principles (E) Working Group exposed proposed revisions to SSAP No. 62R which were recommended by the informal property and casualty reinsurance drafting group. The revisions to SSAP No. 62R were to clarify reinsurance risk transfer requirements and to provide clarifications that reinsurance accounting credit for contracts that pass risk transfer is only for the amount of risk ceded. These revisions were consistent with the informal drafting group consensus that SSAP No. 62R intends to match U.S. GAAP to the extent feasible. The clarifications were primarily accomplished by incorporating U.S. GAAP guidance which was previously adopted by reference. The revisions in the exposure included the following key elements:

a. Explicitly incorporate guidance from FASB *Emerging Issues Task Force No. 93-6, Accounting for Multi-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises* (EITF 93-6) which was adopted previously by reference.

b. Explicitly incorporate guidance from the EITF 93-6 related implementation guidance in *EITF Topic D-35, FASB Staff Views on Issue No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises*.

c. The revisions also rearranged existing implementation guidance in SSAP No. 62R Exhibit A to be closer to the related topic.

d. Incorporated other revisions to be more consistent with ASC topic 994-20 format.

21. The 2018 Summer National Meeting exposure noted that although the informal property and casualty reinsurance drafting group views the revisions as consistency updates, due to the extent of revisions, NAIC staff recommended categorizing the revisions as substantive and exposing the revisions to SSAP No. 62R. With the exposure, the Working Group also requested input on the effective date.

22. In response to the exposure, comments from interested parties noted that interested parties had no comments.

23. During the 2018 Fall National Meeting, after considering the interested parties' comments the Working Group adopted the exposed revisions to SSAP No. 62R. As part of the adoption action, the

Working Group identified the revisions as a substantive change, and designated a January 1, 2019 effective date for the revisions.

24. The January 1, 2019 effective date was supported by informal drafting group members because the revisions were viewed as not representing changes for the average user, but more of consistency updates and clarifications. It was believed that the change in accounting revisions will not prompt many entities to revise their evaluation of risk transfer for reinsurance contracts in effect as of January 1, 2019. However, if a reporting entity, after reading the incorporated guidance, now has a better understanding that they were applying existing guidance incorrectly, they do have a duty to update their risk transfer assessments for all contracts that were in effect as of January 1, 2019. With the substantive classification, the Working Group directed NAIC staff to prepare an issue paper for historical documentation. With the effective date in the SSAP, the substantive revisions will be effective prior to the availability of this issue paper.

25. As issue papers are not represented in the Statutory Hierarchy (see Section IV of the Preamble), the subsequent consideration and adoption of this issue paper will not have any impact of the effective date of the substantive revisions adopted to SSAP No. 62R during the 2018 Fall National Meeting.

EXHIBIT A – Substantive Revisions to SSAP No. 62R—Property and Casualty Reinsurance:

Note: These substantive revisions to SSAP No. 62R were adopted during the November 15, 2018 Fall National Meeting with an effective date of January 1, 2019. This issue paper was directed for historical documentation.

Property and Casualty Reinsurance

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for property and casualty reinsurance. A wide range of methods for structuring reinsurance arrangements can be employed depending on the requirements of individual companies. This statement deals with the more commonly employed methods.

SUMMARY CONCLUSION

General

2. Reinsurance is the assumption by an insurer of all or part of a risk undertaken originally by another insurer. The transaction whereby a reinsurer cedes all or part of the reinsurance it has assumed to another reinsurer is known as a retrocession.

3. Reinsurance has many beneficial purposes. Among them are that it enables an insurance entity to (a) expand its capacity, (b) share large risks with other insurers, (c) spread the risk of potential catastrophes and stabilize its underwriting results, (d) finance expanding volume by sharing the financial burden of reserves, (e) withdraw from a line or class of business, and (f) reduce its net liability to amounts appropriate to its financial resources.

4. Reinsurance agreements are generally classified as treaty or facultative. Treaty reinsurance refers to an arrangement involving a class or type of business written, while facultative reinsurance involves individual risks offered and accepted.

5. Reinsurance coverage can be pro rata (i.e., proportional reinsurance) where the reinsurer shares a pro rata portion of the losses and in the same proportion as it shares premium of the ceding entity or excess of loss (i.e., non-proportional) where the reinsurer, subject to a specified limit, indemnifies the ceding entity against the amount of loss in excess of a specified retention. Most reinsurance agreements fall into one of the following categories:

a. Treaty Reinsurance Contracts—Pro Rata:

i. Quota Share Reinsurance—The ceding entity is indemnified against a fixed percentage of loss on each risk covered in the agreement;

ii. Surplus Share Reinsurance—The ceding entity establishes a retention or “line” on the risks to be covered and cedes a fraction or a multiple of that line on each policy subject to a specified maximum cession;

b. Treaty Reinsurance Contracts—Excess of Loss:

i. Excess Per Risk Reinsurance—The ceding entity is indemnified, subject to a specified limit, against the amount of loss in excess of a specified retention with respect to each risk covered by a treaty;

ii. Aggregate Excess of Loss Reinsurance—The ceding entity is indemnified against the amount by which the ceding entity's net retained losses incurred during a specific period exceed either a predetermined dollar amount or a percentage of the entity's subject premiums for the specific period subject to a specified limit;

c. Treaty Reinsurance Contracts—Catastrophe: The ceding entity is indemnified, subject to a specified limit, against the amount of loss in excess of a specified retention with respect to an accumulation of losses resulting from a catastrophic event or series of events;

d. Facultative Reinsurance Contracts—Pro Rata: The ceding entity is indemnified for a specified percentage of losses and loss expenses arising under a specific insurance policy in exchange for that percentage of the policy's premium;

e. Facultative Reinsurance Contracts—Excess of Loss: The ceding entity is indemnified, subject to a specified limit, for losses in excess of its retention with respect to a particular risk.

Characteristics of Reinsurance Agreements

6. Common contract provisions that may affect accounting practices include:

a. Reporting responsibility of the ceding entity—Details required and time schedules shall be established;

b. Payment terms—Time schedules, currencies intended, and the rights of the parties to withhold funds shall be established;

c. Payment of premium taxes—Customarily the responsibility of the ceding entity, a recital of nonliability of the reinsurer may be found;

d. Termination—May be on a cut-off or run-off basis. A cut-off provision stipulates that the reinsurer shall not be liable for loss as a result of occurrences taking place after the date of termination. A run-off provision stipulates that the reinsurer shall remain liable for loss under reinsured policies in force at the date of termination as a result of occurrences taking place after the date of termination until such time as the policies expire or are canceled; and

e. Insolvency clause—Provides for the survival of the reinsurer's obligations in the event of insolvency of the ceding entity, without diminution because of the insolvency.

7. Reinsurance contracts shall not permit entry of an order of rehabilitation or liquidation to constitute an anticipatory breach by the reporting entity, nor grounds for retroactive revocation or retroactive cancellation of any contracts of the reporting entity.

8. In addition to credit for reinsurance requirements applicable to reinsurance transactions generally, no credit or deduction from liabilities shall be allowed by the ceding entity for reinsurance recoverable where the agreement was entered into after the effective date of these requirements (see paragraphs ~~108~~129 and ~~109~~130) unless each of the following conditions is satisfied:

a. The agreement must contain an acceptable insolvency clause;

b. Recoveries due the ceding entity must be available without delay for payment of losses and claim obligations incurred under the agreement, in a manner consistent with orderly payment of incurred policy obligations by the ceding entity;

c. The agreement shall constitute the entire contract between the parties and must provide no guarantee of profit, directly or indirectly, from the reinsurer to the ceding entity or from the ceding entity to the reinsurer;

d. The agreement must provide for reports of premiums and losses, and payment of losses, no less frequently than on a quarterly basis, unless there is no activity during the period. The report of premiums and losses shall set forth the ceding entity's total loss and loss expense reserves on the policy obligations subject to the agreement, so that the respective obligations of the ceding entity and reinsurer will be recorded and reported on a basis consistent with this statement;

e. The agreement must include a proper reinsurance intermediary clause, if applicable, which stipulates that the credit risk for the intermediary is carried by the assuming insurance entity;

f. With respect to reinsurance contracts involving a certified reinsurer, the agreement must include a proper funding clause, which requires the certified reinsurer to provide and maintain security in an amount sufficient to avoid the imposition of any financial statement penalty on the ceding insurance entity for reinsurance ceded to the certified reinsurer. However, this does not preclude negotiation for higher contractual collateral amounts; and

g. With respect to retroactive reinsurance agreements, the following additional conditions apply:

    i. The consideration to be paid by the ceding entity for the retroactive reinsurance must be a sum certain stated in the agreement;

    ii. Direct or indirect compensation to the ceding entity or reinsurer is prohibited;

    iii. Any provision for subsequent adjustment on the basis of actual experience in regard to policy obligations transferred, or on the basis of any other formula, is prohibited in connection with a retroactive reinsurance transaction, except that provision may be made for the ceding entity's participation in the reinsurer's ultimate profit, if any, under the agreement;

    iv. A retroactive reinsurance agreement shall not be canceled or rescinded without the approval of the commissioner of the domiciliary state of the ceding entity.

Reinsurance Agreements with Multiple Cedents

9. Reinsurance agreements with multiple cedents require allocation agreements. The allocation agreement can be part of the reinsurance agreement or a separate agreement. If the agreement has multiple cedents:

a. The allocation must be in writing and

b. The terms of the allocation agreement must be fair and equitable.

Reinsurance Contracts Must Include Transfer of Risk

10. The essential ingredient of a reinsurance contract is the transfer of risk[1]. The essential element of every true reinsurance agreement is the undertaking by the reinsurer to indemnify the ceding entity, i.e., reinsured entity, not only in form but in fact, against loss or liability by reason of the original insurance. Unless the agreement contains this essential element of risk--transfer, no credit shall be recorded.(INT 02-22)

11. Insurance risk involves uncertainties about both (a) the ultimate amount of net cash flows from premiums, commissions, claims, and claims settlement expenses (underwriting risk) and (b) the timing of the receipt and payment of those cash flows (timing risk). Actual or imputed investment returns are not an element of insurance risk. Insurance risk is fortuitous—the possibility of adverse events occurring is outside the control of the insured.

12. Determining whether an agreement with a reinsurer provides indemnification against loss or liability (transfer of risk) relating to insurance risk requires a complete understanding of that contract and other contracts or agreements between the ceding entity and related reinsurers. A complete understanding includes an evaluation of all contractual features that (a) limit the amount of insurance risk to which the reinsurer is subject (e.g., experience refunds, cancellation provisions, adjustable features, or additions of profitable lines of business to the reinsurance contract) or (b) delay the timely reimbursement of claims by the reinsurer (e.g., payment schedules or accumulating retentions from multiple years).

13. Indemnification of the ceding entity against loss or liability relating to insurance risk in reinsurance requires both of the following:

a. The reinsurer assumes significant insurance risk under the reinsured portions of the underlying insurance agreements; and

b. It is reasonably possible that the reinsurer may realize a significant loss from the transaction.

The conditions are independent and the ability to meet one does not mean that the other has been met. A substantive demonstration that both conditions have been met is required to transfer risk.

14. The reference in paragraph 13.a. acknowledges that a ceding entity may reinsure only part of the risks associated with the underlying contracts. For example, a proportionate share of all risks or only specified risks may be reinsured. The conditions for reinsurance accounting are evaluated in relation to the reinsured portions of the underlying insurance contracts, rather than all aspects of those contracts.

[1] Exhibit A Questions and Answers, questions 6-19 provide additional risk-transfer implementation guidance.

15. The word "timely" is used in paragraph 12 in the ordinary temporal sense to refer to the length of time between payment of the underlying reinsured claims and reimbursement by the reinsurer. While the test for reasonable possibility of significant loss to the reinsurer provides for a present-value-based assessment of the economic characteristics of the reinsurance contract, the concept of timely reimbursement relates to the transfer of insurance risk (the condition in paragraph 13.a.), not the reasonable possibility of significant loss (the condition in paragraph 13.b.). Accordingly, timely reimbursement shall be evaluated based solely on the length of time between payment of the underlying reinsured claims and reimbursement by the reinsurer.

~~14.~~16. Whether underwriting risk has transferred to the reinsurer depends on how much uncertainty about the ultimate amount of net cash flows from premiums, commissions, claims, and claim settlement expenses paid under a contract has been transferred to the reinsurer. A reinsurer shall not have assumed significant insurance risk under the reinsured contracts if the probability of a significant variation in either the amount or timing of payments by the reinsurer is remote. Implicit in this condition is the requirement that both the amount and timing of the reinsurer's payments depend on and directly vary with the amount and timing of claims settled by the ceding entity. Accordingly, the significance of the amount of underwriting risk transferred shall be evaluated in relation to the ceding entity's claims payments. Contractual provisions that delay timely reimbursement to the ceding entity prevent this condition from being met.

~~15.~~17. The ceding entity's evaluation of whether it is reasonably possible for a reinsurer to realize a significant loss from the transaction shall be based on the present value of all cash flows between the ceding and assuming companies under reasonably possible outcomes, without regard to how the individual cash flows are described or characterized. An outcome is reasonably possible if its probability is more than remote. The same interest rate shall be used to compute the present value of cash flows for each reasonably possible outcome tested. A constant interest rate shall be used in determining those present values because the possibility of investment income varying from expectations is not an element of insurance risk. Judgment is required to identify a reasonable and appropriate interest rate. To be reasonable and appropriate, that interest rate shall reflect both of the following:

a. The expected timing of payments to the reinsurer; and

b. The duration over which those cash flows are expected to be invested by the reinsurer.

~~16.~~18. Significance of loss shall be evaluated by comparing the present value of all cash flows, determined as described in paragraph ~~15~~17, with the present value of the amounts paid or deemed to have been paid to the reinsurer. If, based on this comparison, the reinsurer is not exposed to the reasonable possibility of significant loss, the ceding entity shall be considered indemnified against loss or liability relating to insurance risk only if substantially all of the insurance risk relating to the reinsured portions of the underlying insurance agreements has been assumed by the reinsurer. In this narrow circumstance, the reinsurer's economic position is virtually equivalent to having written the insurance contract directly. This condition is met only if insignificant insurance risk is retained by the ceding entity on the retained portions of the underlying insurance contracts, so that the reinsurer's exposure to loss is essentially the same as that of the reporting entity. The assessment of that condition shall be made by comparing both of the following:

a. The net cash flows of the reinsurer under the reinsurance contract; and

b. The net cash flows of the ceding entity on the reinsured portions of the underlying insurance contracts.

If the economic position of the reinsurer relative to the insurer cannot be determined, the contract shall not qualify under the exception in this paragraph[2].

19. An extremely narrow and limited exemption is provided for contracts that reinsure either an individual risk or an underlying book of business that is inherently profitable. When substantially all of the insurance risk relating to the reinsured portions of the underlying insurance contracts has been assumed by the reinsurer, the contract meets the conditions for reinsurance accounting. To qualify under this exception, no more than insignificant insurance risk on the reinsured portions of the underlying insurance contracts may be retained by the ceding entity.

~~17.~~20. Payment schedules and accumulating retentions from multiple years are contractual features inherently designed to delay the timing of reimbursement to the ceding entity. 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. Therefore, any feature that may affect the timing of the reinsurer's reimbursement to the ceding entity shall be closely scrutinized.

21. Contracts that reinsure insurance risks over a significantly longer period than the underlying insurance contract are, in substance, financing transactions, if any of the following conditions exist:

a. Premiums are deferred over a period beyond the term of the underlying insurance contracts;

b. Losses are recognized in a different period than the period in which the event causing the loss takes place; or

c. Both events, 21.a. and 21.b., occur at different points in time.

Contracts that are in substance financing receive deposit accounting treatment.

Accounting for Reinsurance

~~18.~~22. Reinsurance recoverables shall be recognized in a manner consistent with the liabilities (including estimated amounts for claims incurred but not reported) relating to the underlying reinsured contracts. Assumptions used in estimating reinsurance recoverables shall be consistent with those used in estimating the related liabilities. Certain assets and liabilities are created by entities when they engage in reinsurance contracts. Reinsurance assets meet the definition of assets as defined by *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted to the extent they conform to the requirements of this statement.

~~19.~~23. Accounting for members of a reinsurance pool shall follow the accounting for the pool member which issued the underlying policy.(INT 03-02) Specific accounting rules for underwriting pools and associations are addressed in *SSAP No. 63—Underwriting Pools* (SSAP No. 63).

~~20.~~24. Reinsurance recoverable on loss payments is an admitted asset. Notwithstanding the fact that reinsurance recoverables on paid losses may meet the criteria for offsetting under the provisions of *SSAP No. 64—Offsetting and Netting of Assets and Liabilities* (SSAP No. 64), reinsurance recoverables on

[2] See additional detail on this topic in Exhibit A, question 19.

paid losses shall be reported as an asset without any available offset. Unauthorized reinsurance and reinsurance ceded to certified reinsurers is included in this asset and reflected separately as a liability to the extent required. Penalty for overdue authorized reinsurance shall be reflected as a liability.

~~21.~~25. Funds held or deposited with reinsured companies, whether premiums withheld as security for unearned premium and outstanding loss reserves or advances for loss payments, are admitted assets provided they do not exceed the liabilities they secure and provided the reinsured is solvent. Those funds which are in excess of the liabilities, and any funds held by an insolvent reinsured shall be nonadmitted.

~~22.~~26. Prospective reinsurance is defined as reinsurance in which a reinsurer agrees to reimburse a ceding entity for losses that may be incurred as a result of future insurable events covered under contracts subject to the reinsurance. Retroactive reinsurance is defined as reinsurance in which a reinsurer agrees to reimburse a ceding entity for liabilities incurred as a result of past insurable events covered under contracts subject to the reinsurance. A reinsurance agreement may include both prospective and retroactive reinsurance provisions.

~~23.~~27. The distinction between prospective and retroactive reinsurance agreements is based on whether the agreement reinsures future or past insured events covered by the underlying insurance policies. For example, in occurrence-based insurance, the insured event is the occurrence of a loss covered by the insurance contract. In claims-made insurance, the insured event is the reporting to the insurer, within the period specified by the policy, of a claim for a loss covered by the insurance agreement. A claims-made reinsurance contract that reinsures claims asserted to the reinsurer in a future period as a result of insured events that occurred prior to entering into the reinsurance agreement is a retroactive agreement. (However, a reinsurance agreement that reinsures claims reported to an insurer that are covered under currently effective claims-made insurance policies is a prospective reinsurance agreement.)

~~24.~~28. It is not uncommon for a reinsurance arrangement to be initiated before the beginning of a policy period but not finalized until after the policy period begins. Whether there was agreement in principle at the beginning of the policy period and, therefore, the agreement is substantively prospective shall be determined based on the facts and circumstances. However, except as respects business assumed by a U.S. reinsurer from ceding companies domiciled outside the U.S. and not affiliated with such reinsurer, or business assumed by a U.S. reinsurer where either the lead reinsurer or a majority of the capacity on the agreement is domiciled outside the U.S. and is not affiliated with such reinsurer, if an agreement entered into, renewed or amended on or after January 1, 1994 has not been finalized, reduced to a written form and signed by the parties within nine months after the commencement of the policy period covered by the reinsurance arrangement, then the arrangement is presumed to be retroactive and shall be accounted for as a retroactive reinsurance agreement. This presumption shall not apply to: (a) facultative reinsurance contracts, nor to (b) reinsurance agreements with more than one reinsurer which are signed by the lead reinsurer (i.e., the reinsurer setting the terms of the agreement for the reinsurers) within nine months after the commencement of the policy period covered by the reinsurance agreement, nor to (c) reinsurance agreements with more than one reinsurer (whether signed by the lead reinsurer or not) which were entered into, renewed or amended on or before December 31, 1996, (and which were not renewed or amended after that date) if reinsurers representing more than 50% of the capacity on the agreement have signed cover notes, placement slips or similar documents describing the essential terms of coverage and exclusions within nine months after the commencement of the policy period covered by the reinsurance arrangement. Also exempt from this presumption are reinsurance agreements where one of the parties is in conservation, rehabilitation, receivership or liquidation proceedings.

~~25.~~29. Prospective and retroactive provisions included within a single agreement shall be accounted for separately. If separate accounting for prospective and retroactive provisions included within a single agreement is impracticable, the agreement shall be accounted for as a retroactive agreement provided the conditions for reinsurance accounting are met.

Accounting for Prospective Reinsurance Agreements

~~26.~~30. Amounts paid for prospective reinsurance that meet the conditions for reinsurance accounting shall be reported as a reduction of written and earned premiums by the ceding entity and shall be earned over the remaining contract period in proportion to the amount of reinsurance protection provided or, if applicable, until the reinsurer's maximum liability under the agreement has been exhausted. If the amounts paid are subject to adjustment and can be reasonably estimated, the basis for amortization shall be the estimated ultimate amount to be paid. Reinstatement premium, if any, shall be earned over the period from the reinstatement of the limit to the expiration of the agreement.

~~27.~~31. Changes in amounts of estimated reinsurance recoverables shall be recognized as a reduction of gross losses and loss expenses incurred in the current period statement of income. Reinsurance recoverables on paid losses shall be reported as an asset, reinsurance recoverables on loss and loss adjustment expense payments, in the balance sheet. Reinsurance recoverables on unpaid case-basis and incurred but not reported losses and loss adjustment expenses shall be netted against the liability for gross losses and loss adjustment expenses.

32. Prospective reinsurance agreements that meet the conditions for reinsurance accounting shall only reflect reinsurance credit for the portion of risk which is ceded. Provisions that would limit the reinsurer's losses (e.g., a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions) caused by any applicable risk-limiting provision(s) shall be reflected adjustments to ceded premiums, commissions or losses. Reporting entities shall only take credit for reinsurance, i.e., record a reinsurance recoverable, for non-proportional reinsurance when and to the extent that incurred losses on the underlying subject business exceed the attachment point of the applicable reinsurance contract(s).

Accounting for Retroactive Reinsurance Agreements

~~28.~~33. Certain reinsurance agreements which transfer both components of insurance risk cover liabilities which occurred prior to the effective date of the agreement. Due to potential abuses involving the creation of surplus to policyholders and the distortion of underwriting results, special accounting treatment for these agreements is warranted.

~~29.~~34. All retroactive reinsurance agreements entered into, renewed or amended on or after January 1, 1994 (including subsequent development of such transactions) shall be accounted for and reported in the following manner:

a. The ceding entity shall record, without recognition of the retroactive reinsurance, loss and loss expense reserves on a gross basis on the balance sheet and in all schedules and exhibits;

b. The assuming entity shall exclude the retroactive reinsurance from loss and loss expense reserves and from all schedules and exhibits;

c. 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;

d. 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;

e. 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;

f. 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 under such agreement, or adjusted as provided in paragraph ~~29~~34.j.;

g. For each agreement, the reduction in the special surplus from retroactive reinsurance account shall be limited to the lesser of (i) the actual amount recovered in excess of consideration paid or (ii) the initial surplus gain resulting from the respective retroactive reinsurance agreement. Any remaining balance in the special surplus from retroactive reinsurance account derived from any such agreement shall be returned to unassigned funds (surplus) upon elimination of all policy obligations subject to the retroactive reinsurance agreement;

h. The ceding entity shall report the initial gain arising from a retroactive reinsurance transaction (i.e., the difference between the consideration paid to the reinsurer and the total reserves ceded to the reinsurer) as a write-in item on the statement of income, to be identified as Retroactive Reinsurance Gain and included under Other Income;

i. The assuming entity shall report the initial loss arising from a retroactive reinsurance transaction, as defined in the preceding paragraph ~~29~~34.g., as a write-in item on the statement of income, to be identified as Retroactive Reinsurance Loss and included under Other Income;

j. Any subsequent increase or reduction in the total reserves ceded under a retroactive reinsurance agreement shall be reported in the manner described in the preceding paragraphs ~~29~~34.h. and ~~29~~34.i., in order to recognize the gain or loss arising from such increase or reduction in reserves ceded. The Special Surplus from Retroactive Reinsurance Account write-in entry on the balance sheet shall be adjusted, upward or downward, to reflect such increase or reduction in reserves ceded. The Special Surplus from Retroactive Reinsurance Account write-in entry shall be equal to or less than the total ceded reserves under all retroactive reinsurance agreements in-force as of the date of the financial statement. Special surplus arising from a retroactive reinsurance transaction shall be considered to be earned surplus (i.e., transferred to unassigned funds (surplus)) only when cash recoveries from the assuming entity exceed the consideration paid by the ceding entity as respects such retroactive reinsurance transaction; and

k. The consideration paid for a retroactive reinsurance agreement shall be reported as a decrease in ledger assets by the ceding entity and as an increase in ledger assets by the assuming entity.

(For an illustration of ceding entity accounting entries see question 31~~33~~ in Exhibit A.)

~~30.~~35. Portfolio reinsurance is the transfer of an insurer's entire liability for in force policies or outstanding losses, or both, of a segment of the insurer's business. Loss portfolio transactions are to be accounted for as retroactive reinsurance.

~~31.~~36. The accounting principles for retroactive reinsurance agreements in paragraph ~~29~~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;

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 ~~81-84~~102-105.

~~32.~~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.

~~33.~~38. The accounting and reporting provisions applicable to retroactive reinsurance apply to all transactions transferring liabilities in connection with a court-ordered rehabilitation, liquidation, or receivership. The requirement to include stipulated contract provisions in the reinsurance agreements shall not apply to these transactions, with written approval of the ceding entity's domiciliary commissioner.

~~34.~~39. Novations meeting the requirements of paragraph ~~31~~36.b. shall be accounted for as prospective reinsurance agreements. The original direct insurer, or the original assuming insurer, shall report amounts paid as a reduction of written and earned premiums, and unearned premiums to the extent that premiums have not been earned. Novated balances (e.g., loss and loss adjustment expense reserves) shall be written off through the accounts, exhibits, and schedules in which they were originally recorded. The assuming insurer shall report amounts received as written and earned premiums, and obligations assumed as incurred losses in the statement of income.

Deposit Accounting

~~35.~~40. To the extent that a reinsurance agreement does not, despite its form, transfer both components of insurance risk, all or part of the agreement shall be accounted for and reported as deposits in the following manner:

a. At the outset of the reinsurance agreement, the net consideration paid by the ceding entity (premiums less commissions or other allowances) shall be recorded as a deposit by the ceding company and as a liability by the assuming entity. The deposit shall be reported as an admitted asset by the ceding company if (i) the assuming company is licensed, accredited or otherwise qualified in the ceding company's state of domicile as described in Appendix A-785 or (ii) there are funds held by or on behalf of the ceding company which meet the requirements of paragraph 18 of Appendix A-785;

b. At subsequent reporting dates, the amount of the deposit/liability shall be adjusted by calculating the effective yield on the deposit agreement to reflect actual payments to date (receipts and disbursements shall be recorded through the deposit/liability accounts) and expected future payments (as discussed below), with a corresponding credit or charge to interest income or interest expense;

c. The calculation of the effective yield shall use the estimated amount and timing of cash flows. If a change in the actual or estimated timing or amount of cash flows occurs, the effective yield shall be recalculated to reflect the revised actual or estimated cash flows. The deposit shall be adjusted to the amount that would have existed at the reporting date had the new effective yield been applied since the inception of the reinsurance agreement. Changes in the carrying amount of the deposit asset/liability resulting from changes in the effective yield shall be recorded as interest income or interest expense;

d. It shall be assumed that any cash transactions for the settlement of losses will reduce the asset/liability accounts by the amount of the cash transferred. When the remaining losses are revalued upward, an increase in the deposit liability shall be recorded as interest expense – by the assuming company. Conversely, the ceding company shall increase its deposit (asset) with an offsetting credit to interest income; and increase its outstanding loss liability with an offsetting charge to incurred losses;

e. No deduction shall be made from the loss and loss adjustment expense reserves on the ceding company's Statement of Financial Position, schedules, and exhibits;

f. The assuming company shall record net consideration to be returned to the ceding company as a liability.

(For an illustration of the provisions of paragraph ~~35~~40, see Exhibit C)

41. Deposit accounting shall not be used to avoid loss recognition that would otherwise be required. For example, if the ceding entity has no future coverage relating to the deposit with the reinsurer, the deposit is not recoverable.

Assumed Reinsurance

~~36.~~42. Reinsurance premiums receivable at the end of the accounting period are combined with direct business receivables and reported as agents' balances or uncollected premiums. Where the ceding entity withholds premium funds pursuant to the terms of the reinsurance agreement, such assets shall be shown by the assuming entity as funds held by or deposited with reinsured companies. Reporting entities shall record any interest earned or receivable on the funds withheld as a component of aggregate write-ins for miscellaneous income.

~~37.~~43. If the assuming entity receives reinsurance premium prior to the effective date of the reinsurance contract, consistent with *SSAP No. 53—Property Casualty Contracts-Premiums*, paragraph 15, advance premiums shall be reported as a liability in the statutory financial statement and not considered income until the effective date of the coverage. Such amounts are not included in written premium or the unearned premium reserve. If the assuming entity receives reinsurance premium after the effective date of the reinsurance contract but prior to the due date, the amount received shall be reported as a reduction of the asset for deferred but not yet due (earned but unbilled premiums).

~~38.~~44. Reinsurance premiums more than 90 days overdue shall be nonadmitted except (a) to the extent the assuming entity maintains unearned premium and loss reserves as to the ceding entity, under principles of offset accounting as discussed in SSAP No. 64, or (b) where the ceding entity is licensed and in good standing in assuming entity's state of domicile. Reinsurance premiums are due pursuant to the original contract terms (as the agreement stood on the date of execution). In the absence of a specific contract date, reinsurance premiums will be deemed due thirty (30) days after the date on which (i) notice or demand of premium due is provided to the ceding entity or (ii) the assuming entity books the premium (see *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*).

~~39.~~45. A lag will develop between the time of the entry of the underlying policy transaction on the books of the ceding entity and the transmittal of information and entry on the books of the assuming entity. Assuming companies shall estimate unreported premiums and related costs to the extent necessary to prevent material distortions in the loss development contained in the assuming entity's annual statement schedules where calendar year premiums are compared to accident year losses.

~~40.~~46. Proportional reinsurance (i.e., first dollar pro rata reinsurance) premiums shall be allocated to the appropriate annual statement lines of business in the Underwriting and Investment exhibits. Non-proportional assumed reinsurance premiums shall be classified as reinsurance under the appropriate subcategories.

~~41.~~47. Assumed retroactive reinsurance premiums shall be excluded from all schedules and exhibits as addressed in paragraph ~~29~~34.

~~42.~~48. Amounts payable by reinsurers on losses shall be classified as unpaid losses. Assumed reinsurance payable on paid losses shall be classified as a separate liability item on the balance sheet. IBNR losses on assumed reinsurance business shall be netted with ceded losses on the balance sheet and listed separately by annual statement line of business in the Underwriting and Investment exhibits.

~~43.~~49. Ceded reinsurance premiums payable (net of ceding commission) shall be classified as a liability. Consistent with SSAP No. 64, ceded reinsurance premiums payable may be deducted from amounts due from the reinsurer, such as amounts due on assumed reinsurance, when a legal right of offset exists.

~~44.~~50. With regard to reinsurance premium paid prior to the effective date of the contract, the ceding entity shall reflect the prepaid item as a write-in admitted asset and it should not be recognized in the income statement until the effective date of the coverage. Such amounts are not included in ceded written premiums or ceded unearned premium but should be subject to impairment analysis. With regard to reinsurance premium paid by ceding entity after the reinsurance contract is in effect but prior to the due date, the ceding entity shall treat this item as a reduction to the liability for ceded reinsurance premiums payable. That liability reflects not only premiums unpaid but also amounts booked but deferred and not yet due.

~~45.~~51. Amounts withheld by the ceding entity that would otherwise be payable under the reinsurance agreement shall be reported as funds held by entity under reinsurance treaties. Reporting entities shall record any interest due or payable on the amounts withheld as a component of aggregate write-ins for miscellaneous income.

~~46.~~52. Ceded reinsurance transactions shall be classified in the annual statement line of business which relates to the direct or assumed transactions creating the cession or retrocession.

~~47.~~53. Ceded retroactive reinsurance premiums shall be excluded from all schedules and exhibits as addressed in paragraph ~~29~~34.

~~48.~~54. Reinsurance accounting shall not be allowed for modeled trigger securitizations. Modeled trigger securitization transactions do not result in the kind of indemnification (in form and in fact) required by this SSAP, and are therefore not eligible for reinsurance accounting. Modeled trigger transactions should be evaluated as securitization transactions rather than as reinsurance transactions and should receive the accounting treatment recommended for securitization transactions.

Adjustable Features/Retrospective Rating

~~49.~~55. Reinsurance treaties may provide for adjustment of commission, premium, or amount of coverage, based on loss experience. The accounting for common examples is outlined in the following paragraphs:

Commission Adjustments

~~50.~~56. An accrual shall be maintained for the following adjustable features based upon the experience recorded for the accounting period:

a. Contingent or Straight Profit—The reinsurer returns to the ceding entity a stipulated percentage of the profit produced by the business assumed from the ceding entity. Profit may be calculated for any specified period of time, but the calculation is often based on an average over a period of years; and

b. Sliding Scale—A provisional rate of commission is paid over the course of the agreement, with a final adjustment based on the experience of the business ceded under the agreement.

Premium Adjustments

~~51.~~57. If the reinsurance agreement incorporates an obligation on the part of the ceding entity to pay additional premium to the assuming entity based upon loss experience under the agreement, a liability in the amount of such additional premium shall be recognized by the ceding entity during the accounting period in which the loss event(s) giving rise to the obligation to pay such additional premium occur(s). The assuming entity shall recognize an asset in a consistent manner. If the reinsurance agreement incorporates an obligation on the part of the assuming entity to refund to the ceding entity any portion of the consideration received by the assuming entity based upon loss experience under the agreement, an asset in the amount of any such refund shall be recognized by the ceding entity during the accounting period in which the loss event(s) giving rise to the obligation to make such refund occur(s). The initial provisional or deposit premium is recalculated retrospectively, based on loss experience under the agreement during a specified period of time; the calculation is often based on an average over a period of years. The assuming entity shall recognize a liability in a consistent manner.

Adjustments in the Amount of Coverage

~~52.~~58. The amount of coverage available for future periods is adjusted, upward or downward, based on loss experience under the agreement during a specified period of time. If the reinsurance agreement incorporates a provision under which the reinsurance coverage afforded to the ceding entity may be increased or reduced based upon loss experience under the agreement, an asset or a liability shall be recognized by the ceding entity in an amount equal to that percentage of the consideration received by the assuming entity which the increase or reduction in coverage represents of the amount of coverage originally afforded. The asset or liability shall be recognized during the accounting period in which the loss event(s) (or absence thereof) giving rise to the increase or decrease in reinsurance coverage occur(s), and shall be amortized over all accounting periods for which the increased or reduced coverage is applicable. The term "consideration" shall mean, for this purpose, the annualized deposit premium for the period used as the basis for calculating the adjustment in the amount of coverage to be afforded thereafter under the agreement.

59. The ceding entity and the assuming entity shall account for changes in coverage in the same manner as changes in other contract costs. For example, the effects of decreases in coverage without a commensurate reduction in premium shall be recognized as a loss by the ceding entity and as a gain by the assuming entity when the event causing the decrease in coverage takes place.

60. Changes in either the probability or amount of potential future recoveries are considered a change in coverage. For example, if the contract limit stayed the same but the ceding entity could not receive any recoveries unless losses forthe industry as a whole reached a certain level, coverage has been reduced. What matters is not the specific contract provisions regarding coverage, but whether the probability or amount of potential future recoveries has increased or decreased as a result of those provisions.

Multiple-Year Retrospectively-Rated Contracts

61. Many short-duration insurance and reinsurance contracts have retrospective rating provisions. A retrospectively-rated contract is a multiple-year contract in which events in one period of the contract create rights and obligations in another. For example, if losses above a certain level occur in one contract year, premiums increase in future years unless the ceding entity compensates the reinsurer through a settlement adjustment. The ceding entity has an obligation because it must pay either the settlement adjustment or the higher future premiums.

62. An insurer (ceding entity) may enter into a multiple-year retrospectively-rated reinsurance contract with a reinsurer (assuming entity). Examples of these contracts may include transactions referred to as funded catastrophe covers. These contracts include a retrospective rating provision that provides for at least one of the following based on contract experience:

a. Changes in the amount or timing of future contractual cash flows, including premium adjustments, settlement adjustments, or refunds to the ceding entity; or

b. Changes in the contract's future coverage.

63. A critical distinguishing feature of these contracts is that part or all of the retrospective rating provision is obligatory such that the retrospective rating provision creates future rights and obligations as a result of past events. Therefore, a retrospectively-rated contract that could be cancelled without further obligation (because it does not create rights and obligations that will be realized in a future period) is excluded.

64. The principal issues in accounting for a multiple-year retrospectively-rated contract involve how to recognize and measure assets and liabilities resulting from the obligatory retrospective rating provisions. While it may be difficult for some types of multiple–year retrospectively-rated contracts to pass the risk-transfer test, the recognition and measurement questions are present regardless of whether the contract transfers risk. In fact, the questions become clearly evident with contracts that meet the risk-transfer test and are accounted for as reinsurance.

Multiple-Year Retrospectively-Rated Contracts by Ceding and Assuming Entities

65. To be accounted for as reinsurance, a reinsurance contract must meet all of the following conditions:

a. The contract shall not contain features that prevent the risk-transfer criteria from being reasonably applied and the risk-transfer criteria shall be met.

b. The ultimate premium expected to be paid or received under the contract shall be reasonably estimable and allocable in proportion to the reinsurance protection provided.

If any of these conditions are not met, a deposit method of accounting shall be applied by the ceding and assuming entities.

66. The condition in paragraph 65.a. applies to a contract and determining the substance of a contract is a judgmental matter. If an agreement with a reinsurer consists of both risk-transfer and non-risk-transfer coverages that have been combined into a single legal document, those coverages must be considered separately for accounting purposes. This statement does 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 that in total meets the conditions for reinsurance accounting.

67. Recognizing a smaller asset based on potential unfavorable loss development implies that claim liabilities are understated at the financial reporting date. Accordingly, changes in estimates of claim liabilities shall not be recognized in measuring the related asset until the change in estimate takes place.

Obligatory Retrospective Rating Provisions

68. This guidance discusses how the guidance on multiple-year retrospectively-rated contracts is based on the concept that there is a substantive difference between a contract that contains an obligatory retrospective rating provision and one that does not. This distinction is derived from *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5R), which requires recognition of liabilities (which are defined as present obligations) as of a financial reporting date but prohibits recognition of losses and expenses that will result from future events. For example, it may be a virtual certainty that an entity will pay employee salaries next year. But because there is no present obligation to pay those salaries, they are not recognized today.

69. Similarly, under SSAP No. 5R even if there is a high probability that an asset will be impaired in the future or a liability incurred in the future, the conditions for accrual have not been met because there is no present impairment or obligation to be recognized. Consistent with this principle, the guidance on multiple-year retrospectively-rated contracts does not permit recognition of the effects of retrospective rating provisions unless those provisions are obligatory.

Allocation of Certain Payments Between Coverage and Past Losses

70. This guidance addresses a circumstance in which, under a multiple-year retrospectively-rated reinsurance contract, the ceding entity has to make additional payments to the reinsurer but the ceding entity also receives expanded coverage. The single payment is allocated to the two separate transactions. In one transaction, the ceding entity has acquired an asset by making a payment to the reinsurer in exchange for expanded coverage. In the other, the ceding entity has incurred a loss or liability to the extent that it is reimbursing the reinsurer for past losses. Because a variety of factors may affect the value of reinsurance coverage at any point in time, the most appropriate measure of the value of additional coverage generally is the price of the initial coverage. For example, if coverage of $6.00 was acquired for a $1.00 premium, and the ceding entity would pay $4.00 more for another $6.00 of coverage if a loss occurs, the most relevant measure of the amount of premium that relates to the new coverage would be $1.00. The other $3.00 presumably is a reimbursement for the loss that has been incurred.

Contractual Termination Features

71. In some circumstances, the ceding entity will be relieved of its obligation if the reinsurer cancels the contract and only has to pay additional amounts if either:

a. The contract remains in force; or

b. The ceding entity cancels before the end of the contract term.

Unless the reinsurer has terminated the contract, the ceding entity has an obligation for the additional amounts and must recognize the related liability. The effect of termination, which is to relieve the ceding entity of its liability, shall not be recognized until termination takes place.

72. If either party entering into a new contract in consideration for canceling a retrospectively-rated contract would not have agreed to cancel the existing retrospectively-rated contract unless a new contract were entered into, the two contracts are, in effect, the same contract for purposes of measuring assets and liabilities and shall be accounted for in that way.

Impairment

~~53.~~73. Include as a nonadmitted asset, amounts accrued for premium adjustments on retrospectively rated reinsurance agreements with respect to which all uncollected balances due from the ceding company have been classified as nonadmitted.

74. The amount of the asset to be recognized may be affected by credit risk, and appropriate impairment shall be recognized for any amounts deemed uncollectible. The relevant recorded claim liability at that date represents the ceding entity's best estimate of the expected ultimate claim liability and is the liability that must be used in measuring the refundable amount based on contract experience to date.

Commissions

~~54.~~75. Commissions payable on reinsurance assumed business shall be included as an offset to Agents' Balances or Uncollected Premiums. Commissions receivable on reinsurance ceded business shall be included as an offset to Ceded Reinsurance Balances Payable.

~~55.~~76. If the ceding commission paid under a reinsurance agreement exceeds the anticipated acquisition cost of the business ceded, the ceding entity shall establish a liability, equal to the difference between the anticipated acquisition cost and the reinsurance commissions received, to be amortized pro rata over the effective period of the reinsurance agreement in proportion to the amount of coverage provided under the reinsurance contract.

Unauthorized Reinsurance

~~56.~~77. If the assuming reinsurer is not authorized, otherwise approved or certified to do business in the ceding entity's domiciliary state, the assumed reinsurance is considered to be unauthorized. A provision is established to offset credit taken in various balance sheet accounts for reinsurance ceded to unauthorized reinsurers. Credit for reinsurance with unauthorized reinsurers shall be permitted to the extent the ceding entity holds collateral in accordance with Appendix A-785. If the assuming reinsurer is not licensed or is not an authorized reinsurer in the domiciliary state of the ceding entity or if the reinsurance does not meet required standards, the ceding entity must set up a provision for reinsurance liability in accordance with the NAIC Annual Statement Instructions for Property and Casualty Insurance Companies Schedule F.

~~57.~~78. The provision defined in paragraph ~~56~~77 shall never be less than zero for any particular reinsurer. The change in liability for unauthorized reinsurance is a direct charge or credit to surplus.

Reinsurance Ceded to a Certified Reinsurer

~~58.~~79. The term certified reinsurer shall have the same meaning as set forth in the Appendix A-785.

~~59.~~80. Credit for reinsurance ceded to a certified reinsurer is permitted if security is held by or on behalf of the ceding entity in accordance with the certified reinsurer's rating assigned by the domestic state of the ceding insurance entity, and in accordance with Appendix A-785 of this manual. However, nothing in this guidance would prohibit the parties to a reinsurance agreement from agreeing to provisions establishing security requirements that exceed the minimum security requirements established for certified reinsurers.

~~60.~~81. An upgrade in a certified reinsurer's assigned rating applies on a prospective basis, i.e., the revised collateral requirement applies only to contracts entered into or renewed on or after the effective date of the new rating (see A-785). A downgrade in a certified reinsurer's rating applies on a retroactive basis, i.e., the revised collateral requirement applies to all reinsurance obligations incurred by the assuming insurer under its certified reinsurer status. Notwithstanding a change in a certified reinsurer's rating or revocation of its certification, a reporting entity that has ceded reinsurance to such certified reinsurer is allowed a three (3)-month grace period before recording a provision for reinsurance due to collateral deficiency associated with such rating downgrade and increased collateral requirement for all reinsurance ceded to such assuming insurer under its certified reinsurer status, unless the reinsurance is found by the commissioner of the reporting entity's domestic state to be at high risk of uncollectibility.

~~61.~~82. A provision is established by the ceding entity to offset credit taken in various balance sheet accounts for reinsurance ceded to a certified reinsurer in an amount proportionate to any deficiency in the amount of acceptable security that is provided by the certified reinsurer as compared to the amount of security that is required to be provided in accordance with the certified reinsurer's rating. The calculation of the provision for a collateral shortfall is separate from the calculation of the provision for overdue reinsurance ceded to certified reinsurers and shall be calculated in accordance with the NAIC Annual Statement Instructions for Property and Casualty Insurance Companies.

~~62.~~83. The provision defined in paragraph ~~61~~82 shall never be less than zero for any particular certified reinsurer. The change in liability for reinsurance with certified reinsurers is a direct charge or credit to surplus.

Funds Held Under Reinsurance Treaties

~~63.~~84. This liability is established for funds deposited by or contractually withheld from reinsurers or reinsurers.

Provision for Reinsurance

~~64.~~85. The NAIC Annual Statement Instructions for Property and Casualty Companies for Schedule F—Provision for Overdue Reinsurance, provide for a minimum reserve for uncollectible reinsurance with an additional reserve required if an entity's experience indicates that a higher amount should be provided. The minimum reserve Provision for Reinsurance is recorded as a liability and the change between years is recorded as a gain or loss directly to unassigned funds (surplus). Any reserve over the minimum amount shall be recorded on the statement of income by reversing the accounts previously utilized to establish the reinsurance recoverable.

~~65.~~86. The provision for reinsurance is calculated separately for unauthorized, authorized and certified reinsurers. An authorized reinsurer is licensed, accredited or approved by the ceding entity's state of domicile; a certified reinsurer is certified by the ceding entity's state of domicile; an unauthorized reinsurer is not so licensed, accredited, approved or certified.

Asbestos and Pollution Contracts – Counterparty Reporting Exception

~~66.~~87. Upon approval by the domiciliary regulator(s) of the ceding entity (either the original direct insurer in the case of a reinsurance agreement or the original assuming reinsurer in the case of a retrocession agreement), an exception may be allowed with respect to a retroactive reinsurance agreement providing substantially duplicate coverage as prior reinsurance agreements on asbestos and/or pollution exposures, including reinsurance provided through an affiliated reinsurer that retrocedes to the retroactive reinsurance counterparty. Under this exception, a reporting entity may aggregate reinsurers into one line item in Schedule F reflecting the counterparty under the retroactive agreement for the purposes of determining the Provision for Reinsurance regarding overdue amounts paid by the retroactive counterparty (both authorized and unauthorized). This exception would allow the Provision for Reinsurance to be reduced by reflecting that amounts have been recovered by the reporting entity under the duplicate coverage provided by the retroactive contract, and that inuring balances from the original contract(s) are payable to the retroactive counterparty. In addition, such approval would also permit the substitution of the retroactive counterparty for authorized original reinsurers without overdue balances for purposes of reporting on the primary section of the annual statement Schedule F. An agreement must meet all of the requirements in paragraphs ~~66~~87.a. through ~~66~~87.e. in order to be considered for this exception.

a. The underlying agreement clearly indicates the credit risk associated with the collection of the reporting entity's inuring reinsurance recoverables and losses related to the credit risk will be covered by the retroactive reinsurance counterparty.

b. The retroactive reinsurance agreement must transfer significant risk of loss.

c. The assuming retroactive reinsurance counterparty must have a financial strength rating from at least two nationally recognized statistical rating organizations (NRSRO), the lowest of which is higher than or equal to the NRSRO ratings of the underlying third-party reinsurers.

d. The transaction is limited to reinsurance recoverables attributable to asbestos, and/or pollution.

e. The recoverables from the inuring reinsurers remain subject to credit analysis and contingent liability analysis.

~~67.~~88. With the approval of the reporting entity's domestic state commissioner pursuant to the applicable state credit for reinsurance law regarding the use of other forms of collateral acceptable to the commissioner, the reporting entity shall present the amount of other approved security related to the retroactive reinsurance agreement as an "Other Allowed Offset Item" with respect to the uncollateralized amounts recoverable from unauthorized reinsurers for paid and unpaid losses and loss adjustment expenses under the original reinsurance contracts. Amounts approved as "Other Allowed Offset Items" shall be reflected as amounts recoverable from the retroactive counterparty and aggregated reporting described in paragraph ~~66~~87 shall also be applied for unpaid losses and loss adjustment expenses under the original reinsurance contracts. The security applied as an "Other Allowed Offset Item" shall also be reflected in the designated sub-schedule and disclosed as a prescribed or permitted practice. (See Exhibit D of this statement.)

~~68.~~89. The reporting entity will continue to detail the reporting of original reinsurers that were aggregated for one line reporting per paragraph ~~66~~87 as provided in the annual statement instructions. The aggregation reporting in schedule F applies only to the extent that inuring balances currently receivable under original reinsurance contracts are also payable to the retroactive reinsurance counterparty, and additionally to reinsurance recoverable on unpaid losses if the domestic state commissioner has approved amounts related to the retroactive reinsurance contract as any other form of security acceptable under the applicable provisions of the state's credit for reinsurance law. This guidance is not intended to otherwise change the application of retroactive accounting guidance for the retroactive portions of the contract that are not duplicative of the original reinsurance. Other than measurement of the provision for reinsurance and presentation in Schedule F, the retroactive contracts should continue to follow guidance applicable to retroactive accounting and reporting.

Syndicated Letters of Credit

~~69.~~90. With a Syndicated Letter of Credit (Syndicated LC), the reinsurer enters into an agreement with a group of banks (the "Issuing Banks") and an agent bank (the "Agent"). Each Issuing Bank and the Agent is an NAIC-approved bank and a "qualified bank". This agreement requires the Agent to issue, on behalf of the each of the Issuing Banks, letters of credit in favor of the ceding insurer. The credit is issued (as an administrative matter) only through the Agent's letter of credit department. Each issuing bank signs the Syndicated LC through the Agent, as its attorney-in-fact. Syndicated LCs are consistent with A-785, in that the Syndicated LC is the legal equivalent of multiple letters of credit separately issued by each of the issuing banks. Reporting entities shall take a reduction in the liability on account of reinsurance recoverables secured by the Syndicated LC if all of the following conditions are met:

a. All listed banks on the letter of credit are qualified and meet the criteria of the NAIC SVO approved bank listing;

b. Banks are severally and not jointly liable; and

c. Specific percentages for each assuming bank are listed in the letter of credit.

Disputed Items

~~70.~~91. Occasionally a reinsurer will question whether an individual claim is covered under a reinsurance agreement or may even attempt to nullify an entire agreement. A ceding entity, depending upon the individual facts, may or may not choose to continue to take credit for such disputed balances. A ceding entity shall take no credit whatsoever for reinsurance recoverables in dispute with an affiliate.

~~71.~~92. Items in dispute are those claims with respect to which the ceding entity has received formal written communication from the reinsurer denying the validity of coverage.

Uncollectible Reinsurance

~~72.~~93. Uncollectible reinsurance balances shall be written off through the accounts, exhibits, and schedules in which they were originally recorded.

Commutations

~~73.~~94. A commutation of a reinsurance agreement, or any portion thereof, is a transaction which results in the complete and final settlement and discharge of all, or the commuted portion thereof, present and future obligations between the parties arising out of the reinsurance agreement.

~~74.~~95. In commutation agreements, an agreed upon amount determined by the parties is paid by the reinsurer to the ceding entity. The ceding entity immediately eliminates the reinsurance recoverable recorded against the ultimate loss reserve and records the cash received as a negative paid loss. Any net gain or loss shall be reported in underwriting income in the statement of income.

~~75.~~96. The reinsurer eliminates a loss reserve carried at ultimate cost for a cash payout calculated at present value. Any net gain or loss shall be reported in underwriting income in the statement of income.

~~76.~~97. Commuted balances shall be written off through the accounts, exhibits, and schedules in which they were originally recorded.

National Flood Insurance Program

~~77.~~98. The National Flood Insurance Program was created by the Federal Emergency Management Agency (FEMA) and is designed to involve private insurers in a write-your-own (WYO) flood insurance program financially backed by FEMA at no risk to the insurer. To become a participating WYO entity, the entity signs a document with the Federal Insurance Administration (FIA) of the Federal Emergency Management Agency known as the Financial Assistance/Subsidy Arrangement.

~~78.~~99. Premium rates are set by FEMA. The WYO participating companies write the flood insurance coverage qualifying for the program on their own policies, perform their own underwriting, premium collections, claim payments, administration, and premium tax payments for policies written under the program.

~~79.~~100. Monthly accountings are made to FIA and participants draw upon FEMA letters of credit for deficiencies of losses, loss expenses, and administrative expenses in excess of premiums, subject to certain percentage limitations on expenses.

~~80.~~101. Policies written by the reporting entity under the National Flood Insurance Program are considered insurance policies issued by the reporting entity, with reinsurance ceded to FEMA. (Such policies are not considered uninsured plans under *SSAP No. 47—Uninsured Plans* (SSAP No. 47.) Balances due from or to FEMA shall be reported as ceded reinsurance balances receivable or payable. The commission and fee allowances received from FEMA shall be reported consistent with reinsurance ceding commission.

Accounting for the Transfer of Property and Casualty Run-Off Agreements

~~81.~~102. Property and casualty run-off agreements are reinsurance or retrocession agreements that are intended to transfer essentially all of the risks and benefits of a specific line of business or market segment that is no longer actively marketed by the transferring insurer or reinsurer. A property and casualty run-off agreement is not a novation as the transferring insurer or reinsurer remains primarily liable to the policyholder or ceding entity under the original contracts of insurance or reinsurance. Reinsurance agreements between affiliates or between insurers under common control (as those terms are defined in Appendix A-440) are not eligible for the exception for property and casualty run-off agreements in paragraph ~~31~~36.e.

Criteria

~~82.~~103. The accounting treatment for property and casualty run-off agreements must be approved by the domiciliary regulators of the transferring entity (either the original direct insurer in the case of a reinsurance agreement or the original assuming reinsurer in the case of a retrocession agreement) and the assuming entity. If the transferring entity and assuming entity are domiciled in the same state, then the regulator of the state where the majority of the transferred liabilities is located shall be asked to approve the accounting treatment. In determining whether to approve an agreement for this accounting treatment, the regulators shall require the following:

a. Assuming Entity Properly Licensed – The entity assuming the run-off agreement must have the appropriate authority or license to write the business being assumed.

b. Limits and Coverages – The reinsurance or retrocession agreement shall provide the same limits and coverages that were afforded in the original insurance or reinsurance agreement.

c. Non-recourse – The reinsurance or retrocession agreement shall not contain any adjustable features or profit share or retrospective rating, and there shall be no recourse (other than normal representations and warranties that would be associated with a purchase and sale agreement) directly or indirectly against the transferring entity.

d. Risk-~~-~~Transfer – The reinsurance or retrocession agreement must meet the requirements of risk-~~-~~transfer as described in this statement.

e. Financial Strength of Reinsurer – The assuming reinsurer shall have a financial strength rating from at least two independent rating agencies (from NAIC credit rating providers (CRP)) which is equal to or greater than the current ratings of the transferring entity. The lowest financial strength rating received from an NAIC acceptable rating organization rating agency will be used to compare the financial strength ratings of the transferring and assuming entities.

f. Assessments – The assuming reinsurer or retrocessionaire (if required in the original reinsurance contract) shall be financially responsible for any and all assessments, including guaranty fund assessments, that are assessed against the transferring entity related to the insurance business being assumed.

g. Applicable Only to "Run-off" Business – The reinsurance or retrocession agreement shall only cover liabilities relating to a line(s) of business or specific market segments no longer actively marketed by the transferring entity.

h. Non-cancelable Reinsurance – The reinsurance or retrocession agreement shall provide that the reinsurance or retrocessional coverage provided by the proposed agreement cannot be cancelable by either party for any reason. (However, this provision will not override standard contracts law and principles and will not prevent any remedies, including rescission or termination that might be available for breach, misrepresentation, etc.)

Statutory Schedules and Exhibits

~~83.~~104. At the inception of the transaction, the transferring entity shall record the consideration paid to the assuming entity as a paid loss. If the consideration paid by the transferring entity is less than the loss reserves transferred, the difference shall be recorded by the ceding entity as a decrease in losses incurred. The assuming entity shall record the consideration received as a negative paid loss. In addition, the transferring entity shall record an increase to ceded reinsurance recoverable for the amount of the transferred reserve. Journal entries illustrating these transactions, including situations in which the transaction includes an unearned premium reserve, are included in Exhibit B of this statement.

~~84.~~105. The assuming entity will report the business in the same line of business as reported by the original insurer or reinsurer. The assuming entity will report the business at the same level of detail using the appropriate statutory schedules and exhibits.

Disclosures

~~85.~~106. Unsecured Reinsurance Recoverables:

a. If the entity has with any individual reinsurers, authorized, unauthorized, or certified an unsecured aggregate recoverable for losses, paid and unpaid including IBNR, loss adjustment expenses, and unearned premium, that exceeds 3% of the entity's policyholder surplus, list each individual reinsurer and the unsecured aggregate recoverable pertaining to that reinsurer; and

b. If the individual reinsurer is part of a group, list the individual reinsurers, each of its related group members having reinsurance with the reporting entity, and the total unsecured aggregate recoverables for the entire group.

~~86.~~107. Reinsurance Recoverables in Dispute—Reinsurance recoverable on paid and unpaid (including IBNR) losses in dispute by reason of notification, arbitration or litigation shall be identified if the amounts in dispute from any entity (and/or affiliate) exceed 5% of the ceding entity's policyholders surplus or if the aggregate of all disputed items exceeds 10% of the ceding entity's policyholders surplus. Notification means a formal written communication from a reinsurer denying the validity of coverage.

~~87.~~108. Uncollectible Reinsurance—Describe uncollectible reinsurance written off during the year reported in the following annual statement classifications, including the name(s) of the reinsurer(s):

a. Losses incurred;

b. Loss adjustment expenses incurred;

c. Premiums earned; and

d. Other.

~~88.~~109. Commutation of Ceded Reinsurance—Describe commutation of ceded reinsurance during the year reported in the following annual statement classifications, including the name(s) of the reinsurer(s):

a. Losses incurred;

b. Loss adjustment expenses incurred;

c. Premiums earned; and

d. Other.

~~89.~~110. Retroactive Reinsurance—The table illustrated in the NAIC Annual Statement Instructions for Property and Casualty Companies under Retroactive Reinsurance in the Notes to Financial Statements section shall be completed for all retroactive reinsurance agreements that transfer liabilities for losses that have already occurred and that will generate special surplus transactions. The insurer (assuming or ceding) shall assign a unique number to each retroactive reinsurance agreement and shall utilize this number for as long as the agreement exists. Transactions utilizing deposit accounting shall not be reported in this note.

~~90.~~111. Reinsurance Assumed and Ceded—The tables illustrated in the NAIC Annual Statement Instructions for Property and Casualty Companies under "Reinsurance Assumed and Ceded in the Notes to Financial Statements" section shall be completed as follows:

a. The financial statements shall disclose the maximum amount of return commission which would have been due reinsurers if all reinsurance were canceled with the return of the unearned premium reserve; and

b. The financial statements shall disclose the accrual of additional or return commission, predicated on loss experience or on any other form of profit sharing arrangements as a result of existing contractual arrangements.

~~91.~~112. A specific interrogatory requires information on reinsurance of risk accompanied by an agreement to release the reinsurer from liability, in whole or in part, from any loss that may occur on the risk or portion thereof.

~~92.~~113. Disclosures for paragraphs ~~93-98~~114-119 represent annual statement interrogatories, which are required to be included with the annual audit report beginning with audit reports on financial statements as of and for the period ended December 31, 2006. The disclosures required within paragraphs ~~93-98~~114-119 shall be included in accompanying supplemental schedules of the annual audit report beginning in year-end 2006. These disclosures shall be limited to reinsurance contracts entered into, renewed or amended on or after January 1, 1994. This limitation applies to the annual audit report only and does not apply to the statutory annual statement interrogatories and the reinsurance summary supplemental filing.

~~93.~~114. Disclose if any risks are reinsured under a quota share reinsurance contract with any other entity that includes a provision that would limit the reinsurer's losses below the stated quota share percentage (e.g. a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions)? If yes, indicate the number of reinsurance contracts containing such provisions and if the amount of reinsurance credit taken reflects the reduction in quota share coverage caused by any applicable limiting provision(s).

~~94.~~115. Disclose if the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:

a. A contract term longer than two years and the contract is noncancellable by the reporting entity during the contract term;

b. A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;

c. Aggregate stop loss reinsurance coverage;

d. A unilateral right by either party (or both parties) to commute the reinsurance contract, whether conditional or not, except for such provisions which are only triggered by a decline in the credit status of the other party;

e. A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or

f. Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

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

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

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

~~96.~~117. If affirmative disclosure is required for paragraph ~~94~~115 or ~~95~~116, provide the following information:

a. A summary of the reinsurance contract terms and indicate whether it applies to the contracts meeting paragraph ~~94~~115 or ~~95~~116;

b. A brief discussion of management's principal objectives in entering into the reinsurance contract including the economic purpose to be achieved; and

c. The aggregate financial statement impact gross of all such ceded reinsurance contracts on the balance sheet and statement of income.

~~97.~~118. Except for transactions meeting the requirements of paragraph ~~31~~36, disclose if the reporting entity ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:

a. Accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles (SAP) and as a deposit under generally accepted accounting principles (GAAP); or

b. Accounted for that contract as reinsurance under GAAP and as a deposit under SAP.

~~98.~~119. If affirmative disclosure is required for paragraph ~~97~~118, explain in a supplemental filing why the contract(s) is treated differently for GAAP and SAP.

~~99.~~120. Disclosures for the Transfer of Property and Casualty Run-off Agreements

a. Disclose if the reporting entity has entered into any agreements which have been approved by their domiciliary regulator and have qualified pursuant to paragraph ~~31~~36.e. (also see paragraphs ~~81-84~~102-105).

b. If affirmative, provide a description of the agreement and the amount of consideration paid and liabilities transferred.

~~100.~~121. The financial statements shall disclose the following with respect to reinsurance agreements which qualify for reinsurer aggregation in accordance with paragraphs ~~66-68~~87-89:

a. A description of the significant terms of the reinsurance agreement, including established limits and collateral, and

b. The amount of unexhausted limit as of the reporting date.

c. To the extent that the domestic state insurance department approves the use of the retroactive contract as an acceptable form of security related to the original reinsurers under the applicable provisions of the state's credit for reinsurance law, the use of such discretion shall be disclosed in the annual statement Note 1 as a prescribed or permitted practice. In addition, Note 1 shall disclose as part of the total impact on the provision for reinsurance the impact on the overdue aspects of the calculation if the reporting entity also receives commissioner approval pursuant to paragraph ~~66~~87 related to overdue paid amounts (both authorized and unauthorized).

~~101.~~122. The financial statements shall disclose the following with respect to reinsurance agreements that have been accounted for as deposits:

a. A description of the reinsurance agreements.

b. Any adjustment of the amounts initially recognized for expected recoveries. The individual components of the adjustment (e.g., interest accrual, change due to a change in estimated or actual cash flow) shall be disclosed separately.

~~102.~~123. The financial statements shall disclose the impact on any reporting period in which a certified reinsurer's rating has been downgraded or its certified reinsurer status is subject to revocation and additional collateral has not been received as of the filing date. The disclosure should include the following:

a. Name of certified reinsurer downgraded or subject to revocation of certified reinsurer status and relationship to the reporting entity;

b. Date of downgrade or revocation and jurisdiction of action;

c. Collateral percentage requirements pre and post downgrade or revocation;

d. Net ceded recoverable subject to collateral;

e. As of the end of the current quarter, the estimated impact of the collateral deficiency to the reporting entity as a result of the assuming entity's downgrade or revocation of certified reinsurer status. (At year-end the actual impact of the collateral deficiency on the provision for reinsurance shall be disclosed.)

~~103.~~124. U.S. domiciled reinsurers are eligible for certified reinsurer status. If the reporting entity is a certified reinsurer, the financial statements shall disclose the impact on any reporting period in which its certified reinsurer rating is downgraded or status as a certified reinsurer is subject to revocation. Such disclosure shall include information similar to paragraphs ~~102~~123.b., ~~102~~123.c. and ~~102~~123.d. and the expectation of its certified reinsurer's ability to meet the increased requirements.

~~104.~~125. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

~~105.~~126. This statement adopts with modification *FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* (FAS 113) and FASB *Emerging Issues Task Force No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises* for the following:

a. Reinsurance recoverables on unpaid case-basis and incurred but not reported losses and loss adjustment expenses shall be reported as a contra-liability netted against the liability for gross losses and loss adjustment expenses;

b. Amounts paid for prospective reinsurance that meet the conditions for reinsurance accounting shall be reported as a reduction of unearned premiums;

c. The gain created by a retroactive reinsurance agreement because the amount paid to the reinsurer is less than the gross liabilities for losses and loss adjustment expenses ceded to the reinsurer is reported in the statement of income as a write-in gain in other income by the ceding entity and a write-in loss by the assuming entity. The gain created by a retroactive reinsurance agreement is restricted as a special surplus account until the actual retroactive reinsurance recovered is in excess of the consideration paid;

d. This statement requires that a liability (provision for reinsurance) be established through a provision reducing unassigned funds (surplus) for unsecured reinsurance recoverables from unauthorized or certified reinsurers and for certain overdue balances due from authorized reinsurers;

e. Some reinsurance agreements contain adjustable features that provide for adjustment of commission, premium or amount of coverage, based on loss experience. This statement requires that the asset or liability arising from the adjustable feature be computed based on experience to date under the agreement, and the impact of early termination may only be considered at the time the agreement has actually been terminated;

f. Structured settlements are addressed in *SSAP No. 65—Property and Casualty Contracts*. Statutory accounting and FAS 113 are consistent in accounting for structured settlement annuities where the reporting entity is the owner and payee and where the claimant is the payee and the reporting entity has been released from its obligation. FAS 113 distinguishes structured settlement annuities where the claimant is the payee and a legally enforceable release from the reporting entity's liability is obtained from those where the claimant is the payee but the reporting entity has not been released from its obligation. GAAP requires the deferral of any gain resulting from the purchase of a structured settlement annuity where the reporting entity has not been released from its obligation; and

g. This statement requires that reinsurance recoverables on unpaid losses and loss adjustment expenses be presented as a contra-liability. Requirements for offsetting and netting are addressed in SSAP No. 64.

~~106.~~127. This statement adopts American Institute of Certified Public Accountants (AICPA) *Statement of Position 98-7, Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk* (SOP 98-7) paragraphs 10-12 and 19 (subsection b only). This statement rejects AICPA SOP 98-7 paragraphs 13-17 and 19 (subsections a and c).

~~107.~~128. This statement rejects AICPA *Statement of Position No. 92-5, Accounting for Foreign Property and Liability Reinsurance*. This statement incorporates Appendix A-785 as applicable.

Effective Date and Transition

~~108.~~129. This statement shall apply to:

a. Reinsurance agreements entered into, renewed, or amended on or after January 1, 1994. An amendment is any revision or adjustment of contractual terms. The payment of premiums or reimbursement of losses recoverable under the agreement shall not constitute an amendment; and

b. Reinsurance agreements in force on January 1, 1995, which cover losses occurring or claims made on or after that date on policies reinsured under such agreements.

~~109.~~130. The guidance shall not apply to:

a. Reinsurance agreements which cover only losses occurring or claims made before January 1, 1994, and which were entered into before January 1, 1994, and were not subsequently renewed or amended; and

b. Reinsurance agreements that expired before and were not renewed or amended after January 1, 1995.

~~110.~~131. The guidance in paragraphs ~~49-53~~55-74 shall be effective for all accounting periods beginning on or after January 1, 1996, and shall apply to reinsurance agreements entered into, renewed or amended on or after January 1, 1994.

~~111.~~132. This statement, including the guidance in paragraph ~~35~~40 incorporated from SSAP No. 75, is effective for years beginning January 1, 2001. Changes 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.*

a. Revisions to paragraph ~~31~~36.e., related to paragraphs ~~81-84~~102-105, and disclosures in paragraph ~~99~~120 documented in *Issue Paper No. 137—Transfer of Property and Casualty Reinsurance Run-off Agreements* are effective for contracts entered on or after January 1, 2010.

b. The guidance in paragraphs ~~35~~40, ~~101~~122 and ~~106~~127 was previously included within *SSAP No. 75—Reinsurance Deposit Accounting—An Amendment to SSAP No. 62R, Property and Casualty Reinsurance* (SSAP No. 75) and was also effective for years beginning January. 1, 2001. In 2011, the guidance from SSAP No. 75 was incorporated within this statement, with SSAP No. 75 nullified. The original guidance included in this statement for deposit accounting, as well as the original guidance adopted in SSAP No. 75, are retained for historical purposes in Issue Paper No. 104. The guidance in paragraph ~~48~~54 was originally contained within *INT 02-06: Indemnification in Modeled Trigger Transactions* and was effective June 9, 2002. The guidance in paragraph ~~69~~90 was originally contained within *INT 02-09: A-785 and Syndicated Letters of Credit* and was effective September 12, 2004.

c. The guidance related to certified reinsurers is applicable only to cedents domiciled in states that have enacted/promulgated the new collateral framework and only for their cessions to reinsurers certified under that domestic law/rule. The requirements applicable to contracts with certified reinsurers shall be effective for all reporting periods beginning on or after December 31, 2012.

133. The guidance in paragraphs ~~66-68~~87-89 and ~~100~~121 which allowed retroactive reinsurance exceptions for asbestos and pollution contracts was effective for all accounting periods beginning on or after January 1, 2014, for paid losses. This guidance was revised to also allow for unpaid losses effective for reporting periods ending on and after December 31, 2015.

134. The substantive revisions adopted November 15, 2018, which primarily incorporated guidance originally from *EITF 93-6, Accounting for Multiple-Year Retrospectively-Rated Contracts by Ceding and Assuming Enterprises*, and from *EITF Topic D-35, FASB Staff Views on Issue No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises* are effective January 1, 2019. These revisions are documented in *Issue Paper No. 16X—Property and Casualty Reinsurance Credit.*

REFERENCES

Relevant Issue Papers

Issue Paper No. 75—Property and Casualty Reinsurance

Issue Paper No. 104—Reinsurance Deposit Accounting – An Amendment to SSAP No. 62R—Property and Casualty Reinsurance

Issue Paper No. 137—Transfer of Property and Casualty Reinsurance Run-off Agreements

Issue Paper No. 153— Counterparty Reporting Exception for Asbestos and Pollution Contracts

Issue Paper No. 16X—Property and Casualty Reinsurance Credit

CLASSIFYING REINSURANCE CONTRACTS

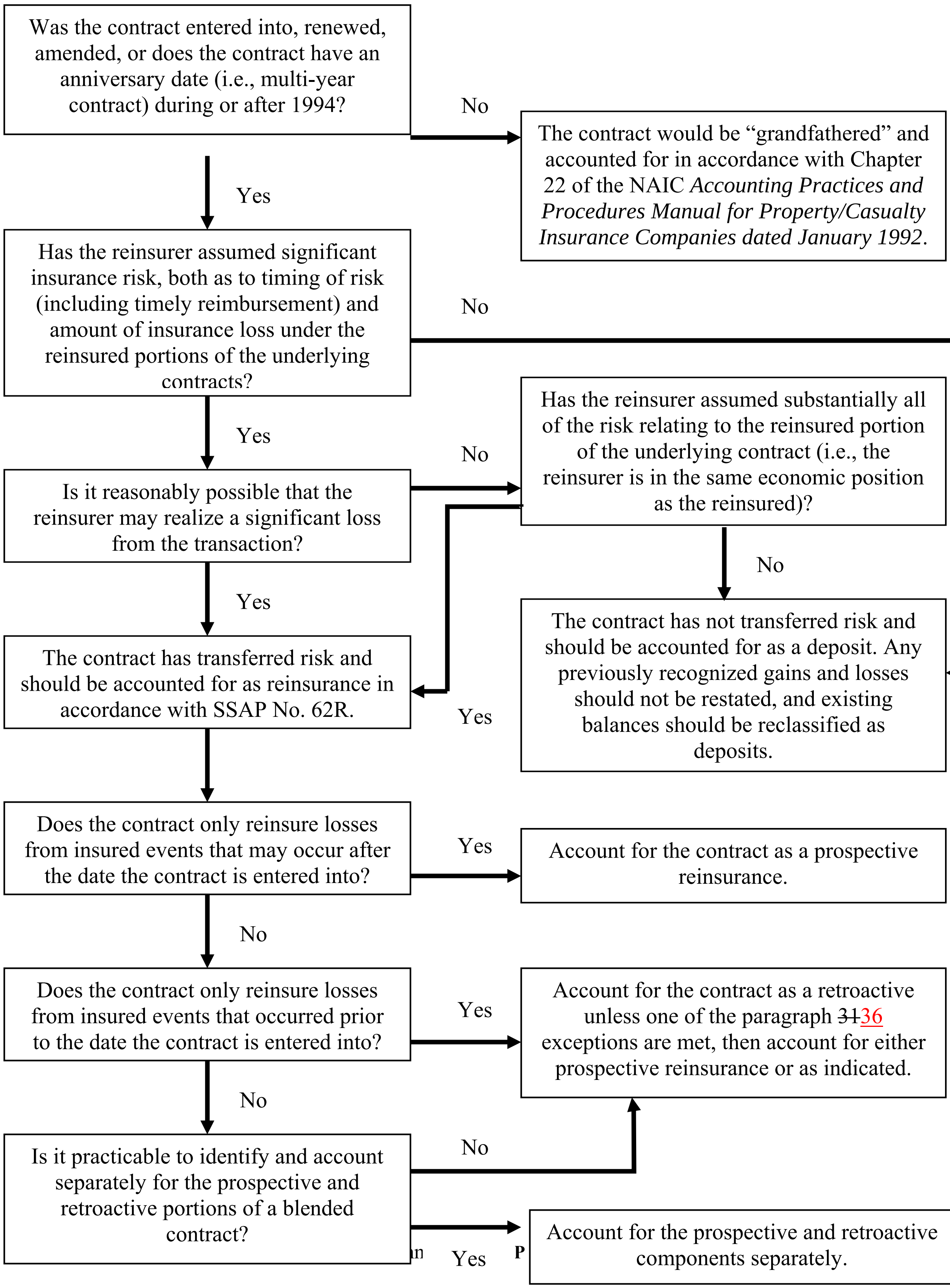

EXHIBIT A – IMPLEMENTATION QUESTIONS AND ANSWERS

Applicability

1. Q: The accounting practices in SSAP No. 62R specify the accounting and reporting for reinsurance contracts. What contracts are considered reinsurance contracts for purposes of applying these accounting practices?

   A: Any transaction that indemnifies an insurer against loss or liability relating to insurance risk shall be accounted for in accordance with the accounting practices included in SSAP No. 62R. Therefore, all contracts, including contracts that may not be structured or described as reinsurance, shall be accounted for as reinsurance when those conditions are met.

2. Q: The provisions of this statement will apply to (a) reinsurance contracts entered into, renewed or amended on or after January 1, 1994, and (b) any other reinsurance contracts that are in force on January 1, 1995 and cover insurable events on the underlying insurance policies that occur on or after that date. What contracts would be exempt from the ~~new~~ accounting rules included in SSAP No. 62R?

   A: The only exempt contracts are:

   1) Purely retroactive reinsurance contracts that cover only insured events occurring before January 1, 1994, provided those contracts were entered into before that date and are not subsequently amended and

   2) Contracts that expired before January 1, 1995 and are not amended after that date.

3. Q: This statement is to be applied to contracts which are amended on or after January 1, 1994. What if the change in terms is not significant, or the terms changed have no financial effect on the contract?

   A: In general, the term amendment should be viewed broadly to include all but the most trivial changes. Examples of amendments include, but are not limited to, replacing one assuming entity with another (including an affiliated entity), or modifying the contract's limit, coverage, premiums, commissions, or experience-related adjustable features. No distinction is made between financial and non-financial terms.

4. Q: Must the accounting provisions of SSAP No. 62R be applied to an *otherwise exempt* contract if the ceding entity pays additional premiums under the contract on or after January 1, 1994?

   A: The answer depends on why the additional premiums are paid. If the additional premiums are the result of a renegotiation, adjustment, or extension of terms, the contract is subject to the accounting provisions of SSAP No. 62R. However, additional premiums paid without renegotiation, adjustment, or extension of terms would not make an otherwise exempt contract subject to those provisions.

5. Q: Prospective and retroactive portions of a reinsurance contract are allowed to be accounted for separately, if practicable. Can the retroactive portion of an existing contract be segregated and, therefore, exempted with other retroactive contracts covering insured events occurring prior to January 1, 1994?

   A: No. The transition provisions apply to an entire contract, which is either subject to or exempt from the ~~revised~~ provisions of SSAP No. 62R. A ceding entity may bifurcate a contract already subject to the ~~new~~ accounting rules in SSAP No. 62R and then account for both the prospective and retroactive portions in accordance with the ~~new~~ accounting standard.

Risk-Transfer

6. Q: Do the ~~new~~ risk-transfer provisions apply to existing contracts?

   A: Yes, the ~~new~~ risk-transfer provisions apply to some existing contracts. SSAP No. 62R applies in its entirety only to existing contracts which were renewed or amended on or after January 1, 1994, or which cover losses occurring or claims made after that date. Therefore, those contracts must be evaluated to determine whether they transfer risk and qualify for reinsurance accounting. For accounting periods commencing on or after January 1, 1995, balances relating to such contracts which do not transfer insurance risk shall be reclassified as deposits and shall be accounted for and reported in the manner described under the caption Reinsurance Contracts Must Include Transfer of Risk.

   SSAP No. 62R does not apply to existing contracts which were entered into before, and were not renewed or amended on or after, January 1, 1994, and which cover only losses occurring or claims made before that date, nor to contracts which expired before, and were not renewed or amended on or after, January 1, 1995. Those contracts will continue to be accounted for in the manner provided by SSAP No. 62R before these revisions.

7. Q: How does the effective date affect the assessment of whether a significant loss to the reinsurer was reasonably possible?

   A: The risk-transfer assessment is made at contract inception, based on facts and circumstances known at the time. Because that point in time has passed for existing contracts, some have suggested that the risk-transfer provisions be applied as of the effective date. However, that approach to the risk-transfer assessment would violate the requirement to consider all cash flows from the contract. Therefore, the test must be applied from contract inception, considering the effect of any subsequent contract amendments. Careful evaluation and considered judgment will be required to determine whether a significant loss to the reinsurer was reasonably possible at inception.

8. Q: Should risk-transfer be reassessed if contractual terms are subsequently amended?

   A: Yes. When contractual terms are amended, risk-transfer should be reassessed. For example, a contract that upon inception met the conditions for reinsurance accounting could later be amended so that it no longer meets those conditions. The contract should then be reclassified and accounted for as a deposit.

9. Q: How should the risk-transfer assessment be made when a contract has been amended?

   A: No particular method is prescribed for assessing risk-transfer in light of a contract amendment. Whether an amended contract in substance transfers risk must be determined considering all of the facts and circumstances in light of the risk-transfer requirements. Judgment also will be required to determine whether an amendment in effect creates a new contract.

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.

11. Q: If the assessment of risk-transfer changes after the initial assessment at contract inception, how should the ceding entity account for the change?

A: The status of a contract should be determinable at inception and, absent amendment, subsequent changes should be very rare. If the risk of significant loss was not deemed reasonably possible at inception, and a significant loss subsequently occurred, the initial assessment was not necessarily wrong, because remote events do occur. Likewise, once a reasonable possibility of significant loss has been established, such loss need not occur in order to maintain the contract's status as reinsurance.

12. Q: SSAP No. 62R requires that reasonably possible outcomes be evaluated to determine the reinsurer's exposure to significant loss. What factors should be considered in determining whether a scenario being evaluated is reasonably possible?

A: The term *reasonably possible* means that the probability is more than remote. The test is applied to a particular scenario, not to the individual assumptions used in the scenario. Therefore, a scenario is not reasonably possible unless the likelihood of the entire set of assumptions used in the scenario occurring together is reasonably possible.

13. Q: In determining the amount of the reinsurer's loss under reasonably possible outcomes, may cash flows directly related to the contract other than those between the ceding and assuming companies, such as taxes and operating expenses of the reinsurer, be considered in the calculation?

A: No. The evaluation is based on the present value of all cash flows *between the ceding and assuming enterprises* under reasonably possible outcomes and, therefore, precludes considering other expenses of the reinsurer in the calculation.

14. Q: In evaluating the significance of a reasonably possible loss, should the reasonably possible loss be compared to gross or net premiums?

A: Gross premiums should be used.

15. Q: How does a commutation clause affect the period of time over which cash flows are evaluated for reasonable possibility of significant loss to the reinsurer?

A: All cash flows are to be assessed under reasonably possible outcomes. Therefore, unless commutation is expected in the scenario being evaluated, it should not be assumed in the calculation. Further, the assumptions used in a scenario must be internally consistent and economically rational in order for that scenario's outcome to be considered reasonably possible.

~~16. Q: What interest rate should be used in each evaluated scenario to make the present value calculation?~~

~~A: A reasonable and appropriate rate is required, which generally would reflect the expected timing of payments to the reinsurer and the duration over which those cash flows are expected to be invested by the reinsurer.~~

~~17~~16. Q: SSAP No. 62R refers to payment schedules and accumulating retentions from multiple years as features that delay timely reimbursement of claims. Does the presence of those features generally prevent a contract from meeting the conditions for reinsurance accounting?

A: Yes. Payment schedules and accumulating retentions from multiple years are contractual features inherently designed to delay the timing of reimbursement to the ceding entity. 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 payments 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. Therefore, any feature that may affect the timing of the reinsurer's reimbursement to the ceding entity should be closely scrutinized.

~~18~~17. Q: What if a contract contains a feature such as a payment schedule or accumulating retention but could still result in the reasonable possibility of significant loss to the reinsurer?

A: Both of the following conditions are required for reinsurance accounting:

a. Transfer of significant risk arising from uncertainties about both (i) the ultimate amount of net cash flows from premiums, commission, claims, and claim settlement expenses paid under a contract (underwriting risk) and (ii) the timing of the receipt and payment of those cash flows (timing risk); and

b. Reasonable possibility of significant loss to the reinsurer.

Because both condition (a) and condition (b) must be met, failure to transfer significant timing and underwriting risk is not overcome by the possibility of significant loss to the reinsurer.

18. Q: Can a reinsurance agreement compensate a reinsurer for losses?

A: A contract does not meet the conditions for reinsurance accounting if features of the reinsurance contract or other contracts or agreements directly or indirectly compensate the reinsurer or related reinsurers for losses to an extent that risk-transfer criteria is violated. That compensation may take many forms, and an understanding of the substance of the contracts or agreements is required to determine whether the ceding entity has been indemnified against loss or liability relating to insurance risk. For example, contractual features may limit the reinsurer's exposure to insurance risk or delay the reimbursement of claims so that investment income mitigates exposure to insurance risk. Examples of those contractual features noted in paragraph 12 are not all-inclusive.

~~19. Q: Is it permissible to evaluate timely reimbursement on a present value basis?~~

~~A: No. The word timely is used in the ordinary temporal sense to refer to the length of time between payment of the underlying reinsured claims and reimbursement by the reinsurer.~~

~~While the test for reasonable possibility of significant loss to the reinsurer provides for a present value-based assessment of the economic characteristics of the reinsurance contract, the concept of timely reimbursement relates to the transfer of insurance risk (condition a. above), not the reasonable possibility of significant loss (condition b. above). Accordingly, timely reimbursement should be evaluated based solely on the length of time between payment of the underlying reinsured losses and reimbursement by the reinsurer.~~

~~20. Q: Are there any circumstances under which the conditions for risk transfer need not be met?~~

~~A: Yes. An extremely narrow and limited exemption is provided for contracts that reinsure either an individual risk or an underlying book of business that is inherently profitable. When substantially all of the insurance risk relating to the reinsured portions of the underlying insurance contracts has been assumed by the reinsurer, the contract meets the conditions for reinsurance accounting. To qualify under this exception, no more than trivial insurance risk on the reinsured portions of the underlying insurance contracts may be retained by the ceding entity. The reinsurer's economic position must be virtually equivalent to having written the relevant portions of the reinsured contracts directly.~~

~~21~~19. Q: In determining whether a reinsurance contract qualifies under the exception referred to in ~~the preceding question~~paragraph 18, how should the economic position of the reinsurer be assessed in relation to that of the ceding entity?

A: The assessment should be made by comparing the net cash flows of the reinsurer under the reinsurance contract with the net cash flows of ceding entity on the reinsured portions of the underlying insurance contracts. This may be relatively easy for reinsurance of individual risks or for unlimited-risk quota-share reinsurance, because the premiums and losses on these types of reinsurance generally are the same as the premiums and losses on the reinsured portions of the underlying insurance policies.

In other types of reinsurance, determining the reinsurer's net cash flows relative to the insurer is likely to be substantially more difficult. For example, it generally would be difficult to demonstrate that the ceding entity's premiums and losses for a particular layer of insurance are the same as the reinsurer's premiums and losses related to that layer. If the economic position of the reinsurer relative to the insurer cannot be determined, the contract would not qualify under the exception.

Accounting Provisions

~~22~~20. Q: An existing contract that was accounted for as reinsurance no longer qualifies for reinsurance accounting under the ~~new~~ accounting rules included in SSAP No. 62R. How should the ceding and assuming companies account for the contract in future periods?

A: Because the statement of income cannot be restated, previously recognized gains and losses are not revised. If the contract was entered into before, and not renewed or amended on or after, January 1, 1994 and covers only losses occurring or claims made before that date, or the contract expired before January 1, 1995 and was not renewed or amended on or after that date, it would continue to be accounted for in the manner provided before these revisions.

For accounting periods commencing on or after January 1, 1995, existing balances relating to contracts which do not transfer insurance risk and which were entered into on or after

January 1, 1994 (covering losses occurring or claims made after that date) would be reclassified as deposits.

Premium payments to a reinsurer would be recorded as deposits. Likewise, losses recoverable from a reinsurer would not be recognized as receivables. Rather, any reimbursement for losses would be accounted for upon receipt as a refund of a deposit.

~~23~~21. Q: What is the definition of past insurable events that governs whether reinsurance coverage is prospective or retroactive? For example, could a reinsurance contract that covers losses from asbestos and pollution claims on occurrence-based insurance policies effective during previous periods be considered prospective if the reinsurance coverage is triggered by a court interpretation that a loss is covered within the terms of the underlying insurance policies?

A: The distinction between prospective and retroactive reinsurance is based on whether a contract reinsures future or past insured events covered by the underlying reinsurance contracts. In the example above, the insured event is the occurrence of loss within the coverage of the underlying insurance contracts, not the finding of a court. Therefore, the fact that the asbestos exposure or pollution is covered under insurance policies effective during prior periods makes the reinsurance coverage in this example retroactive.

~~24~~22. Q: Would the answer to the above question change if the reinsurance were written on a claims-made basis?

A: No. The form of the reinsurance—whether claims-made or occurrence-based—does not determine whether the reinsurance is prospective or retroactive. A claims-made reinsurance contract that reinsures claims asserted to the reinsurer in a future period as a result of insured events that occurred prior to entering into the reinsurance contract is a retroactive contract.

~~25~~23. Q: What is the effect of adjustments to future premiums or coverage in determining whether reinsurance is prospective or retroactive?

A: Adjustments to future premiums or coverage may affect the accounting for a reinsurance contract. Whenever an adjustment results in a reinsurer providing new or additional coverage for past insurable events, that coverage is retroactive. For example, if subsequent years' premiums under a multiple accident year contract create additional coverage for previous accident years, the additional coverage is retroactive, even if the original coverage provided in the contract for those accident years was prospective. Likewise, if current losses under a multiple-year contract eliminate coverage in future periods, some or all of the premiums to be paid in those future periods should be charged to the current period.

~~26~~24. Q: A reinsurance contract is entered into after the contract's effective date. Is the coverage between the contract's effective date and the date the contract was entered into prospective or retroactive?

A: The portion of the contract related to the period of time between the effective date of the contract and the date the contract was entered into is retroactive because it covers insured events that occurred prior to entering into the reinsurance contract.

~~27~~25. Q: How is the date the reinsurance contract was entered into determined?

A: It is not uncommon for a reinsurance arrangement to be initiated before the beginning of a policy period but not finalized until after the policy period begins. Whether there was agreement in principle at the beginning of the policy period and, therefore, the contract is substantively prospective must be determined based on the facts and circumstances. For example, a contract may be considered to have been substantively entered into even though regulatory approval of that contract has not taken place.

The absence of agreement on significant terms, or the intention to establish or amend those terms at a later date based on experience or other factors, generally indicates that the parties to the contract have not entered into a reinsurance contact, but rather have agreed to enter into a reinsurance contract at a future date. If contractual provisions under a contract substantively entered into at a future date covered insurable events prior to that date, that coverage is retroactive.

In any event, SSAP No. 62R provides that if a contract (except facultative contracts and contracts signed by the lead reinsurer and certain cover notes or similar documents signed by reinsurers representing more than 50% of the capacity on the contract) has not been finalized, reduced to written form and signed by the parties within 9 months after its effective date, it is presumed to be retroactive.

~~28~~26. Q: Are contracts to reinsure calendar-year incurred losses considered blended contracts that have both prospective and retroactive elements?

A: Yes. Most reinsurance contracts covering calendar-year incurred losses combine coverage for insured events that occurred prior to entering into the reinsurance contract with coverage for future insured events and, therefore, include both prospective and retroactive elements.

In any event, SSAP No. 62R provides that if a contract (except facultative contracts, contracts signed by the lead reinsurer and certain cover notes or similar documents signed by reinsurers representing more than 50% of the capacity on the contract) has not been finalized, reduced to written form and signed by the parties within 9 months after its effective date it is presumed retroactive.

~~29~~27. Q: When the prospective and retroactive portions of a contract are being accounted for separately, how should premiums be allocated to each portion of the contract?

A: No specific method for allocating the reinsurance premiums to the risks covered by the prospective and retroactive portions of a contract is required. However, separate accounting for the prospective and retroactive portions of a contract may take place only when an allocation is practicable.

Practicability requires a reasonable basis for allocating the reinsurance premiums to the risks covered by the prospective and retroactive portions of the contract, considering all amounts paid or deemed to have been paid regardless of the timing of payment. If a reasonable basis for allocating the premiums between the prospective and retroactive coverage does not exist, the entire contract must be accounted for as a retroactive contract.

~~30~~28. Q: A retroactive reinsurance contract contains a cut-through provision that provides the ceding entity’s policyholders and claimants with the right to recover their claims directly from the reinsurer. May the ceding entity immediately recognize earned surplus associated with this type of contract?

A: No. SSAP No. 62R states that earned surplus may not be recognized "until the actual retroactive reinsurance recovered exceeds the consideration paid."

~~31~~29. Q: A ceding entity enters into a retroactive reinsurance agreement that gives rise to segregated surplus. If the reinsurer prepays its obligation under the contract, may the ceding entity recognize earned surplus at the time the prepayment is received?

A: Segregated surplus arising from retroactive reinsurance transactions is earned as actual liabilities that have been transferred are recovered or terminated. Therefore, earned surplus is based on when the reinsurer settles its obligations to the ceding entity, and it may be appropriate to recognize earned surplus at the time the prepayment is received.

However, all of the facts and circumstances must be considered to determine whether the ceding entity has substantively recovered the liabilities transferred to the reinsurer. For example, if the ceding entity agrees to compensate the reinsurer for the prepayment, such as by crediting the reinsurer with investment income on prepaid amounts or balances held, the ceding entity has not, in substance, recovered its transferred liabilities but rather has received a deposit from the reinsurer that should be accounted for accordingly.

~~32~~30. Q: If the ceding entity does not expect to receive any recoveries because the reinsurer has agreed to reimburse claimants under the reinsured contracts directly, would the ceding entity be considered to have recovered or terminated its transferred liabilities?

A: No. In the example given, the reinsurer is substantively acting as disbursing agent for the ceding entity. Therefore, the ceding entity cannot be said to have recovered amounts due from the reinsurer before payment is made to the claimant.

~~33~~31. Q: What accounting entries would a ceding entity make to report a retroactive reinsurance contract?

A: Accounting Entries for a Ceding Entity to Report a Retroactive Reinsurance Contract:

Entry 1

Retroactive Reinsurance Reserves Ceded or Assumed (B/S)	10,000	
Retroactive Reinsurance Gain (I/S)		2,000
Cash		8,000

To record initial portfolio transfer, see items #3 and #8. The ceding entity must establish the segregated surplus per item #4.

Entry 1A

Retro. Reins. Gain	2,000	
Profit/Loss Account		2,000

To close gain from retroactive transaction.

Entry 1B

Profit/Loss Account	2,000	
Special Surplus from Retro. Reins.		2,000

To close profit from retroactive reinsurance to special surplus.

Entry 2

Cash	2,000	
Retroactive Reinsurance Reserves Ceded or Assumed (B/S)		2,000

To record recovery of paid losses from the reinsurer. Outstanding ceded reserves after this recovery equals $8,000, and special surplus from retroactive reinsurance account equals $2,000; therefore, segregated surplus account is not changed per item #10.

Entry 3

Retroactive Reinsurance Reserves Ceded or Assumed (B/S)	3,000	
Retroactive Reinsurance Gain (I/S)		3,000

To record subsequent revision of the initial reserves ceded per item #10. The segregated surplus account is increased to $5,000 as a result of this upward development.

Entry 3A

Retro. Reinsurance Gain	3,000	
Profit/Loss Account		3,000

To close profit from retroactive reinsurance.

Entry 3B

Profit/Loss (I/S)	3,000	
Special Surplus from Retro. Reins.		3,000

To close profit and loss account to special surplus. (Retroactive reinsurance reserves ceded or assumed account balance equals $11,000. Special Surplus from retroactive reinsurance balance equals $5,000.)

Entry 4

Cash	4,000	
Retroactive Reinsurance Reserves Ceded or Assumed (B/S)		4,000

To record recovery of paid losses from the reinsurer. Outstanding ceded reserves after this recovery equals $7,000, therefore segregated surplus account is not changed per item #10.

Entry 5

Cash	3,000	
Retroactive Reinsurance Reserves Ceded or Assumed (B/S)		3,000

To record recovery of paid losses from reinsurer. Outstanding ceded reserves after recovery equals $4,000, therefore the following entry is needed per items #6 and #10.

Entry 5A

Special Surplus—Retro. Reins.	1,000	

Unassigned Funds		1,000

Retroactive Reinsurance reserves ceded or assumed after this entry equals $4,000.

Entry 6

Retroactive Reinsurance Loss (I/S)	1,000	
Retroactive Reinsurance Reserves Ceded or Assumed (B/S)		1,000

To record subsequent revision of the initial reserves ceded per item #10. The segregated surplus account is decreased as a result of this downward development to $3,000. The following entry is needed per items #6 and #10.

Entry 6A

Profit/Loss Account	1,000	
Retro. Reins. Loss		1,000

To close loss to profit and loss account.

Entry 6B

Special Surplus from Retro. Reins.	1,000	
Profit/Loss Account		1,000

To close profit and loss account to special surplus. (Remaining balance of retroactive reinsurance reserve ceded or assumed account equals $3,000.) (Special surplus from retro. reins. account balance equals $3,000.)

Entry 7

Cash	2,500	
Retroactive Reinsurance Gain (I/S)	500	
Retroactive Reinsurance Reserves Ceded or Assumed (B/S)		3,000

Entry 7A

Profit and Loss Account	500	
Retro. Reins. Gain		500

To close other income to profit and loss account.

Entry 7B

Special Surplus from Retro. Reins.	500	
Profit/Loss Account		500

To close profit and loss account to special surplus. (Remaining balance of special surplus from retro. reins. account equals $2,500.) (Remaining balance of retroactive reinsurance reserve ceded or assumed account -0-.)

Entry 7C

Special Surplus from Retro. Reins.	2,500	
Unassigned Funds		2,500

To close remaining special surplus account to unassigned surplus.

~~34~~32. Q: How should the parties account for an adverse loss development reinsurance contract where, as of the statement date, the attachment level of the contract exceeds the ceding company's current case and IBNR reserves for the covered accident years (i.e. no surplus gain and no reinsurance recoverable as of the statement date), and the ceding company transferred cash to the reinsurer at the inception of the contract?

A: An adverse loss development reinsurance contract covering prior accident years meets the definition of "retroactive reinsurance" set forth in paragraph ~~22~~26 of SSAP No. 62R:

> ….reinsurance in which a reinsurer agrees to reimburse a ceding entity for liabilities incurred as a result of past insurable events covered under contracts subject to the reinsurance….

Paragraph ~~29~~34.k. of SSAP No. 62R specifically provides that the consideration paid for a retroactive reinsurance contract is to be recorded as a decrease in ledger assets by the ceding entity and an increase in ledger assets by the assuming entity.

Question 31~~33~~ illustrates the accounting entries for retroactive reinsurance contracts.

If the retroactive reinsurance contract transfers both components of insurance risk then, pursuant to paragraph ~~29~~34 of SSAP No. 62R, the ceding company would record the consideration paid as a decrease in ledger assets, recognize an expense for the reinsurance ceded through Other Income or Loss accounts as a write-in item identified as "Retroactive Reinsurance Ceded", and record the recoverable from the reinsurer as a contra liability.

No contra liability is established until and unless (and then only to the extent that) the ceding company establishes reserves which exceed the attachment point.

For the contract described, at inception no contra liability is recorded to offset current liability for the business ceded, since the ceded retroactive reinsurance premium relates to coverage in excess of the current liabilities recorded by the ceding company.

Once the ceding company's recorded liabilities exceed the attachment point of the adverse loss development reinsurance contract and triggers reinsurance recoverable from the reinsurer, a contra liability is established by the ceding company for the amount of the reinsurance recoverable. Any surplus resulting from the retroactive reinsurance is carried as a write-in item on the balance sheet designated as "Special Surplus from Retroactive Reinsurance Account." The surplus gain may not be classified as unassigned funds (surplus) until the actual retroactive reinsurance recovered exceeds the consideration paid.

If any portion of a retroactive reinsurance contract does not transfer insurance risk, then the portion which does not transfer risk is accounted for as a deposit pursuant to paragraph ~~35~~40. The deposit is reported as an admitted asset of the ceding company if the reinsurer is licensed, accredited, certified or otherwise qualified in the ceding company's state of domicile as described in Appendix A-785, or if there are funds held by or on behalf of the ceding company as described in that appendix. Receipts and disbursements under the contract are recorded through the deposit/liability accounts. Amounts received in excess of the deposit made are recognized as a gain in the Other Income or Loss account.

Accounting entries for a ceding entity to report a retroactive reinsurance contract at the inception of which the cedent's reserves are lower than the attachment point of the reinsurance coverage:

Assume the company pays $16m to purchase adverse development coverage of $50m, above an attachment point.

Entry 1: Payment of Retrospective Reinsurance Premium

Retrospective Reinsurance Expense*	$16m	
Cash		$16m

The company pays $16m premium for the retrospective reinsurance contract.
*This is an Other Expense item, it does not flow through Schedule F or Schedule P.

Entry 2: Adverse Development Reaches the Attachment Point

Losses Incurred	$25m	
Gross Loss Reserve		$25m
Recoverable on Retro Reinsurance Contract**	$25m	
Other Income*		$9m
Contra – Retro Reinsurance Expense*		$16m
Surplus***	$9m	
Segregated Surplus***		$9m

The company incurs $25m development on reserves related to the contract.
*These are Other Income/Expense items do not flow through Schedule F or Schedule P.
**A contra-liability write-in item~~,~~ not netted against loss reserves.
***Surplus is segregated in the amount of [$25m - $16m = $9m] recoverables less consideration paid.

Entry 3: Cash is Recovered on Paid Losses

Cash	$20m	
Recoverable on Retrospective Reinsurance Contract		$20m
Segregated Surplus	$4m	
Surplus		$4m

The company recovers $20m cash from reinsurer on this retro contract. Segregated Surplus decreases in the amount of [$20m - $16m = $4m] (decreases for amount recovered in excess of consideration paid).

~~35~~33. Q: How should a ceding company account for payment of the premium for a retroactive reinsurance contract by the ceding company's parent company or some other person not a party to the reinsurance contract (for example, adverse loss development reinsurance contracts purchased by the parent company in the context of the purchase or sale of the ceding company)?

A: If the reinsurance premium is not paid directly by the ceding company but is instead paid on behalf of the ceding company by the ceding company's parent company or some other entity not a party to the reinsurance contract, then the ceding company should (1) record an increase in gross paid in and contributed surplus in the amount of the reinsurance premium to reflect the contribution to surplus by the parent or third party payor, and (2) record an expense in the amount of the reinsurance premium and account for the contract as provided in questions ~~33~~31 and ~~34~~32.

EXHIBIT B – P&C RUNOFF REINSURANCE TRANSACTIONS

Exhibit is unchanged- Omitted to save space.

EXHIBIT C – ILLUSTRATION OF A REINSURANCE CONTRACT THAT IS ACCOUNTED FOR AS A DEPOSIT USING THE INTEREST METHOD

Exhibit is unchanged- Omitted to save space.

EXHIBIT D – ILLUSTRATION OF ASBESTOS AND POLLUTION COUNTERPARTY REPORTING EXCEPTION

Exhibit is unchanged- Omitted to save space

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

Issue: Reporting NAIC Designations as Weighted Averages Under 43R

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue: This agenda item has been drafted to clarify accounting and reporting guidance for securities acquired in lots under *SSAP No. 43R—Loan-backed and Structured Securities*. Particularly, this agenda item addresses whether securities acquired at different purchase prices, can report NAIC designations under a "weighted average" method under the "financial modeling" or "modified filing exempt" process.

This item intends to clarify the guidance in SSAP No. 43R in response to questions received after the "clean-up" revisions adopted in agenda item 2017-22: *(The following revisions were adopted on October 12, 2017. These paragraphs were reflected as Q/A issues 17 and 19, but were renumbered as 8 and 10 with the revisions.)*

8. ***Question*** – Do ~~RMBS~~ LBSS purchased in different lots result in a different NAIC designation for the same CUSIP? Can reporting entities use a weighted average method determined on a legal entity basis?

8.1 SSAP No. 43R and several other statements of statutory accounting principle require use of the scientific (constant yield) method of amortization. In addition to purchase price, the purchase date is an inherent part of this method and will typically result in different amortization values for different lots. Therefore, ~~RMBS~~ LBSS in different lots can result in a different NAIC designation for the same CUSIP. In accordance with the current instructions for calculating AVR and IMR, reporting entities are required to keep track of the different lots separately, which means reporting the different designations. ~~Specific to the RMBS proposal only, for year-end 2009 and until an alternative long-term solution is developed, if companies' accounting and reporting systems do not accommodate this approach, a weighted-average method on a legal entity basis can be used.~~ To the extent that a different accounting method applies to a legal entity's general and separate account, then the weighted average for each account should be calculated separately for the general account and separate account.

10. ***Question*** - For companies that have separate accounts, can the NAIC designation be assigned based upon the total legal entity or whether it needs to be calculated separately for the general account and the total separate account?

10.1 *The answer to this question is identical to the answer for question 17.* SSAP No. 43R and several other statements of statutory accounting principle require use of the scientific (constant yield) method of amortization. In addition to purchase price, the purchase date is an inherent part of this method and will typically result in different amortization values for different lots. Therefore, ~~RMBS~~ LBSS in different lots can result in a different NAIC designation for the same CUSIP. In accordance with the current instructions for calculating AVR and IMR, reporting entities are required to keep track of the different lots separately, which means reporting the different designations. ~~Specific to the RMBS proposal only, for year-end 2009 and until an alternative long-term solution is developed, if companies' accounting and reporting systems do not accommodate this approach, a weighted-average method on a legal entity basis can be used.~~ To the extent that a different accounting method applies to a legal entity's general and separate account, then the weighted average for each account should be calculated separately for the general account and separate account.

As the calculation of RBC for these securities is an automatic pull from the investment schedules, there is no current mechanism to allow reporting entities to change the NAIC designation for RBC purposes to reflect an NAIC 1 or NAIC 3 for a particular lot. Rather, the weighted-average (NAIC 2) is used to determine RBC for the entire investment.

<u>As an example scenario (identical CUSIP assuming equal division):</u>

- Acquired at a discount. The MFE approach (based on price points) results with NAIC 1 designation.
- Acquired at premium. The MFE approach (based on price points) results with NAIC 3 designation.
- Weighted average approach results with a reported NAIC 2 designation on Schedule D-1.
- The NAIC 2 designation is currently used for RBC purposes for the entire investment.

Existing Authoritative Literature:

- The statutory accounting guidance does not generally prescribe whether securities shall be reported in aggregate or by lot in the investment schedules. Reporting guidance is detailed in the A/S instructions.
- AVR/IMR instructions require reporting entities to track different lots separately:

  <u>AVR Instruction Excerpt:</u>
  Determination of AVR gain/(loss) on multiple lots of the same fixed income securities should follow the underlying accounting treatment in determining gain/(loss). **<u>Thus, the designation, on a purchase lot basis, should be compared to the designation at the end of the holding period to determine IMR or AVR gain or loss.</u>** Other-than-temporary impairment write-downs are treated as credit-related (losses) and recorded through the AVR, except for other-than-temporary impairments taken on interest-related declines in value, as described in INT 06-07, Definition of Phrase "Other-Than-Temporary." Interest-related other-than-temporary impairments are treated as interest-related losses and recorded through the IMR.

  <u>IMR Instruction Excerpts:</u>

  All realized capital gains/(losses), due to interest rate changes on fixed income investments, net of related capital gains tax, should be captured in the IMR and amortized into income (Column 2, Lines 1 through 31) according to Table 1 or the seriatim method. Realized capital gains/(losses) must be classified as either interest (IMR) or credit (AVR) related, not a combination except as specified in *SSAP No. 43R—Loan-Backed and Structured Securities*. **<u>Purchase lots with the same CUSIP are treated as individual assets for IMR and AVR purposes.</u>**

  Determination of IMR gain/(loss) on multiple lots of the same securities should follow the underlying accounting treatment in determining the gain/(loss). **<u>Thus, the designation, on a purchase lot basis, should be compared to the designation at the end of the holding period to determine IMR or AVR gain or loss.</u>**

- SAP guidelines do not preclude an entity from reporting a security more than once on an investment schedule.
- Guidance in the A/S instructions identifies that a reporting entity would only be required to break down information to a lower-level of detail if the information was inaccurate if reported in the aggregate:

  The information included in the investment schedules shall be broken down to the level of detail as required when all columns and rows are considered together unless otherwise addressed in specific instructions. For example, on Schedule D Part 4, a reporting entity is required to list the CUSIP book adjusted carrying value, among other things. **<u>The reporting entity would only be required to break this information down to a lower level of detail if the information was inaccurate if reported in the aggregate.</u>** Thus, the reporting entity would not be required to break the information down by lot (information for each individual purchase) and could utilize the information for book/adjusted carrying value using an average cost basis, or some other method, provided the underlying data reported in that cell was calculated in accordance with the *Accounting Practices and Procedures Manual*. **However, reporting entities are not precluded from reporting the information at a more detailed level (by lot) if not opposed by their domiciliary commissioner**.

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): On Oct. 12, 2017, the Working Group incorporated several "clean-up" revisions to SSAP No. 43R. These revisions removed outdated effective date and transition guidance, as well as addressed elements in the implementation guide. With the clean-up revisions, the guidance regarding the reporting of "lots" as a weighted average was deleted. After this deletion, questions from industry has identified that the 2009 guidance was still being applied as the "reporting in lots" issue had not been clarified.

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

Staff Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, classified as nonsubstantive, and incorporate revisions to clarify that if a SSAP No. 43R security has different NAIC designations by lot, then the reporting entity shall either 1) report the entire investment in a single reporting line at the lowest NAIC designation that would apply to a lot or 2) report the investment separately by purchase lot in the investment schedule. If a commissioner opposes the separate reporting by lot, then the reporting entity would default to reporting the entire investment at the lowest applicable NAIC designation (lowest lot that would be reported if separately reporting).

From information gathered by NAIC staff, investment software already captures information on the granular detail for each acquisition (by lot). As such, information is already available regarding the purchase lot detail that can be used for separate reporting. Furthermore, NAIC staff received information that it is not unusual for reporting entities to separately report by lot, particularly if the lots would have different NAIC designations.

This recommendation is consistent with the existing annual statement instructions in which lower-level reporting is required if the information reported in the aggregate would be inaccurate. As the NAIC designation impacts the overall RBC charge, and regulators often assess overall investment quality through review of NAIC designations, use of a weighted average NAIC designation results with inaccurate aggregate information. **Upon adoption, a blanks proposal would be sponsored to further expand the guidance in the annual statement instructions to reflect the guidance incorporated into SSAP No. 43R.**

Proposed Revisions to SSAP No. 43R:

8. ***Question*** – Do LBSS purchased in different lots result in a different NAIC designation for the same CUSIP? Can reporting entities use a weighted average method determined on a legal entity basis?

8.1 SSAP No. 43R and several other statements of statutory accounting principle require use of the scientific (constant yield) method of amortization. In addition to purchase price, the purchase date is an inherent part of this method and will typically result in different amortization values for different lots. Therefore, LBSS in different lots can result in a different NAIC designation for the same CUSIP. In accordance with the current instructions for calculating AVR and IMR, reporting entities are required to keep track of the different lots separately, which means reporting the different designations. If a SSAP No. 43R security (by CUSIP) has different NAIC designations by lot, the reporting entity shall either 1) report the aggregate investment with the lowest applicable NAIC designation or 2) report the investment separately by purchase lot on the investment schedule. If reporting separately, the investment may be aggregated by NAIC designation. (For example, all acquisitions of the identical CUSIP resulting with an NAIC 1 designation may be aggregated, and all acquisitions of the identical CUSIP resulting with an NAIC 3 designation may be aggregated.) ~~To the extent that a different accounting method applies to a legal entity's general and separate account, then the weighted average for each account should be calculated separately for the general account and separate account.~~

10. ***Question*** - For companies that have separate accounts, can the NAIC designation be assigned based upon the total legal entity or whether it needs to be calculated separately for the general account and the total separate account?

10.1 *The answer to this question is identical to the answer for question 17.* SSAP No. 43R and several other statements of statutory accounting principle require use of the scientific (constant yield) method of amortization. In addition to Repurchase price, the purchase date is an inherent part of this method and will typically result in different amortization values for different lots. Therefore, LBSS in different lots can result in a different NAIC designation for the same CUSIP. In accordance with the current instructions for calculating AVR and IMR, reporting entities are required to keep track of the different lots separately, which means reporting the different designations. If a SSAP No. 43R security (by CUSIP) has different NAIC designations by lot, the reporting entity shall either 1) report the aggregate investment with the lowest applicable NAIC designation or 2) report the investment separately by purchase lot on the investment schedule. If reporting separately, the investment may be aggregated by NAIC designation. (For example, all acquisitions of the identical CUSIP resulting with an NAIC 1 designation may be aggregated, and all acquisitions of the identical CUSIP resulting with an NAIC 3 designation may be aggregated.) An investment held both in the general account and separate account shall be reported based on the actual investment (by purchase lot) held in those accounts using the same guidelines (lowest NAIC designation or separate line reporting) applicable to the general account. ~~To the extent that a different accounting method applies to a legal entity's general and separate account, then the weighted average for each account should be calculated separately for the general account and separate account.~~

Staff Review Completed by: Julie Gann – October 2017

Status:

On March 24, 2018, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed proposed revisions to *SSAP No. 43R—Loan-Backed and Structured Securities* to clarify that if a loan-backed or structured security has different NAIC designations by lot, then the reporting entity shall either report the entire investment on a single reporting line with the lowest applicable NAIC designation or report separately by purchase lots aggregated by NAIC designation.

On August 4, 2018, the Statutory Accounting Principles (E) Working Group deferred discussion of this agenda item until agenda item #2018-19—Elimination of Modified Filing Exempt on the modified filing exempt designation approach has been addressed.

On April 6, 2019, the Statutory Accounting Principles (E) Working Group exposed revisions (as shown below) to *SSAP No. 43R—Loan-Backed and Structured Securities* to require securities with differing NAIC designations by acquisition lot to be reported in aggregate at either the lowest NAIC designation or reported in groupings by differing NAIC designation. These concepts are consistent with the original exposure, but the proposed edits have been revised to reflect the updated guidance after adopting changes to eliminate Modified Filing Exempt (MFE) in agenda item 2018-19.

(With the updates to SSAP No. 43R to eliminate MFE, only paragraph 8 of Q&A is proposed to be revised.)

April 2019 Exposed Revisions to SSAP No. 43R Q&A

8. ***Question*** – Do LBSS purchased in different lots result in a different NAIC designation for the same CUSIP? Can reporting entities use a weighted average method determined on a legal entity basis?

8.1 Under the financial modeling process (applicable to qualifying RMBS/CMBS reviewed by the NAIC Structured Securities Group), the amortized cost of the security impacts the "final" NAIC designation used for reporting and RBC purposes. As such, securities subject to the financial modeling process acquired in different lots can result in a different NAIC designation for the same CUSIP. In accordance with the current instructions for calculating AVR and IMR, reporting entities are required to keep track of the different lots separately, which means reporting the different designations. For reporting purposes, if a SSAP No. 43R security (by CUSIP) has different NAIC designations by lot, the reporting entity shall either 1) report the aggregate investment with the lowest applicable NAIC designation or 2) report the investment separately by purchase lot on the investment schedule. If reporting separately, the investment may be aggregated by NAIC designation. (For example, all acquisitions of the identical CUSIP resulting with an NAIC 1 designation may be aggregated, and all acquisitions of the identical CUSIP resulting with an NAIC 3 designation may be aggregated.) ~~To the extent that a different accounting method applies to a legal entity's general and separate account, then the weighted average for each account should be calculated separately for the general account and separate account.~~

9. ***Question*** – The NAIC Designation process for LBSS subject to the financial modeling process may incorporate loss expectations that differ from the reporting entity's expectations related to OTTI conclusions. Should the reporting entities be required to incorporate recovery values obtained from data provided by the service provider used for the NAIC Designation process for impairment analysis as required by SSAP No. 43R?

9.1 In accordance with *INT 06-07: Definition of Phrase "Other Than Temporary*," reporting entities are expected to "consider all available evidence" at their disposal, including the information that can be derived from the NAIC designation.

10. ***Question*** - For companies that have separate accounts, can the NAIC designation be assigned based upon the total legal entity or whether it needs to be calculated separately for the general account and the total separate account?

10.1 The financial modeling process for qualifying RMBS/CMBS securities is required for applicable securities held in either the general or separate account.

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

Issue: SSAP No. 62R effective date

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue:
Summary:
This agenda item has been drafted to further clarify the effective date guidance regarding the updates to *SSAP No. 62R—Property and Casualty Reinsurance*, which was adopted on November 15, 2018. The Working Group adopted substantive revisions to SSAP No. 62R to clarify the determination of reinsurance credit and incorporate language from *EITF 93-6, Accounting for Multi-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises* and *EITF Topic D-35, FASB Staff Views on Issue No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises,* with a January 1, 2019 effective date in agenda item 2017-28 - Reinsurance Credit.

The majority of adopted revisions explicitly incorporated U.S. generally accepted accounting principles (GAAP) guidance that had previously been adopted by reference in SSAP No. 62R. EITF 93-6 was adopted with modification by reference in SSAP No. 62R when it was originally effective in 2001. The revisions provided clarity and improved consistency with GAAP and incorporated more of the GAAP implementation guidance on existing concepts into relevant locations.

The revisions were drafted in cooperation with an informal drafting group which included members of industry and regulators. The exposure of the revisions requested comments on the effective date and no comments were received. Members of the drafting group supported the January 1, 2019 effective date.

Subsequent to the November 2018 adoption, NAIC staff received queries asking if the adopted revisions were to be applied to reinsurance contracts in effect as of January 1, 2019 or reinsurance contracts entered into or amended on or after January 1, 2019. Since risk transfer is evaluated at inception of the reinsurance contract, the distinction of the applicability of the effective date of the clarifying guidance may be important for some reporting entities

Because of the following reasons, NAIC staff thinks that the intent of the January 1, 2019 effective date was not intended to “grandfather” any contracts that existed prior to January 1, 2019 which continue to be effective on January 1, 2019:

- EITF 93-6 has been adopted by reference in SSAP No. 62R since its inception.

- The extensive drafting group discussions noted that the outcome of the revisions was to provide more explicit alignment with GAAP and was consistent with the original intent and currently understood application of the existing guidance.

- Some of the guidance was incorporated to be more consistent with the current GAAP formatting after the 2009 FASB codification.

NAIC staff believes that the revisions will not prompt many entities to revise their evaluation of risk transfer for reinsurance contracts in effect as of January 1, 2019. However, if a reporting entity, after reading the incorporated guidance, now has a better understanding that they were applying existing guidance incorrectly, they do have a duty to update their risk transfer assessments for all contracts that were in effect as of January 1, 2019. For these entities, their risk transfer determination at the contract's inception date was not in accordance with the original intent of the guidance.

Existing Authoritative Literature:

SSAP No. 62R—Property and Casualty Reinsurance provides the following:

129. This statement adopts with modification *FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* (FAS 113) and FASB *Emerging Issues Task Force No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises* for the following:

a. Reinsurance recoverables on unpaid case-basis and incurred but not reported losses and loss adjustment expenses shall be reported as a contra-liability netted against the liability for gross losses and loss adjustment expenses;

b. Amounts paid for prospective reinsurance that meet the conditions for reinsurance accounting shall be reported as a reduction of unearned premiums;

c. The gain created by a retroactive reinsurance agreement because the amount paid to the reinsurer is less than the gross liabilities for losses and loss adjustment expenses ceded to the reinsurer is reported in the statement of income as a write-in gain in other income by the ceding entity and a write-in loss by the assuming entity. The gain created by a retroactive reinsurance agreement is restricted as a special surplus account until the actual retroactive reinsurance recovered is in excess of the consideration paid;

d. This statement requires that a liability (provision for reinsurance) be established through a provision reducing unassigned funds (surplus) for unsecured reinsurance recoverables from unauthorized or certified reinsurers and for certain overdue balances due from authorized reinsurers;

e. Some reinsurance agreements contain adjustable features that provide for adjustment of commission, premium or amount of coverage, based on loss experience. This statement requires that the asset or liability arising from the adjustable feature be computed based on experience to date under the agreement, and the impact of early termination may only be considered at the time the agreement has actually been terminated;

f. Structured settlements are addressed in *SSAP No. 65—Property and Casualty Contracts*. Statutory accounting and FAS 113 are consistent in accounting for structured settlement annuities where the reporting entity is the owner and payee and where the claimant is the payee and the reporting entity has been released from its obligation. FAS 113 distinguishes structured settlement annuities where the claimant is the payee and a legally enforceable release from the reporting entity's liability is obtained from those where the claimant is the payee but the reporting entity has not been released from its obligation. GAAP requires the deferral of any gain resulting from the purchase of a structured settlement annuity where the reporting entity has not been released from its obligation; and

g. This statement requires that reinsurance recoverables on unpaid losses and loss adjustment expenses be presented as a contra-liability. Requirements for offsetting and netting are addressed in SSAP No. 64.

134. The substantive revisions adopted November 15, 2018, which primarily incorporated guidance originally from EITF 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises and from EITF D-035, FASB Staff Views on Issue No. 93, are effective January 1, 2019.

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):
Revisions to SSAP No. 62R were adopted in November 2018 in agenda item 2017-28 Reinsurance Credit

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

Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 62R as illustrated below:

> 134. The substantive revisions adopted November 15, 2018, which primarily incorporated guidance originally from *EITF 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises* and from *EITF Topic D-~~0~~35, FASB Staff Views on Issue No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises*, are effective for contracts in effect on or after January 1, 2019. These revisions are required for contracts in effect as *EITF 93-6* had been adopted with modification in this statement from its original 2001 effective date. The revisions adopted in November 2018 primarily added clarification and implementation guidance. (Companies that have previously been following the original intent, as clarified in the revisions, should not be impacted by the November 2018 revisions.) However, if a reporting entity becomes aware that the prior application of reinsurance credit guidance was not consistent with the adopted guidance, the updates should be applied as a change in accounting principle to contracts in effect as of January 1, 2019.

Staff Review Completed by:
Robin Marcotte
NAIC Staff

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. 62R—Property and Casualty Reinsurance*, as detailed above, to further clarify the effective date guidance regarding the updates to SSAP No. 62R, which were adopted on November 15, 2018. The exposed guidance clarifies that it applies to contracts in effect as of Jan. 1, 2019. If a change is required to prior application, it shall be applied as a change in accounting principle

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NAIC Accounting Practices and Procedures Manual
Editorial and Maintenance Update
Released: April 6, 2019

Maintenance updates provide revisions to the *Accounting Practices and Procedures Manual*, such as editorial corrections, reference changes and formatting.

SSAP/Appendix	Description/Revision[1]
SSAP No. 62 – Revised Property and Casualty Reinsurance	Update the Exhibit D – Illustration of Asbestos and Pollution Counterparty Reporting Exception to match the current format of Property and Casualty Annual Statement Schedule F. For 2018 Schedule F, Reinsurance had formatting updates for in the annual statement which included multiple parts of Schedule F into Schedule F part 3.
SSAP No. 63—Underwriting Pools	Update paragraph 11g references to Schedule F, Part 8 to reference the current section of Property and Casualty Annual Statement Schedule F, Part 3.
SSAP No. 84—Health Care and Government Insured Receivables	Delete the paragraph duplicating SSAP No. 4, paragraph 3.
SSAP No. 86—Derivatives	Update language in weather derivative exhibit to eliminate “proposed” wording.
SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities	Update the footnote to regarding items excluded from the wash sale disclosure.

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1. SSAP No. 62R, Update the Exhibit D – Illustration of Asbestos and Pollution Counterparty Reporting Exception.

   The proposed revisions update the SSAP No. 62R Exhibit D to match the current format of Property and Casualty Annual Statement Schedule F-Reinsurance. This revision will remove the prior schedule F portion of the Exhibit and replace it with new tables and columns to match the current format of the Annual Statement Schedule F Reinsurance. The new Schedule F illustration is not proposed to be tracked for readability, but the removal of the old schedule will be tracked. The Supplemental Schedule for Reinsurance Counterparty Reporting Exception – Asbestos and Pollution Contracts at the end of the Exhibit D is not changing with this editorial update.

EXHIBIT D – ILLUSTRATION OF ASBESTOS AND POLLUTION COUNTERPARTY REPORTING EXCEPTION

~~SCHEDULE F – PART 3~~

~~Ceded Reinsurance as of December 31, Current Year~~

~~(000 Omitted)~~

~~1~~ ~~ID Number~~	~~2~~ ~~NAIC Company Code~~	~~3~~ ~~Name of Reinsurer~~	~~4~~ ~~Domiciliary Jurisdiction~~	~~5~~ ~~Special Code~~	~~6~~ ~~Reinsurance Premiums Ceded~~
~~FEIN~~	~~#####~~	~~Retroactive Reinsurer X~~ ~~Original Company A~~	~~NE~~ ~~US~~	~~3~~ ~~3~~	
~~Subtotal Other U.S. Authorized~~					
		~~Original Company B~~ ~~Original Company C~~	~~UK~~ ~~UK~~	~~3~~ ~~3~~	
~~Subtotal Other Non-U.S. Unauthorized~~					
~~9999999 Totals~~					

~~Reinsurance Recoverable On~~									~~Reinsurance Payable~~		~~18~~ ~~Net Amount Recover-able From Rein-surers Cols. 15 – [16 + 17]~~	~~19~~ ~~Funds Held by Company Under Reinsur-ance Treaties~~
~~7~~ ~~Paid Losses~~	~~8~~ ~~Paid LAE~~	~~9~~ ~~Known Case Loss Reserves~~	~~10~~ ~~Known Case LAE Reserves~~	~~11~~ ~~IBNR Loss Reserves~~	~~12~~ ~~IBNR LAE Reserves~~	~~13~~ ~~Unearned Premiums~~	~~14~~ ~~Contingent Commissions~~	~~15~~ ~~Cols. 7 through 14 Totals~~	~~16~~ ~~Ceded Balances Payable~~	~~17~~ ~~Other Amounts Due to Reinsurers~~		
~~3,000~~	~~3,000~~	~~15,000~~ ~~5,000~~	~~15,000~~ ~~2,500~~	**~~25,000~~**[1] ~~10,000~~	~~37,500~~ ~~15,000~~			~~98,500~~ ~~32,500~~	~~6,000~~	~~-~~	~~92,500~~ ~~32,500~~	~~-~~
~~3,000~~	**~~3,000~~**	**~~20,000~~**	**~~17,500~~**	**~~35,000~~**	**~~52,500~~**			**~~131,000~~**	**~~6,000~~**	~~-~~	**~~125,000~~**	~~-~~
~~12,000~~ ~~6,000~~	~~9,000~~ ~~3,000~~	~~2,500~~ ~~7,500~~	~~7,500~~ ~~5,000~~	~~12,500~~ ~~2,500~~	~~5,000~~ ~~17,500~~			~~48,500~~ ~~41,500~~ ~~-~~	~~-~~ ~~-~~ ~~-~~	~~-~~ ~~-~~ ~~-~~	~~48,500~~ ~~41,500~~ ~~-~~	~~-~~ ~~-~~ ~~-~~
~~18,000~~	**~~12,000~~**	**~~10,000~~**	**~~12,500~~**	**~~15,000~~**	**~~22,500~~**			**~~90,000~~**	~~-~~	~~-~~	**~~90,000~~**	
~~21,000~~	**~~15,000~~**	**~~30,000~~**	**~~30,000~~**	**~~50,000~~**	**~~75,000~~**	~~-~~	~~-~~	**~~221,000~~**	**~~6,000~~**	~~-~~	**~~215,000~~**	~~-~~

[1] ~~This example assumes 1/2 of the original company reinsurers' unpaid recoverables are Asbestos and Pollution related.~~

~~SCHEDULE F – PART 4~~[2]
~~Aging of Ceded Reinsurance as of December 31, Current Year~~
~~(000 Omitted)~~

~~1~~ ~~ID Number~~	~~2~~ ~~NAIC Company Code~~	~~3~~ ~~Name of Reinsurer~~	~~4~~ ~~Domiciliary Jurisdiction~~
~~FEIN~~	~~#####~~	~~Retroactive Reinsurer X~~	~~NE~~
~~Subtotal Other U.S. Authorized~~			
~~AA-~~ ~~AA-~~		~~Original Company B~~ ~~Original Company C~~	~~UK~~ ~~UK~~
~~Subtotal Other Non-U.S. Unauthorized~~			
~~9999999 Totals~~			

~~Reinsurance Recoverable on Paid Losses and Paid Loss Adjustment Expenses~~							~~12~~	~~13~~
~~5~~	~~Overdue~~					~~11~~		
~~Current~~	~~6~~ ~~1 to 29 Days~~	~~7~~ ~~30 - 90 Days~~	~~8~~ ~~91 - 120 Days~~	~~9~~ ~~Over 120 Days~~	~~10~~ ~~Total Overdue Cols. 6 + 7 + 8 + 9~~	~~Total Due Cols. 5 + 10~~	~~Percentage Overdue Col. 10/Col. 11~~	~~Percentage More Than 120 Days Overdue Col. 9/Col.11~~
~~6,000~~						~~6,000~~	~~-~~	~~-~~
~~6,000~~						**~~6,000~~**	~~-~~	~~-~~
~~21,000~~ ~~9,000~~						~~21,000~~ ~~9,000~~		
~~30,000~~				~~-~~	~~-~~	**~~30,000~~**	~~-~~	
~~36,000~~	~~-~~	~~-~~	~~-~~	~~-~~	~~-~~	**~~36,000~~**	~~-~~	~~-~~

[2] ~~This exhibit reflects Schedule F from the 2017 annual statement instructions/illustrations. Beginning in 2018, the components of this schedule are embedded as part of Schedule F, Part 3.~~

~~SCHEDULE F – PART 5~~[3]
~~Provision for Unauthorized Reinsurance as of December 31, Current Year~~
~~(000 Omitted)~~

~~1~~ ~~ID Number~~	~~2~~ ~~NAIC Company Code~~	~~3~~ ~~Name of Reinsurer~~	~~4~~ ~~Domiciliary Jurisdiction~~	~~5~~ ~~Reinsurance Recoverable All Items Schedule F Part 3 Col. 15~~	~~6~~ ~~Funds Held by Company Under Reinsurance Treaties~~	~~7~~ ~~Letters of Credit~~	~~8~~ ~~Issuing or Confirming Bank Number~~	~~9~~ ~~Ceded Balances Payable~~
		~~Original Company B~~ ~~Original Company C~~	~~UK~~ ~~UK~~	~~48,500~~ ~~41,500~~	-	-		-
~~Subtotal - Other Non-U.S. Unauthorized~~				**~~90,000~~**	-	-	-	-
~~9999999 Totals~~				**~~90,000~~**	-	-	-	-

~~10~~ ~~Miscellan-eous Balances Payable~~	~~11~~ ~~Trust Funds and Other Allowed Offset Items~~	~~12~~ ~~Total Collateral and Offsets Allowed (Cols. 6+7+9+10+ 11 but not in excess of Col. 5)~~	~~13~~ ~~Provision for Unauthorized Reinsurance (Col. 5 minus Col. 12)~~	~~14~~ ~~Recoverable Paid Losses & LAE Over 90 Days Past Due not in Dispute~~	~~15~~ ~~20% of Amount in Col. 14~~	~~16~~ ~~20% of Amount in Dispute Included in Col. 5~~	~~17~~ ~~Provision for Overdue Reinsur-ance (Col. 15 plus Col. 16)~~	~~18~~ ~~Total Provision for Reinsurance Ceded to Unauthorized Reinsurers (Col. 13 plus Col. 17 but not in Excess of Col. 5)~~
-	~~48,500~~ ~~41,500~~ -	~~48,500~~ ~~41,500~~ -	-	-	-	- - -	- - -	- - -
-	**~~90,000~~**	**~~90,000~~**	-	-	-	-	-	-
-	**~~90,000~~**	**~~90,000~~**	-	-	-	-	-	-

~~Note: Company A and Retroactive Reinsurer are authorized and therefore not shown above.~~

[3] ~~See Footnote 4~~

D – ILLUSTRATION OF ASBESTOS AND POLLUTION COUNTERPARTY REPORTING EXCEPTION

Drafting Note: Updated below table will not be shown as tracked for readability.

SCHEDULE F – PART 3[4]

Aging of Ceded Reinsurance as of December 31, Current Year

(000 Omitted)

1	2	3	4	5	6	Reinsurance Recoverable On		
						7	8	9
ID Number	NAIC Company Code	Name of Reinsurer	Domiciliary Jurisdiction	Special Code	Reinsurance Premiums Ceded	Paid Losses	Paid LAE	Known Case Loss Reserves
FEIN	####	Retroactive Reinsurer X	NE	3		3,000	3,000	15,000
FEIN	####	Original Company A	US	3				5,000
Subtotal Other U.S. Authorized						**3,000**	**3,000**	**20,000**
AA-	####	Original Company B	UK	3		12,000	9,000	2,500
AA-	####	Original Company C	UK	3		6,000	3,000	7,500
Subtotal Other Non-U.S. Unauthorized						**18,000**	**12,000**	**10,000**
999999 Totals						**21,000**	**15,000**	**30,000**

Reinsurance Recoverable On				16	Reinsurance Payable		19	Collateral	
10	11	12	15		17	18		24	25
Known Case LAE Reserves	IBNR Loss Reserves	IBNR LAE Reserves	Cols. 7 through 14 Totals	Amount in Dispute Included in Column 15	Ceded Balances Payable	Other Amounts Due to Reinsurers	Net Amount Recoverable from Reinsurers Cols. 15 – [17 + 18]	Single Beneficiary Trusts Other Allowable Collateral	Total Funds Held Payables and Collateral
15,000	25,000[5]	37,500	98,500		6,000		92,500		
2,500	10,000	15,000	32,500				32,500		
17,500	**35,000**	**52,500**	**131,000**		**6,000**		**125,000**		
7,500	12,500	5,000	48,500				48,500	48,500	48,500
5,000	2,500	17,500	41,500				41,500	41,500	41,500
12,500	**15,000**	**22,500**	**90,000**				**90,000**	**90,000**	**90,000**
30,000	**50,000**	**75,000**	**221,000**		**6,000**		**215,000**	**90,000**	**90,000**

Reinsurance Recoverable on Paid Losses and Paid Loss Adjustment Expenses						
	Overdue					
37	38	39	40	41	42	43
Current Reinsurance Recoverable on Paid Losses and Paid LAE	1 to 29 days Reinsurance Recoverable on Paid Losses and Paid LAE	30 to 90 days Reinsurance Recoverable on Paid Losses and Paid LAE	91 to 120 days Reinsurance Recoverable on Paid Losses and Paid LAE	Over 120 days Reinsurance Recoverable on Paid Losses and Paid LAE	Total Overdue Reinsurance Recoverable on Paid Losses and Paid LAE	Total Due Reinsurance Recoverable on Paid Losses and Paid LAE Cols. 37 + 42 (In total should equal Cols. 7 + 8)
6,000						6,000
6,000						**6,000**
21,000						21,000
9,000						9,000
30,000						**30,000**
36,000						**36,000**

Drafting Note: *The Supplemental Schedule for Reinsurance Counterparty Reporting Exception – Asbestos and Pollution Contracts at the end of the Exhibit D is not changing with this editorial update.*

[4] Note that unused columns have been removed for this exhibit.

[5] This example assumes 1/2 of the original company reinsurers' unpaid recoverables are Asbestos and Pollution related.

2. Update Schedule F reference in SSAP No. 63 to match the current format of the Schedule F

SSAP No. 63—Underwriting Pools

Disclosures

11. 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 ~~Provision for Overdue~~Aging of Ceded Reinsurance (Schedule F, Part ~~8~~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.

3. *SSAP No. 84—Health Care and Government Insured Plan Receivables.* Delete the quote of SSAP No. 4, paragraph 3. Paragraphs 7 and 8 will be combined and all remaining paragraphs will be renumbered.

~~7. The definition and accounting treatment for nonadmitted assets is outlined in paragraph 3 of *SSAP No. 4—Assets and Nonadmitted Assets* (SSAP No. 4) as follows:~~

> ~~As stated in the Statement of Concepts, "The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet", and are, therefore, considered nonadmitted. For purposes of statutory accounting principles, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2, which is accorded limited or no value in statutory reporting, and is one which is:~~
>
> > ~~a. Specifically identified within the *Accounting Practices and Procedures Manual* as a nonadmitted asset; or~~

~~b. Not specifically identified as an admitted asset within the *Accounting Practices and Procedures Manual*.~~

~~If an asset meets one of these criteria, the asset shall be reported as a nonadmitted asset and charged against surplus unless otherwise specifically addressed within the *Accounting Practices and Procedures Manual*. The asset shall be depreciated or amortized against net income as the estimated economic benefit expires. In accordance with the reporting entity's written capitalization policy, amounts less than a predefined threshold of furniture, fixtures, equipment, or supplies, shall be expensed when purchased.~~

~~8.~~7. The definition and accounting treatment for nonadmitted assets is outlined in paragraph 3 of *SSAP No. 4—Assets and Nonadmitted Assets* (SSAP No. 4). Pharmaceutical rebate receivables, claim overpayment receivables, loans and advances to providers, capitation arrangement receivables, risk-sharing receivables, and amounts receivable under government insured plans meet the definition of assets as set forth in SSAP No. 4, and are admitted assets to the extent that the requirements for admission defined in this statement are met.

4. *SSAP No. 86—Derivatives*: Remove "proposed" language from the weather derivative exhibit:

(Actual exhibit not duplicated.)

A: Security issued directly (or through a broker), in which settlement is based on a climatic or geological variable (i.e., earthquake). This security would meet the definition of a weather derivative (~~proposed to be~~ incorporated into SSAP No. 86) and shall be accounted for and reported consistent with other derivatives in SSAP No. 86.

B: A policy issued directly from the insurer to the policyholder in which coverage (and payment of claims) is based on a climatic or geological variable (i.e., earthquake coverage). This would be classified as insurance contract and be subject to the scope exclusion in ASC 815-45-15-2 that is also included in SSAP No. 86.

5. *SSAP No. 103—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*: Update the footnote to paragraph 12 to identify the exclusions from the wash sale disclosure:

12. Repurchase agreements, reverse repurchase agreements, repurchase financing, collateral requirements and dollar repurchase agreements are described in paragraphs 102-118. When an asset is sold and the proceeds are reinvested within 30 days in the same or substantially the same security, such transfers shall be considered to be wash sales and shall be accounted for as sales as discussed in paragraphs 96-101 and disclosed as required by paragraph 28.~~l~~l[2]. Unless there is a concurrent contract to repurchase or redeem the transferred financial assets from the transferee, the transferor does not maintain effective control over the transferred financial assets.

Footnote 2: Paragraph 28.l also details the items that ~~Money market mutual funds~~ are excluded from the wash sale disclosure.

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 the editorial maintenance revisions as detailed above.

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

Issue: ***ASU 2015-08, Business Combinations – Pushdown Accounting, Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115***

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue:
ASU 2015-08, Business Combinations – Pushdown Accounting, Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115 (ASU 2015-08) was issued to provide Securities and Exchange Commission (SEC) guidance specific to pushdown accounting for Topic 805, Business Combinations. The guidance in ASU 2015-08 is specific to SEC registrants.

Existing Authoritative Literature:
SSAP No. 68—Business Combinations and Goodwill and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* provide guidance on the accounting and reporting for business combinations, specific valuation methods for purchased entities and permissibility of pushdown accounting for statutory accounting.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Agenda item 2019-12 includes a discussion of pushdown accounting for public and nonpublic entities.

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

Convergence with International Financial Reporting Standards (IFRS):
Currently, there is no guidance in IFRS on pushdown accounting as this is not a method of accounting that is accepted under IFRS.

Staff Recommendation:
Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *Appendix D—Nonapplicable GAAP* Pronouncements to reject *ASU 2015-08, Business Combinations – Pushdown Accounting, Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115* as not applicable for statutory accounting.

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 *Appendix D—Nonapplicable GAAP* Pronouncements to reject *ASU 2015-08, Business Combinations – Pushdown Accounting, Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115* as not applicable for statutory accounting.

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

Issue: *ASU 2019-02, Improvements to Accounting for Costs of Films and License Agreements for Program Materials*

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue:
Historically, for episodic television series, production costs specified in Subtopic 926-20 were capitalized up to the amount of revenue contracted for each episode in the initial market until persuasive evidence existed that revenue from secondary markets would occur or an entity could demonstrate a history of earning such revenue in that market. For films, all production costs were capitalized. Due to a shift in the way that episodic television is consumed through on-demand and streaming services, which is more similar to the film revenue model than the old broadcast television model, FASB elected to align the accounting for production costs of an episodic television series with the accounting for production costs of films by removing the content distinction for capitalization.

Existing Authoritative Literature:
There is no current SAP guidance for film or television production. U.S. GAAP guidance for film and television production is included in Subtopic 926-20.

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

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

Convergence with International Financial Reporting Standards (IFRS): IFRS standards do not provide industry guidance on the accounting for film costs by producers or for the acquisition of program material licenses by broadcasters.

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2019-02, Improvements to Accounting for Costs of Films and License Agreements for Program Materials Comments* as not applicable to statutory accounting. This item is proposed to be rejected as not applicable as ASU 2019-02 provides specific guidance for episodic television producers which is not applicable for statutory accounting purposes.

Staff Review Completed by: Jake Stultz – 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 *Appendix D—Nonapplicable GAAP* Pronouncements to reject *ASU 2019-02, Improvements to Accounting for Costs of Films and License Agreements for Program Materials* as not applicable for statutory accounting.

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Statement of Statutory Accounting Principles No. 22 – Revised

Leases

Status

Type of Issue	Common Area
Issued	Initial Draft; Substantively revised August 3, 2019
Effective Date	January 1, 2001; Substantive revisions detailed in Issue Paper 16X are proposed to be effective January 1, 2020.
Affects	Nullifies and incorporates INT 00-02, INT 00-27, INT 04-20 and INT 09-05; Nullifies INT 02-15 and INT 04-18
Affected by	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	None

STATUS **1**
SCOPE OF STATEMENT 2
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Leases

SCOPE OF STATEMENT

1. The purpose of this statement is to establish statutory accounting principles for leases. It addresses:

   a. Accounting and reporting by lessees;

   b. Accounting and reporting by lessors;

   c. Sale-leaseback transactions;

   d. Leveraged leases for lessors;

   e. Related party leases; and

   f. Disclosures.

SUMMARY CONCLUSION

2. A lease is defined as a contract or part of a contract conveying the right to control the use of property, plant or equipment (land and/or depreciable assets) for a stated period of time in exchange for consideration. This definition does not include contracts for services that do not transfer the right to use property, plant or equipment from one contracting party to the other (i.e., employee lease contracts) or service concession arrangements[1]. Agreements that do transfer the right to control the use of property, plant or equipment meet the definition of a lease even though substantial services by the contractor (lessor) may be called for in connection with the operation or maintenance of the assets.

3. Property, plant or equipment, (including computer software) as used in this SSAP, includes only land and/or depreciable assets. Therefore, inventory (including equipment parts inventory), other intangible assets, assets under construction, leases to explore for or use minerals, natural gas and similar nonregenerative resources, and leases of biological assets, such as timber cannot be the subject of a lease for accounting purposes. Additionally, non-depreciable assets, including investments and premium receivables do not meet the definition of property, plant or equipment and cannot be the subject of a lease for accounting purposes.

Determining Whether an Arrangement Contains a Lease

4. Determining whether an arrangement contains a lease that is within the scope of this SSAP should be based on the substance of the arrangement. At inception of a contract, an entity shall determine whether that contract is or contains a lease. A contract is or contains a lease if the contract conveys the right to control the use of identified property, plant or equipment (an identified asset) for a period of time in exchange for consideration. A period of time may be described in terms of the amount of use of an

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[1] A service concession arrangement is an arrangement between a public sector entity grantor and an operating entity under which the operating entity operates the grantor's infrastructure (for example, airports, roads, bridges, tunnels, prisons and hospitals) for a specified period of time. A public-sector entity includes a governmental body or an entity to which the responsibility to provide public service has been delegated. In a service concession arrangement, both of the following conditions exist:

   a. The grantor controls or has the ability to modify or approve the services that the operating entity must provide with the infrastructure, to whom it must provide them and at what price.
   b. The grantor controls, through ownership, beneficial entitlement, or otherwise, any residual interest in the infrastructure at the end of the term of the arrangement.

identified asset (for example, the number of production units that an item of equipment will be used to produce).

Identifying an Asset

5. An asset can be identified by being explicitly or implicitly specified within the contract. Although specific property, plant or equipment may be explicitly identified in an arrangement, it is not the subject of a lease if fulfillment of the arrangement is not dependent on the use of the specified property, plant or equipment. A warranty obligation that permits or requires the substitution of the same or similar property, plant or equipment when the specified property, plant or equipment is not operating properly does not preclude lease treatment. In addition, a contractual provision (contingent or otherwise) permitting or requiring the owner/seller to substitute other property, plant or equipment for any reason on or after a specified date does not preclude lease treatment prior to the date of substitution. Property, plant or equipment has been implicitly specified if, for example, the seller owns or leases only one asset with which to fulfill the obligation and it is not economically feasible or practicable for the owner/seller to perform its obligation through the use of alternative property, plant or equipment. Property, plant or equipment can also be implicitly specified at the time the asset is made available for use by the lessee.

6. Even if an asset is specified, the asset does not qualify as an identified asset if the lessor has the substantive right to substitute the asset throughout the period of use. A lessor's right to substitute an asset is substantive only if (1) the lessor has the practical ability to substitute alternative assets throughout the period of use (for example, the lessee cannot prevent the lessor from substituting an asset, and alternative assets are readily available to the lessor or could be sourced by the lessor within a reasonable period of time), and (2) the lessor would benefit economically from the exercise of its right to substitute the asset (that is, the economic benefits associated with substituting the asset is expected to exceed the costs associated with substituting the asset).

7. An entity's evaluation of whether a lessor's substitution right is substantive is based on facts and circumstances at inception of the contract and shall exclude consideration of future events that, at inception, are not considered likely to occur. Examples of future events that, at inception of the contract, would not be considered likely to occur and, thus, should be excluded from the evaluation include, but are not limited to, the following:

a. An agreement by a future lessee to pay an above-market rate for use of the asset;

b. The introduction of new technology that is not substantially developed at inception of the contract;

c. A substantial difference between the lessee's use of the asset, or the performance of the asset and the use or performance considered likely at inception of the contract;

d. A substantial difference between the market price of the asset during the period of use and the market price considered likely at inception of the contract.

8. If the asset is located at the lessee's premises or elsewhere, the costs associated with substitution are generally higher than when located at the lessor's premises and, therefore, are more likely to exceed the benefits associated with substituting the asset. If the lessor has a right or an obligation to substitute the asset only on or after either a particular date or the occurrence of a specified event, the lessor does not have the practical ability to substitute alternative assets throughout the period of use. The lessor's right or obligation to substitute an asset for repairs or maintenance, if the asset is not operating properly, or if a technical upgrade becomes available, does not preclude the lessee from having the right to use an identified asset. If the lessee cannot readily determine whether the lessor has a substantive substitution right, the lessee shall presume that any substitution right is not substantive.

9. A capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building or a segment of a pipeline that connects a single lessee to the larger pipeline). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fiber optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the lessee with the right to obtain substantially all of the economic benefits from use of the asset.

Right to Control the Use of the Identified Asset

10. To determine whether a contract conveys the right to control the use of an identified asset for a period of time, an entity shall assess whether, throughout the period of use, the lessee has both:

a. The right to obtain substantially all of the economic benefits from use of the identified asset.

    i. To control the use of an identified asset, a lessee is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). A lessee can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding, or subleasing the asset. The economic benefits from use of an asset include its primary output and byproducts (including potential cash flows derived from these items) and other economic benefits from using the asset that could be realized from a commercial transaction with a third party.

    ii. When assessing the right to obtain substantially all of the economic benefits from use of an asset, an entity shall consider the economic benefits that result from use of the asset within the defined scope of a lessee’s right to use the asset in the contract.

    iii. If a contract requires a lessee to pay the lessor or another party a portion of the cash flows derived from use of an asset as consideration, those cash flows paid as consideration shall be considered to be part of the economic benefits that the lessee obtains from use of the asset. For example, if a lessee is required to pay the lessor a percentage of sales from use of retail space as consideration for that use, that requirement does not prevent the lessee from having the right to obtain substantially all of the economic benefits from use of the retail space. That is because the cash flows arising from those sales are considered to be economic benefits that the lessee obtains from use of the retail space, a portion of which it then pays to the lessor as consideration for the right to use that space.

b. The right to direct the use of the identified asset.

    i. A lessee has the right to direct the use of an identified asset throughout the period of use in either of the following situations. Additionally, if the lessee in the contract is a joint operation or a joint arrangement, an entity shall consider whether the joint operation or joint arrangement has the right to control the use of an identified asset throughout the period of use.

        (a) The lessee has the right to direct how and for what purpose the asset is used throughout the period of use. If the lessee has the right to control the use of an identified asset for only a portion of the term of the contract, the contract contains a lease for that portion of the term.

(b) The relevant decisions about how and for what purpose the asset is used are predetermined and at least one of the following conditions exists:

(1) The lessee has the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use without the lessor having the right to change those operating instructions.

(2) The lessee designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use.

ii. The relevant decisions about how and for what purpose an asset is used can be predetermined in a number of ways. For example, the relevant decisions can be predetermined by the design of the asset or by contractual restrictions on the use of the asset.

iii. In assessing whether a lessee has the right to direct the use of an asset, an entity shall consider only rights to make decisions about the use of the asset during the period of use unless the lessee designed the asset (or specific aspects of the asset) in accordance with paragraph 10.b.i(b). Consequently, unless that condition exists, an entity shall not consider decisions that are predetermined before the period of use. For example, if a lessee is able only to specify the output of an asset before the period of use, the lessee does not have the right to direct the use of that asset. The ability to specify the output in a contract before the period of use, without any other decision-making rights relating to the use of the asset, gives a lessee the same rights as any lessee that purchases goods or services.

iv. A contract may include terms and conditions designed to protect the lessor's interest in the asset or other assets, to protect its personnel, or to ensure the lessor's compliance with laws or regulations. These are examples of protective rights. For example, a contract may specify the maximum amount of use of an asset or limit where or when the lessee can use the asset, may require a lessee to follow particular operating practices, or may require a lessee to inform the lessor of changes in how an asset will be used. Protective rights typically define the scope of the lessee's right of use but do not, in isolation, prevent the lessee from having the right to direct the use of an asset.

v. A lessee has the right to direct how and for what purpose an asset is used throughout the period of use if, within the scope of its right of use defined in the contract, it can change how and for what purpose the asset is used throughout that period. In making this assessment, an entity considers the decision-making rights that are most relevant to changing how and for what purpose an asset is used throughout the period of use. Decision-making rights are relevant when they affect the economic benefits to be derived from use. The decision-making rights that are most relevant are likely to be different for different contracts, depending on the nature of the asset and the terms and conditions of the contract.

11. An entity shall reassess whether a contract is or contains a lease only if the terms and conditions of the contract are changed.

Separating Components of a Contract

12. An entity shall identify the separate lease components within the contract. An entity shall consider the right to use an underlying asset to be a separate lease component (that is, separate from any other lease components of the contract) if both of the following criteria are met:

a. The lessee can benefit from the right of use either on its own or together with other resources that are readily available to the lessee. Readily available resources are goods or services that are sold or leased separately (by the lessor or other lessors) or resources that the lessee already has obtained (from the lessor or from other transactions or events).

b. The right of use is neither highly dependent on nor highly interrelated with the other right(s) to use underlying assets in the contract. A lessee's right to use an underlying asset is highly dependent on or highly interrelated with another right to use an underlying asset if each right of use significantly affects the other.

13. The consideration in the contract shall be allocated to each separate lease component and nonlease component of the contract. Components of a contract include only those items or activities that transfer a good or service to the lessee.

14. An entity shall account for each separate lease component separately from the nonlease components of the contract. Nonlease components are not within the scope of this statement and shall be accounted for in accordance with the statutory accounting guidance applicable to the nonlease component.

15. An entity shall combine two or more contracts, at least one of which is or contains a lease, entered into at or near the same time with the same counterparty (or related parties) and consider the contracts as a single transaction if any of the following criteria are met:

a. The contracts are negotiated as a package with the same commercial objective(s).

b. The amount of consideration to be paid in one contract depends on the price or performance of the other contract.

c. The rights to use underlying assets conveyed in the contracts are a single lease component.

16. As a practical expedient, when nonlease components are an insignificant part of a lease agreement, a lessee and a lessor may, as an accounting policy election by class of underlying asset, choose not to separate nonlease components from lease components and instead to account for each separate lease component and the nonlease components associated with that lease component as a single lease component. The nonlease components must be closely related to the elements of the lease to be recognized as a single lease component. For lease agreements between related parties, lease and nonlease components must be separated.

Modification

17. An entity shall account for a modification to a contract as a separate contract (that is, separate from the original contract) when both of the following conditions are present:

a. The modification grants the lessee an additional right of use not included in the original lease (for example, the right to use an additional asset).

b. The lease payments increase commensurate with the standalone price for the additional right of use, adjusted for the circumstances of the particular contract. For example, the standalone price for the lease of one floor of an office building in which the lessee already leases other floors in that building may be different from the standalone price of a similar floor in a different office building, because it was not necessary for a lessor to incur costs that it would have incurred for a new lessee.

18. An entity shall account for initial direct costs, lease incentives and any other payments made to or by the entity in connection with a modification to a lease in the same manner as those items would be accounted for in connection with a new lease.

Accounting and Reporting by Lessees

19. All leases shall be considered operating leases, which means that rental expense is recognized over the lease term, without recognition of a right-to-use asset or lease liability. Rent on operating leases, reflecting all lease considerations in paragraph 20, shall be charged to expense on a straight-line basis over the lease term. Statutory accounting rejects the recognition of a right-to-use lease asset and the associated lease liabilities.

20. The consideration in the contract for a lessee includes all of the following payments that will be made during the lease term:

a. Any fixed payments (for example, monthly service charges) or in substance fixed payments, less any incentives paid or payable to the lessee.

b. Any other variable payments that depend on an index or a rate, initially measured using the index or rate at the commencement date.

21. A lessee should recognize contingent rental expense (in annual periods as well as in interim periods) prior to the achievement of the specified target that triggers the contingent rental expense, provided that achievement of that target is considered probable. Previously recorded rental expense should be reversed into income at such time that it is probable that the specified target will not be met.

22. For the early termination or non-use of leased property, plant or equipment benefits, the lessee shall recognize liabilities, initially measured at fair value. Liabilities for costs to terminate a contract before the end of its term shall be recognized when the entity terminates the contract in accordance with the contract terms (i.e., gives written notice of termination or negotiated termination with the lessor).

23. Liabilities for costs that will continue to be incurred under a contract for its remaining term without economic benefit shall be recognized as the cease-date (the date the entity ceases using the right conveyed by the contract – i.e., the right to use a leased property). The fair value of the liability at the cease-use date shall be determined based on the remaining lease rentals, adjusted for the effects of any prepaid or deferred items recognized under the lease, and reduced by estimated sublease rentals that could be reasonably obtained for the property, even if the entity does not intend to enter into a sublease. Remaining lease rentals shall not be reduced to an amount less than zero.

24. An entity shall determine the lease term as the noncancellable period of the lease, together with all of the following:

a. Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option.

b. Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

c. Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the lessor.

25. A lessee shall reassess the lease term or a lessee option to purchase the underlying asset only if and at the point in time that any of the following occurs:

a. There is a significant event or a significant change in circumstances that is within the control of the lessee that directly affects whether the lessee is reasonably certain to exercise or not to exercise an option to extend or terminate the lease or to purchase the underlying asset.

b. There is an event that is written into the contract that obliges the lessee to exercise (or not to exercise) an option to extend or terminate the lease.

c. The lessee elects to exercise an option even though the entity had previously determined that the lessee was not reasonably certain to do so.

d. The lessee elects not to exercise an option even though the entity had previously determined that the lessee was reasonably certain to do so.

26. At the commencement date, an entity shall include the periods described in paragraph 24 in the lease term having considered all relevant factors that create an economic incentive for the lessee (that is, contract-based, asset-based, entity-based and market-based factors). Those factors shall be considered together, and the existence of any one factor does not necessarily signify that a lessee is reasonably certain to exercise or not to exercise an option.

27. Maintenance costs incurred by the lessee for maintenance on the leased item that do not increase the value and enhance the usefulness of the leased asset shall be expensed when incurred pursuant to *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* (SSAP No. 19). Reimbursable deposits shall be reflected as nonadmitted assets. Deposits paid to the lessor, reimbursable when the lessee incurs costs for lease maintenance activities, shall be recorded as nonadmitted assets. When the amount on deposit is less than probable of being returned, the deposit shall be recognized as an additional lease expense.

Accounting and Reporting by Lessors

28. The definition of property, plant and equipment for lessors is defined in paragraph 3 and is the same as for lessees. All leases, except leveraged leases as defined in paragraph 42, shall be considered operating leases and accounted for by the lessor as follows:

a. The leased property, plant or equipment shall be included in the same balance sheet category it would be had the property, plant or equipment not been leased. The property, plant or equipment shall be depreciated following the lessor's normal depreciation policies for such assets;

b. Rental income shall be reported as investment income as it becomes receivable according to the provisions of the lease. Rentals may be recognized before they become due, if rentals vary from the straight-line basis. The guidance in *SSAP No. 34—Investment Income Due and Accrued* shall be applied to the receivable balance; and

c. Initial direct costs shall be charged to expense when incurred and shall not be deferred and allocated over the lease term. Initial direct costs are those incremental costs that the lessor has incurred in directly evaluating, negotiating, administering and closing a lease transaction.

29. If the terms of a variable payment amount other than those in paragraph 20.b. relate to a lease component, even partially, the lessor shall not recognize those payments before the changes in facts and circumstances on which the variable payment is based occur (for example, when the lessee's sales on which the amount of the variable payment depends occur). When the changes in facts and circumstances on which the variable payment is based occur, the lessor shall allocate those payments to the lease and nonlease components of the contract.

30. Contingent rental income shall be recognized as revenue when the changes in the factor(s) on which the contingent lease payments is (are) based actually occur.

Sale-Leaseback Transactions

31. Sale-leaseback transactions involve the sale of property, plant or equipment by the owner and a lease of the property, plant or equipment back to the seller. Sale-leaseback accounting is a method of accounting in which the seller-lessee records the sale and removes all property, plant or equipment and related liabilities from its balance sheet. The definition of property, plant and equipment eligible for sale-leaseback treatment is in paragraph 3. As noted in paragraph 3, non-depreciable assets, including investments and premium receivables, do not meet the definition of property, plant or equipment, are not allowed to be included in lease transactions, and therefore, are not allowed to be included in sale-leaseback transactions. Assets that do not meet the definition of property, plant and equipment in paragraph 3 may only be used in sale-leaseback transactions as permitted practices with regulatory approval.

32. A sale of property, plant or equipment that is accompanied by a leaseback of all or any part of the property, plant or equipment for all or part of its remaining economic life shall be accounted for by the buyer-lessor and seller-lessee as a purchase and operating lease and a sale and an operating lease, respectively, unless the sale-leaseback includes sale of nonadmitted assets to a related party. If the transaction involves a sale of nonadmitted assets to a related party, the transaction shall be accounted for by the deposit method detailed in paragraph 37.

33. Sale-leaseback accounting shall be used by a seller-lessee only if a sale-leaseback transaction includes all of the following:

a. A normal leaseback. A normal leaseback is a lessee-lessor relationship that involves active use of the property by the seller-lessee in consideration for payment of rent, including contingent rentals that are based on future operations of the seller-lessee. The phrase active use of the property by the seller-lessee refers to use of the property during the lease term in the seller-lessee's trade or business, provided that subleasing of the leased property is minor.

b. Admitted assets, if the buyer-lessor is a related party, or either admitted or nonadmitted assets if the buyer-lessor is not a related party. For purposes of this paragraph, related parties include those identified in SSAP No. 25 and entities created for the purpose of buying and leasing nonadmitted assets for the reporting entity and/or its affiliates.

34. Under sale-leaseback accounting, any profit on the sale shall be deferred and amortized in proportion to the related gross rental charged to expense over the lease term, with the exception of a sale of real estate settled entirely in cash.

35. A sale of real estate, settled entirely in cash, that is accompanied by a leaseback of all or any part of the property, plant or equipment for all or part of its remaining economic life shall be accounted for by the buyer-lessor and seller-lessee as a purchase and operating lease and a sale and an operating lease, respectively. The sale and gain shall be recognized directly to special surplus funds and subsequently amortized to unassigned funds (surplus) over the lease term.

Deposit Method and Financing Method

36. The deposit method is used when the transaction involves a sale-leaseback of nonadmitted assets to a related party. To the extent that leases between related parties are, in substance, arms-length transactions the guidance in this statement shall be applied. The determination of whether related party leases qualify as arms-length transactions is addressed in SSAP No. 25.

37. If a sale-leaseback transaction is accounted for by the deposit method, lease payments decrease and collections on the buyer-lessor's note, if any, increase the seller-lessee's deposit account. The sale-leaseback assets identified in paragraph 31 and any related debt continue to be included in the seller-lessee's balance sheet, and the seller-lessee continues to depreciate the sale-leaseback assets. A seller-lessee that is accounting for any transaction by the deposit method shall recognize a loss if at any time the net carrying amount of the sale-leaseback assets exceeds the sum of the balance in the deposit account, the fair value of the unrecorded note receivable and any debt assumed by the buyer.

38. If a sale-leaseback transaction is accounted for by the deposit method and then subsequently qualifies for sales recognition under paragraph 33, the transaction is accounted for using sale-leaseback accounting, and the gain or loss is recognized in accordance with the provisions of paragraph 34 of this statement. In addition, the leaseback is classified and accounted for in accordance with this statement as if the sale had been recognized at the inception of the lease. The change in the related lease accounts that would have been recorded from the inception of the lease had the transaction initially qualified for sale-leaseback accounting is included in computing the gain or loss recognized in accordance with paragraph 34 of this statement.

39. A sale-leaseback transaction that does not qualify for sale-leaseback accounting nor the deposit method shall be accounted for by the financing method. Under this method the seller-lessee shall not derecognize the transferred asset and shall account for any amounts received as a financial liability and the buyer-lessor shall not recognize the transferred asset and shall account for the amounts paid as a receivable.

40. If a sale-leaseback transaction is reported as under the financing method, lease payments, exclusive of an interest portion, decrease and collections on the buyer-lessor's note increase the seller-lessee's liability account with a portion of the lease payments being recognized under the interest method. The seller-lessee reports the sales proceeds as a liability, continues to report the sale-leaseback assets identified in paragraph 31 as an asset and continues to depreciate the sale-leaseback assets.

41. If a sale-leaseback transaction accounted for under the financing method subsequently qualifies under paragraph 33, the transaction is then recorded using sale-leaseback accounting, and the cumulative change in the related balance sheet accounts is included in the computation of the gain recognized in accordance with the provisions of paragraph 34 of this statement. In addition, the leaseback is classified and accounted for as an operating lease as if the sale had been recognized at the inception of the lease.

The change in the related lease accounts from the inception of the lease to the date the sale is recognized is included in the gain recognized in accordance with paragraph 34 of this statement.

Leveraged Leases for Lessors

42. A lessor shall record its investment in a leveraged lease. Generally, leveraged leases are those in which the lessor acquires, through the incurrence of debt (such that the lessor is substantially "leveraged" in the transaction), property, plant or equipment with the intentions to lease the asset(s) to the lessee. The net of the balances of the following accounts as measured in accordance with this guidance shall represent the lessor's initial and continuing investment in leveraged leases:

a. Rentals receivable

b. Investment-tax-credit receivable

c. Estimated residual value of the leased asset

d. Unearned and deferred income.

43. A lessor shall initially measure its investment in a leveraged lease net of the nonrecourse debt. The net of the balances of the following accounts shall represent the initial and continuing investment in leveraged leases:

a. Rentals receivable, net of that portion of the rental applicable to principal and interest on the nonrecourse debt.

b. A receivable for the amount of the investment tax credit to be realized on the transaction.

c. The estimated residual value of the leased asset. The estimated residual value shall not exceed the amount estimated at lease inception except if the lease agreement includes a provision to escalate minimum lease payments either for increases in construction or acquisition cost of the leased property, plant or equipment or for increases in some other measure of cost or value (such as general price levels) during the construction or preacquisition period. In that case, the effect of any increases that have occurred shall be considered in the determination of the estimated residual value of the underlying asset at lease inception.

d. Unearned and deferred income consisting of both of the following:

i. The estimated pretax lease income (or loss), after deducting initial direct costs, remaining to be allocated to income over the lease term.

ii. The investment tax credit remaining to be allocated to income over the lease term.

44. The investment in leveraged leases minus deferred taxes arising from differences between pretax accounting income and taxable income shall represent the lessor's net investment in leveraged leases for purposes of computing periodic net income from the leveraged lease. Given the original investment and using the projected cash receipts and disbursements over the term of the lease, the rate of return on the net investment in the years in which it is positive shall be computed. The rate is that rate that, when applied to the net investment in the years in which the net investment is positive, will distribute the net income to those years and is distinct from the interest rate implicit in the lease. In each year, whether positive or not, the difference between the net cash flow and the amount of income recognized, if any, shall serve to

increase or reduce the net investment balance. The use of the term years is not intended to preclude application of the accounting prescribed in this paragraph to shorter accounting periods.

45. The pretax lease income (or loss) and investment tax credit elements shall be allocated in proportionate amounts from the unearned and deferred income included in the lessor's net investment. The tax effect of the pretax lease income (or loss) recognized shall be reflected in tax expense for the year. The tax effect of the difference between pretax accounting income (or loss) and taxable income (or loss) for the year shall be charged or credited to deferred taxes.

46. If, at any time during the lease term the application of the method prescribed in this section would result in a loss being allocated to future years, that loss shall be recognized immediately. This situation might arise in circumstances in which one of the important assumptions affecting net income is revised.

47. The projected timing of income tax cash flows generated by the leveraged lease is an important assumption and shall be reviewed annually, or more frequently, if events or changes in circumstances indicate that a change in timing has occurred or is projected to occur. The income effect of a change in the income tax rate shall be recognized in the first accounting period ending on or after the date on which the legislation effecting a rate change becomes law.

48. The lessor shall record its investment net of the nonrecourse debt. In cases where the asset being leased is a nonadmitted asset, any net leveraged lease asset shall be nonadmitted. However, leveraged leases involving commercial airplanes are admitted assets.

Disclosures

49. The following disclosures shall be made in the financial statements of lessees:

a. A general description of the lessee's leasing arrangements including, but not limited to, the following:

   i. Rental expense for each period for which an income statement is presented, with separate amounts for minimum rentals, contingent rentals, and sublease rentals. Rental payments under leases with terms of a month or less that were not renewed need not be included;

   ii. The basis on which contingent rental payments are determined;

   iii. The existence and terms of renewal or purchase options and escalation clauses; and

   iv. Restrictions imposed by lease agreements, such as those concerning dividends, additional debt and further leasing;

   v. Identification of lease agreements that have been terminated early or for which the lessee is no longer using the leased property, plant or equipment benefits, and the liability recognized in the financial statements under these agreements.

b. For leases having initial or remaining lease terms in excess of one year:

   i. Future minimum rental payments required as of the date of the latest balance sheet presented, in the aggregate and for each of the five succeeding years; and

ii. The total of minimum rentals to be received in the future under noncancelable subleases as of the date of the latest balance sheet presented.

c. For sale-leaseback transactions:

i. A description of the terms of the sale-leaseback transaction, including future commitments or obligations; and

ii. For those accounted for as deposits, (a) the obligation for future minimum lease payments as of the date of the latest balance sheet presented in the aggregate and for each of the five succeeding years and (b) the total of minimum sublease rentals, if any, to be received in the future under noncancelable subleases in the aggregate and for each of the five succeeding years.

iii. For those accounted for using the financing method, it is required to disclose the information in i. as well as the financing obligation and lease liabilities.

50. When leasing is a significant part of the lessor’s business activities in terms of revenue, net income, or assets, the following information with respect to leases shall be disclosed in the financial statements:

a. For operating leases:

i. The cost and carrying amount, if different, of property, plant or equipment on lease or held for leasing by major classes of property, plant or equipment according to nature or function, and the amount of accumulated depreciation in total as of the date of the latest balance sheet presented;

ii. Minimum future rentals on noncancelable leases as of the date of the latest balance sheet presented, in the aggregate and for each of the five succeeding years;

iii. Total contingent rentals included in income for each period for which an income statement is presented; and

iv. A general description of the lessor’s leasing arrangements.

b. For leveraged leases:

i. A description of the terms including the pretax income from the leveraged leases. For purposes of presenting the investment in a leveraged lease in the lessor’s balance sheet, the amount of related deferred taxes shall be presented separately (from the remainder of the net investment);

ii. Separate presentation (from each other) shall be made of pretax income from the leveraged lease, the tax effect of pretax income, and the amount of investment tax credit recognized as income during the period; and

iii. When leveraged leasing is a significant part of the lessor’s business activities in terms of revenue, net income, or assets, the components of the net investment balance in leveraged leases shall be disclosed.

51. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

52. This statement rejects *ASU 2016-02, Leases*. For statutory accounting, leases are treated as operating leases for lessees and rejects the treatment as financing leases specified in 842-10-25 and rejects the recognition of the right to use assets and related liabilities. For statutory accounting, specific guidance is adopted on sale leaseback transactions, specific guidance from lessors, leveraged leases from sections 842-40 and 842-50, respectively. The financing method is rejected for statutory accounting but adopted for instances where a sale-leaseback transaction fails sale accounting. The guidance within *INT 02-15: EITF 00-11: Lessors' Evaluation of Whether Leases of Certain Integral Equipment Meet the Ownership Transfer Requirements of FASB Statement 13* applied to leases with inception between January 1, 2003 and January 1, 2020. With adoption of substantive revisions to SSAP No. 22R this guidance is nullified.

a. Accounting Standards Codification (ASC) 420-10-25 paragraphs 11-13 and ASC 420-10-30 paragraph 8 regarding the recognition of costs to terminate an operating lease before the end of the term and costs that will continue to be incurred under the contract for its remaining term without economic benefit are adopted. Other provisions of ASC 420 are rejected in SSAP No. 24.

b. *ASU 2014-05, Service Concession Arrangements* (Adopted with modification to only exclude service concession arrangements from the lease definition.)

c. *ASU 2017-10, Determining the Customer of the Operation Services* (Adopted with modification to clarify the customer in the previously adopted service concession arrangement definition.)

d. *ASU 2018-01, Land Easement Practical Expedient for Transition to Topic 842* (Rejected in its entirety.)

e. *ASU 2018-10, Codification Improvements to Topic 842, Leases* (Rejected in its entirety.)

f. *ASU 2018-11, Leases (Topic 842), Targeted Improvements* (Rejected in its entirety.)

g. *ASU 2018-20, Leases (Topic 842), Narrow-Scope Improvements for Lessors* (Rejected for statutory accounting, except for paragraph 842-10-15-(40-42) as it was modified by ASU 2018-20.)

h. *ASU 2019-01, Leases (Topic 842), Codification Improvements* (Rejected in its entirety.)

Effective Date and Transition

53. This statement is effective for years beginning January 1, 2001. The substantive revisions documented in Issue Paper 16X—Leases are effective for all new leases entered into, and for existing leases reassessed due to a change in terms and conditions under paragraph 11, on or after January 1, 2020. Earlier adoption is permitted. The guidance in paragraph 34 regarding commercial airplanes was originally contained within INT 00-02: Accounting for Leveraged Leases Involving Commercial Airplanes Under SSAP No. 22—Leases and was effective March 13, 2000. The guidance in paragraph 5 was originally contained within *INT 04-20: EITF 01-8: Determining Whether an Arrangement Contains a Lease* and was effective March 13, 2005. Guidance in paragraph 27 related to maintenance costs incurred by lessee was previously included within *INT 09-05: EITF 08-3: Accounting by Lessees for Maintenance Deposits* and was effective for periods beginning September 21, 2009. The guidance in paragraphs 17 and 18 was originally contained within *INT 00-27: EITF 98-9: Accounting for Contingent Rent* and was effective September 11, 2000.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 22—Leases*
- *Issue Paper No. 16X—Leases*

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Exposure Draft
Issue Paper 16X

Hearing Date: 2019 Summer National Meeting or Interim Conference Call

Location: 2019 Summer National Meeting or Interim Conference Call

Deadline for Written Notice of Intent to Speak:
June 12, 2019

Deadline for Receipt of Written Comments:
June 12, 2019

Notice of Public Hearing and Request for Written Comments

Basis for hearings. The Statutory Accounting Principles Working Group (SAPWG) will hold a public hearing to obtain information from and views of interested individuals and organizations about the standards proposed in this Exposure Draft. The SAPWG will conduct the hearing in accordance with the National Association of Insurance Commissioners (NAIC) policy statement on open meetings. An individual or organization desiring to speak must notify the NAIC in writing by **June 12, 2019.** Speakers will be notified as to the date, location, and other details of the hearings.

Oral presentation requirements. The intended speaker must submit a position paper, a detailed outline of a proposed presentation or comment letter addressing the standards proposed in the Exposure Draft by **June 12, 2019**. Individuals or organizations whose submission is not received by that date will only be granted permission to present at the discretion of the SAPWG chair. All submissions should be addressed to the NAIC staff at the address listed below.

Format of the hearings. Speakers will be allotted up to 10 minutes for their presentations to be followed by a period for answering questions from the SAPWG. Speakers should use their allotted time to provide information in addition to their already submitted written comments as those comments will have been read and analyzed by the SAPWG. Those submissions will be included in the public record and will be available at the hearings for inspection.

Copies. Exposure Drafts can be obtained on the Internet at the NAIC Home Page (http://www.naic.org). The documents can be downloaded using Microsoft Word.

Written comments. Participation at a public hearing is not a prerequisite to submitting written comments on this Exposure Draft. Written comments are given the same consideration as public hearing testimony.

The Statutory Accounting Principles Statement of Concepts was adopted by the Accounting Practices & Procedures (EX4) Task Force on September 20, 1994, in order to provide a foundation for the evaluation of alternative accounting treatments. All issues considered by the SAPWG will be evaluated in conjunction with the objectives of statutory reporting and the concepts set forth in the Statutory Accounting Principles Statement of Concepts. Whenever possible, establish a relationship between your comments and the principles defining statutory accounting.

The exposure period is not meant to measure support for, or opposition to, a particular accounting treatment but rather to accumulate an analysis of the issues from other perspectives and persuasive comments supporting them. Therefore, form letters and objections without valid support for their conclusions are not helpful in the deliberations of the working group. Comments should not simply register your agreement or disagreement without a detailed explanation, a description of the impact of the proposed guidelines, or possible alternative recommendations for accomplishing the regulatory objective.

Any individual or organization may send written comments addressed to the Working Group to the attention of Julie Gann at jgann@naic.org, Robin Marcotte at rmarcotte@naic.org, Fatima Sediqzad at fsediqzad@naic.org and Jake Stultz at jstultz@naic.org no later than **June 12, 2019**. Electronic submission is preferred. **Jake Stultz** is the NAIC Staff that is the project lead for this topic.

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Statistical Issue Paper No. 16X

Leases

STATUS
Exposure Draft – April 2019

Original SSAP No. 22 and Current Authoritative Guidance: SSAP No. 22R

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. The purpose of this issue paper is to document for the historical record the substantive changes to statutory accounting guidance adopted in ________, 2019, resulting in a substantively revised *SSAP No. 22—Leases*. This SSAP will be known as *SSAP No. 22—Leases – Revised* (SSAP No. 22R).

2. This issue paper illustrates tracked changes adopted in SSAP No. 22R, with an effective date of __________, 2020. The substantive revisions adopted within SSAP No. 22R include revised accounting guidance on leases, including leveraged leases and sale-leaseback transactions. For historical record, the adopted revisions to SSAP No. 22R are reflected as tracked changes in Exhibit A. The substantive revisions to SSAP No. 22 were the result of the FASB issuance of *ASU 2016-02—Leases* (Topic 842), which created ASC Topic 842—Leases.

DISCUSSION

3. This issue paper provides a historical reference that includes tracked changes adopted within SSAP No. 22R. The substantive changes were a result of the Financial Accounting Standards Board (FASB) adopting *ASU 2016-02—Leases* (Topic 842), which created ASC Topic 842—Leases.

Actions of the Statutory Accounting Principles (E) Working Group

4. In February 2016, FASB issued ASU 2016-02—Leases. On April 3, 2016, the Working Group moved agenda item *2016-02: Leases* and exposed three options on how to proceed with statutory accounting lease treatment, which included the following:

a. Maintain existing statutory accounting guidance in SSAP No. 22 for the treatment of operating and financing leases with potential new disclosures to capture information on the lease asset and lease liability that would be required under GAAP,

b. Adopt ASU 2016-02, with modification, to recognize the lease asset and lease liability, but requiring nonadmittance of the lease asset as an asset not available for policyholder obligations pursuant to SSAP No. 4, or

c. Adopt ASU 2016-02, with modification, to recognize lease assets and lease liabilities for a lessee's operating and financing leases. Although there would be some modifications anticipated to GAAP, this option would allow the lease asset to be an admitted asset under SAP.

5. On August 26, 2016, the Working Group elected to retain the current statutory accounting treatment for operating and financing leases by lessees, as prescribed in SSAP No. 22, where the lessee treats all leases as operating leases. The Working Group directed NAIC staff to further evaluate ASU 2016-02 and prepare a draft issue paper to document the Working Group's actions and discussions on ASU 2016-02.

6. On August 6, 2017, the Working Group exposed substantive revisions to SSAP No. 22 to incorporate revised U.S. GAAP guidance from ASU 2016-02, modified to retain the operating lease concept for statutory accounting. The revisions to SSAP No. 22R are significant but do not result in significant changes to statutory accounting:

a. Revisions reflect GAAP guidance from ASU 2016-02, with modifications to continue following the "operating lease" approach for statutory accounting for lessees. (From ASU 2016-02, this modification rejects ASC 842-10-25, as presented in ASU 2016-02, for guidance on treatment of leases as financing leases.) The intent is that all guidance in SSAP No. 22R will agree to that of ASC Topic 842 (as presented in ASU 2016-02), with the exception of the treatment of operating leases for statutory accounting. Statutory accounting treatment for lessors remains largely unchanged.

b. Revisions clarify the definition of a lease as a contract that involves property, plant or equipment (land and/or depreciable assets), and incorporates consistent language to eliminate questions on whether come sections was intended for certain types of leases (e.g., property leases) whereas other sections of the SSAP was intended for different types of leases (e.g., equipment leases). These revisions explicitly clarify that non-depreciable assets, such as investments and premium receivables, do not meet the definition of property, plant or equipment and cannot be subject of a lease, or a sales-leaseback transaction.

c. Revisions clarify the language and flow of the document while maintaining the treatment of leases from a statutory accounting standpoint. SSAP No. 22 had several changes since original implementation, and because of this, a user would have to look in multiple areas of the SSAP for guidance. The updated version groups information together more clearly.

d. Guidance for sale-leaseback transactions brings in language from Subtopic 842-40 (as presented in ASU 2016-02). This guidance contains language updates and does not change statutory accounting for sale-leaseback transactions. Specific guidance for statutory accounting from the prior version of SSAP No. 22 was retained in the current version.

e. Guidance for leveraged leases brings in language from Subtopic 842-50 (as presented in ASU 2016-02), however leveraged lease treatment to remains the same as the prior SSAP.

7. On August 4, 2018, the Working Group exposed substantive revisions to SSAP No. 22 to incorporate revised U.S. GAAP guidance from ASU 2016-02, modified to retain the operating lease concept for statutory accounting. Revisions in this draft primarily focused on the clarity of the SSAP. On November 10, 2018, the Working Group instructed NAIC staff to continue to work with Interested Parties to complete the project.

8. On April 6, 2019, the Working Group exposed substantive revisions to SSAP No. 22 to incorporate revised U.S. GAAP guidance from ASU 2016-02, modified to retain the operating lease

concept for statutory accounting. NAIC staff worked closely with Interested Parties on the draft revisions, and as a result Interest Parties stated that they support the April 6 exposed draft of SSAP No. 22R in their comment letter.

a. Kaiser Permanente provided the following comments on the April 6 exposed draft:

We would like to propose amendments to Paragraph 16 of SSAP 22R to provide further clarity, make this practical expedient operational, and minimize GAAP to STAT differences. We believe the NAIC's primary concern is around stakeholders being able to take advantage of optionality around the treatment of nonlease components when material and not closely related to the lease. We believe that our proposal below does not compromise this risk.

First, we think the guidance can be enhanced to further emphasize the "closely related" concept by providing examples in parenthesis as shown in our proposed revisions below. This will help to provide clarity that this expedient is only intended for these items and stakeholders do not have the option of using it for other types of components not related to the lease. We then propose to change "insignificant part of lease agreement" to "not the predominant components" because often times common area maintenance (a closely related lease element) for instance can be more than insignificant (i.e. more than 10% of overall contract value) but is still not a predominant part of the lease and can be accounted for as a single lease under GAAP. We believe such situations should still be able to apply the practical expedient to keep GAAP & STAT aligned. By limiting the expedient to only nonlease components that are closely related to elements of the lease and where they are not predominant, this still prevents stakeholders from being able to arbitrarily combine nonlease related elements with lease elements and minimizes optionality.

Below are three proposed options for treatment of nonlease components in paragraph 16. Each of these are meant to accomplish the same objectives but just worded/presented in a different way. Our thought process is further described below.

Proposed Option #1

16. As a practical expedient, when nonlease components are closely related to the elements of the lease (e.g. common area maintenance, utilities, labor) and are not the predominant components in a ~~an insignificant part of a~~ lease agreement, a lessee and a lessor may, as an accounting policy election by class of underlying asset, choose not to separate nonlease components from lease components and instead to account for each separate lease component and the nonlease components associated with that lease component as a single lease component. ~~The nonlease components must be closely related to the elements of the lease to be recognized as a single lease component.~~ For lease agreements between related parties, lease and nonlease components must be separated.

Proposed Option #2

16. As a practical expedient, when nonlease components are not the predominant components in ~~an insignificant part of~~ a lease agreement, a lessee and a lessor may, as an accounting policy election by class of underlying asset, choose not to separate nonlease components from lease components and instead to account for each separate lease component and the nonlease components associated with that lease component as a single lease component. The nonlease components must be closely related to the elements of the lease to be recognized as a single lease component (e.g. common area maintenance, utilities, labor). For lease agreements between related parties, lease and nonlease components must be separated.

Proposed Option #3

16. As a practical expedient, for lease contracts between unrelated parties~~when nonlease components are an insignificant part of a lease agreement~~, a lessee and a lessor may, as an accounting policy election by class of underlying asset, choose not to separate nonlease components from lease components and instead to account for each separate lease component and the nonlease components associated with that lease component as a single lease component if both of the following are met:

a) ~~.~~ The nonlease component(s) ~~must be~~are closely related to the lease component (e.g. common area maintenance, utilities, labor); and,

~~a)~~b)The nonlease component(s) are not the predominant component(s) in the contract. ~~elements of the lease to be recognized as a single lease component. For lease agreements between related parties, lease and nonlease components must be separated~~

Additional Thoughts

The change we are proposing is use of the term "predominant" instead of "insignificant," which provides consistency with the term used in ASC 842 for GAAP. We feel that "insignificant" would be too strong and stakeholders would have little benefit at the end of the day from the practical expedient even being in place. Here are the considerations for Predominant vs. Insignificant:

1. Predominant

   a. The guidance within ASC 842 (lessor practical expedient) uses "predominant" so language is consistent with US GAAP
   b. There is interpretive guidance for ASC 842 that allows entities to perform more of a qualitative assessment rather than a detailed quantitative analysis to support whether nonlease or lease components are predominant within a contract, making the expedient more operational.
   c. Would allow more leases to qualify for the practical expedient, and therefore, reduce/mitigate STAT to GAAP differences.
   d. If concern is that entities will design contracts to include non-lease components that are "not" related to lease components, this risk is still addressed by the closely related criterion being in place. The combination of both criteria would appear to still address concerns about undesired nonlease components being accounted for under the leasing guidance.

2. Insignificant

   a. Including such a strong limitation on the significance of non-lease components, can make this practical expedient non-operational for many entities. It can put significant operational burdens on preparers and systems to comply with the guidance. Additionally, it can result in STAT to GAAP differences.
   b. From a contract perspective under US GAAP, insignificant is typically viewed as ~10% or less. Within Real Estate contracts, common items such as utilities/common area maintenance would likely exceed 10% of total contract value. It is likely the expedient would not apply to these contracts if "insignificant" is used.

b. NAIC staff considered the comments provided by Kaiser Permanente. Fundamentally, the updated SSAP No. 22R keeps the existing operating lease treatment for all leases. The guidance included in paragraph 16 will only have income statement impact (which line the nonlease expense/revenue would have been reported) and will not affect the balance sheet as it would with the financing lease treatment that is part of U.S. GAAP. The intent of paragraph 16 is to allow easier reporting of leases for companies that have leases with nonlease components included in the contract, which will allow a small amount of maintenance or other expense to be included with the leasing or rent expense, which should save time and effort for the accounting departments for the reporting entities. The most common examples for insurance companies will be common area maintenance for those that have rented facilities and offices or for maintenance contracts that are commonly used for copiers and other office equipment.

c. Topic 842-10-15-37 does not use a qualifier like "predominant" or "insignificant" for determining when nonlease components can be allowed to be included with lease components for lessees. NAIC staff agree that the interpretation of the use of "insignificant" would be around 10% to possibly as high as 20%. We believe that any higher, that the nonlease amounts should be broken out from the lease component. NAIC staff believe that this is reasonable and provides better financial reporting of lease and rent expense.

d. The language using the term "predominant" comes from lessor guidance in Topic 842-10-15-42A and 842-10-15-42B, which is the practical expedient for revenue recognition for lessors. Revenue recognition for lessors is covered in paragraphs 28 through 30 of SSAP No. 22R. The guidance in paragraphs 28 through 30 is clear on revenue recognition for lessors for statutory accounting, and while this language is not the same as that of U.S. GAAP, it is consistent with U.S. GAAP in the accounting outcomes when operating lease treatment is allowed. NAIC staff do not believe that the use of the word "predominant" is appropriate for this guidance and could allow significant nonlease costs to be incorrectly categorized on the income statement.

e. The proposed revisions would result with a deviation from U.S. GAAP, potentially resulting with more agreements being classified as leases under SAP. With the intent to converge with US GAAP on whether an agreement is a lease, the proposed revisions are not recommended for adoption. NAIC staff highlights that the comments were previously received and considered with the same conclusion. Also, the comments were previously discussed with other interested parties' and they were not supported.

Effective Date

9. The substantive revisions to SSAP No. 22R are contained in Exhibit A. Users of the *Accounting Practices and Procedures Manual* should note that issue papers are not represented in the Statutory Hierarchy (see Section IV of the Preamble) and therefore the conclusions reached in this issue paper should not be applied until the corresponding SSAP No. 22R has been adopted by the Plenary of the NAIC. SSAP No. 22R contains an effective date of years ending December 31, 2019 with early adoption permitted.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

- *SSAP No. 22—Leases*

Generally Accepted Accounting Principles

- *FASB Accounting Standards Update No. 2016-02*

10. FASB issued ASU 2016-02 to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. They believe that to meet that objective, they needed to amend the FASB Accounting Standards Codification and creating Topic 842, Leases. This update, along with IFRS 16, Leases, is the results of the FASB's and the International Accounting Standards Board's (IASB's) efforts to meet that objective and improve financial reporting.

11. FASB noted that many entities utilize leasing as a means of gaining access to assets, of obtaining financing, and/or of reducing an entity's exposure to the full risks of asset ownership. The prevalence of leasing, therefore, means that it is important that users of financial statements have a complete and understandable picture of an entity's leasing activities. FASB noted that previous leases accounting was criticized for failing to meet the needs of users of financial statements because it did not always provide a faithful representation of leasing transactions. In particular, it did not require lessees to recognize assets and liabilities arising from operating leases on the balance sheet. As a result, there had been long-standing requests from many users of financial statements and others to change the accounting requirements so that lessees would be required to recognize the rights and obligations resulting from leases as assets and liabilities.

12. FASB noted that the criticisms associated with previous lease guidance related to the accounting for operating leases in the financial statements of lessees and addressing those concerns with lessee accounting was the focus of the Board. FASB decided not to fundamentally change lessor accounting with the amendments in ASU 2016-02. They did note that some changes had been made to lessor accounting to conform and align that guidance with the lessee guidance and other areas within generally accepted accounting principles (GAAP), such as Topic 606, Revenue from Contracts with Customers.

EXHIBIT A - REVISIONS TO SSAP NO. 22—LEASES

Leases

SCOPE OF STATEMENT

1. The purpose of this statement is to establish statutory accounting principles for leases ~~by lessors and lessees~~. It addresses:

   a. Accounting and reporting by lessees;

   b. Accounting and reporting by lessors;

   c. Sale-leaseback transactions;

   d. Leveraged leases for lessors;

   e. Related party leases; and

   f. Disclosures.

SUMMARY CONCLUSION

2. A lease is defined as a contract or part of a contract ~~an agreement~~ conveying the right to control the use of property, plant~~,~~ or equipment (land and/or depreciable assets) ~~usually~~ for a stated period of time in exchange for consideration. This definition does not include ~~agreements that are~~ contracts for services that do not transfer the right to use property, plant~~,~~ or equipment from one contracting party to the other (i.e., employee lease contracts) or service concession arrangements[1]. ~~On the other hand, a~~Agreements that do transfer the right to control the use of property, plant~~,~~ or equipment meet the definition of a lease even though substantial services by the contractor (lessor) may be called for in connection with the operation or maintenance of the assets. *(Staff Note – This paragraph is in the current SSAP No. 22.)*

~~3. Integral equipment subject to a lease shall be evaluated as real estate per *SSAP No. 40R—Real Estate Investments*. Integral equipment or property improvements for which no statutory title registration system exists, the criterion in this SSAP (that the lease transfers ownership of the property to the lessee by the end of the lease term) is met in lease agreements that provide that, upon the lessee's performance in accordance with the terms of the lease, the lessor shall execute and deliver to the lessee such documents (including, if applicable, a bill of sale for the equipment) as may be required to release the equipment from the lease and to transfer ownership thereto to the lessee. This criterion is also met in situations in which the lease agreement requires the payment by the lessee of a nominal amount (for example, the minimum fee required by statutory regulation to transfer ownership) in connection with the transfer of ownership. Notwithstanding the foregoing guidance, a provision in a lease agreement that ownership of~~

[1] A service concession arrangement is an arrangement between a public sector entity grantor and an operating entity under which the operating entity operates the grantor's infrastructure (for example, airports, roads, bridges, tunnels, prisons and hospitals) for a specified period of time. A public-sector entity includes a governmental body or an entity to which the responsibility to provide public service has been delegated. In a service concession arrangement, both of the following conditions exist:

   a. The grantor controls or has the ability to modify or approve the services that the operating entity must provide with the infrastructure, to whom it must provide them~~,~~ and at what price.

   b. The grantor controls, through ownership, beneficial entitlement, or otherwise, any residual interest in the infrastructure at the end of the term of the arrangement.

~~the leased property is not transferred to the lessee if the lessee elects not to pay the specified fee (whether nominal or otherwise) to complete the transfer of ownership is a purchase option. Such a provision would not satisfy this SSAP.~~

~~5.~~3. Property, plant or equipment, (including computer software) as used in this SSAP, includes only land and/or depreciable assets. Therefore, inventory (including equipment parts inventory), other intangible assets, assets under construction, leases to explore for or use minerals, natural gas and similar nonregenerative resources, and leases of biological assets, such as timber cannot be the subject of a lease for accounting purposes. Additionally, non-depreciable assets, including investments and premium receivables~~ and assets such as premium receivable~~ do not meet the definition of property, plant or equipment and cannot be the subject of a lease for accounting purposes.~~Therefore, inventory (including equipment parts inventory) and minerals, precious metals or other natural resources cannot be the subject of a lease for accounting purposes because those assets are not depreciable. Additionally, intangibles (for example, motion picture film licensing rights or workforce) and rights to explore for minerals, precious metals or other natural resources are not depreciable assets (they are amortized or depleted) so they may not be the subject of a lease.~~ *(Staff Note – This language reflects guidance from 842-10-15-1 and provides improved guidance on what is included in the definition of "Property, Plant and Equipment.")*

Determining Whether an Arrangement Contains a Lease

4. Determining whether an arrangement contains a lease that is within the scope of this SSAP should be based on the substance of the arrangement. At inception of a contract, an entity shall determine whether that contract is or contains a lease. A contract is or contains a lease if the contract conveys the right to control the use of identified property, plant or equipment (an identified asset) for a period of time in exchange for consideration. A period of time may be described in terms of the amount of use of an identified asset (for example, the number of production units that an item of equipment will be used to produce). ~~Separate contracts with the same entity or related parties that are entered into at or near the same time are presumed to have been negotiated as a package and should, therefore, be evaluated as a single arrangement in considering whether there are one or more units of accounting. That presumption may be overcome if there is sufficient evidence to the contrary.~~ *(Staff Note – This language reflects guidance from ASC 842-10-15-(1-3) and provides improved guidance on determining a lease and the consideration of separate contracts.)*

Identifying an Asset

~~6.7.~~5. An asset can be identified by being explicitly or implicitly specified within the contract. Although specific property, plant or equipment may be explicitly identified in an arrangement, it is not the subject of a lease if fulfillment of the arrangement is not dependent on the use of the specified property, plant or equipment. A warranty obligation that permits or requires the substitution of the same or similar property, plant or equipment when the specified property, plant~~,~~ or equipment is not operating properly does not preclude lease treatment. In addition, a contractual provision (contingent or otherwise) permitting or requiring the owner/seller to substitute other property, plant or equipment for any reason on or after a specified date does not preclude lease treatment prior to the date of substitution. Property, plant or equipment has been implicitly specified if, for example, the seller owns or leases only one asset with which to fulfill the obligation and it is not economically feasible or practicable for the owner/seller to perform its obligation through the use of alternative property, plant or equipment. Property, plant or equipment can also be implicitly specified at the time the asset is made available for use by the lessee. *(Staff Note – Includes information from the original SSAP 22 paragraphs 5-7.)*

6. Even if an asset is specified, ~~a lessee does not have the right to use~~ the asset does not qualify as an identified asset if the lessor has the substantive right to substitute the asset throughout the period of use. A

lessor's right to substitute an asset is substantive only if ~~both~~ (1) the lessor has the practical ability to substitute alternative assets throughout the period of use (for example, the lessee cannot prevent the lessor from substituting an asset, and alternative assets are readily available to the lessor or could be sourced by the lessor within a reasonable period of time), and (2) the lessor would benefit economically from the exercise of its right to substitute the asset (that is, the economic benefits associated with substituting the asset is expected to exceed the costs associated with substituting the asset).

7. An entity's evaluation of whether a lessor's substitution right is substantive is based on facts and circumstances at inception of the contract and shall exclude consideration of future events that, at inception, are not considered likely to occur. Examples of future events that, at inception of the contract, would not be considered likely to occur and, thus, should be excluded from the evaluation include, but are not limited to, the following:

a. An agreement by a future lessee to pay an above-market rate for use of the asset;

b. The introduction of new technology that is not substantially developed at inception of the contract;

c. A substantial difference between the lessee's use of the asset, or the performance of the asset and the use or performance considered likely at inception of the contract;

d. A substantial difference between the market price of the asset during the period of use and the market price considered likely at inception of the contract.

8. If the asset is located at the lessee's premises or elsewhere, the costs associated with substitution are generally higher than when located at the lessor's premises and, therefore, are more likely to exceed the benefits associated with substituting the asset. If the lessor has a right or an obligation to substitute the asset only on or after either a particular date or the occurrence of a specified event, the lessor does not have the practical ability to substitute alternative assets throughout the period of use. The lessor's right or obligation to substitute an asset for repairs or maintenance, if the asset is not operating properly, or if a technical upgrade becomes available, does not preclude the lessee from having the right to use an identified asset. If the lessee cannot readily determine whether the lessor has a substantive substitution right, the lessee shall presume that any substitution right is not substantive.

9. A capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building or a segment of a pipeline that connects a single lessee to the larger pipeline). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fiber optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the lessee with the right to obtain substantially all of the economic benefits from use of the asset.

Right to Control the Use of the Identified Asset

10. To determine whether a contract conveys the right to control the use of an identified asset for a period of time, an entity shall assess whether, throughout the period of use, the lessee has both: *(Staff Note – This language reflects guidance from 842-10-15-(15-22) and provides improved guidance on determining if right of control has been transferred.)*

a. The right to obtain substantially all of the economic benefits from use of the identified asset.

i. To control the use of an identified asset, a lessee is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). A lessee can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding, or subleasing the asset. The economic benefits from use of an asset include its primary output and byproducts (including potential cash flows derived from these items) and other economic benefits from using the asset that could be realized from a commercial transaction with a third party.

ii. When assessing the right to obtain substantially all of the economic benefits from use of an asset, an entity shall consider the economic benefits that result from use of the asset within the defined scope of a lessee's right to use the asset in the contract.

iii. If a contract requires a lessee to pay the lessor or another party a portion of the cash flows derived from use of an asset as consideration, those cash flows paid as consideration shall be considered to be part of the economic benefits that the lessee obtains from use of the asset. For example, if a lessee is required to pay the lessor a percentage of sales from use of retail space as consideration for that use, that requirement does not prevent the lessee from having the right to obtain substantially all of the economic benefits from use of the retail space. That is because the cash flows arising from those sales are considered to be economic benefits that the lessee obtains from use of the retail space, a portion of which it then pays to the lessor as consideration for the right to use that space.

b. The right to direct the use of the identified asset.

i. A lessee has the right to direct the use of an identified asset throughout the period of use in either of the following situations. Additionally, if the lessee in the contract is a joint operation or a joint arrangement, an entity shall consider whether the joint operation or joint arrangement has the right to control the use of an identified asset throughout the period of use.

(a) The lessee has the right to direct how and for what purpose the asset is used throughout the period of use. If the lessee has the right to control the use of an identified asset for only a portion of the term of the contract, the contract contains a lease for that portion of the term.

(b) The relevant decisions about how and for what purpose the asset is used are predetermined and at least one of the following conditions exists:

(1) The lessee has the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use without the lessor having the right to change those operating instructions.

(2) The lessee designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use.

ii. The relevant decisions about how and for what purpose an asset is used can be predetermined in a number of ways. For example, the relevant decisions can be predetermined by the design of the asset or by contractual restrictions on the use of the asset.

iii. In assessing whether a lessee has the right to direct the use of an asset, an entity shall consider only rights to make decisions about the use of the asset during the period of use unless the lessee designed the asset (or specific aspects of the asset) in accordance with paragraph 104.b.i(b). Consequently, unless that condition exists, an entity shall not consider decisions that are predetermined before the period of use. For example, if a lessee is able only to specify the output of an asset before the period of use, the lessee does not have the right to direct the use of that asset. The ability to specify the output in a contract before the period of use, without any other decision-making rights relating to the use of the asset, gives a lessee the same rights as any lessee that purchases goods or services.

iv. A contract may include terms and conditions designed to protect the lessor's interest in the asset or other assets, to protect its personnel, or to ensure the lessor's compliance with laws or regulations. These are examples of protective rights. For example, a contract may specify the maximum amount of use of an asset or limit where or when the lessee can use the asset, may require a lessee to follow particular operating practices, or may require a lessee to inform the lessor of changes in how an asset will be used. Protective rights typically define the scope of the lessee's right of use but do not, in isolation, prevent the lessee from having the right to direct the use of an asset.

v. A lessee has the right to direct how and for what purpose an asset is used throughout the period of use if, within the scope of its right of use defined in the contract, it can change how and for what purpose the asset is used throughout that period. In making this assessment, an entity considers the decision-making rights that are most relevant to changing how and for what purpose an asset is used throughout the period of use. Decision-making rights are relevant when they affect the economic benefits to be derived from use. The decision-making rights that are most relevant are likely to be different for different contracts, depending on the nature of the asset and the terms and conditions of the contract.

11. An entity shall reassess whether a contract is or contains a lease only if the terms and conditions of the contract are changed. *(Staff Note – This language was retained from the prior SSAP and agrees to topic 842.)*

~~8. An arrangement conveys the right to use property, plant or equipment if the arrangement conveys to the purchaser (lessee) the right to control the use of the underlying property, plant or equipment. The right to control the use of the underlying property, plant or equipment is conveyed if any one of the following conditions is met:~~

~~a. The purchaser has the ability or right to operate the property, plant or equipment or direct others to operate the property, plant or equipment in a manner it determines while obtaining or controlling more than a minor amount of the output or other utility of the property, plant or equipment,~~

~~b. The purchaser has the ability or right to control physical access to the underlying property, plant or equipment while obtaining or controlling more than a minor amount of the output or other utility of the property, plant or equipment, or~~

~~c. Facts and circumstances indicate that it is remote that one or more parties other than the purchaser will take more than a minor amount of the output or other utility that will be produced or generated by the property, plant or equipment during the term of the arrangement, and the price that the purchaser (lessee) will pay for the output is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output.~~

~~10. When an arrangement (or a portion of an arrangement) ceases to be a lease or becomes a lease due to a modification to the arrangement or other change discussed above, the following guidance shall be applied to account for the revised categorization of the arrangement:~~

~~a. Supply arrangement to operating lease for the Purchaser/Lessee. Any recognized asset (such as a prepaid asset or a derivative) for the purchase contract is considered part of the minimum lease payments and is initially recognized as prepaid rent. Any recognized liability (such as a payable or a derivative) for the purchase contract is considered a reduction of the minimum lease payments and is initially recognized as a lease payable.~~

~~b. Supply arrangement to operating lease for the Seller/Lessor. Any recognized liability (such as a deferred revenue or derivative) for the sales contract is considered part of the minimum lease payments and is initially recognized as deferred rent. Any recognized asset (such as a receivable or derivative) for the sales contract is considered a reduction of the minimum lease payments and is initially recognized as a lease receivable provided the asset is recoverable from future receipts.~~

~~c. Operating lease to supply arrangement for the Purchaser/Lessee. Any recognized prepaid rent or rent payable is initially recognized as an asset or liability associated with the purchase contract.~~

~~d. Operating lease to supply arrangement for the Seller/Lessor. Any recognized deferred rent or rent receivable is initially recognized as a liability or an asset associated with the sales contract, subject to a recoverability test.~~

~~11. If an arrangement contains a lease and related executory costs, as well as other non-lease elements, the classification, recognition, measurement and disclosure requirements of this SSAP shall be applied by both the purchaser and the supplier to the lease element of the arrangement. Other elements of the arrangement not within the scope of this SSAP shall be accounted for in accordance with other applicable generally accepted accounting principles. For purposes of applying this SSAP, payments and other consideration called for by the arrangement shall be separated at the inception of the arrangement or upon a reassessment of the arrangement into (a) those for the lease, including the related executory costs and profits thereon, and (b) those for other services on a relative fair value basis.~~

Separating Components of a Contract

12. An entity shall identify the separate lease components within the contract. An entity shall consider the right to use an underlying asset to be a separate lease component (that is, separate from any other lease components of the contract) if both of the following criteria are met: *(Staff Note – Paragraphs*

12-16 are guidance from 842-10-15-(28-31) and provides improved guidance on how to separate the components of the contract.)

a. The lessee can benefit from the right of use either on its own or together with other resources that are readily available to the lessee. Readily available resources are goods or services that are sold or leased separately (by the lessor or other lessors) or resources that the lessee already has obtained (from the lessor or from other transactions or events).

b. The right of use is neither highly dependent on nor highly interrelated with the other right(s) to use underlying assets in the contract. A lessee's right to use an underlying asset is highly dependent on or highly interrelated with another right to use an underlying asset if each right of use significantly affects the other.

13. The consideration in the contract shall be allocated to each separate lease component and nonlease component of the contract. Components of a contract include only those items or activities that transfer a good or service to the lessee.

14. An entity shall account for each separate lease component separately from the nonlease components of the contract. Nonlease components are not within the scope of this statement and shall be accounted for in accordance with the statutory accounting guidance applicable to the nonlease component.

15. An entity shall combine two or more contracts, at least one of which is or contains a lease, entered into at or near the same time with the same counterparty (or related parties) and consider the contracts as a single transaction if any of the following criteria are met:

a. The contracts are negotiated as a package with the same commercial objective(s).

b. The amount of consideration to be paid in one contract depends on the price or performance of the other contract.

c. The rights to use underlying assets conveyed in the contracts are a single lease component.

16. As a practical expedient, when nonlease components are an insignificant part of a lease agreement, a lessee and a lessor may, as an accounting policy election by class of underlying asset, choose not to separate nonlease components from lease components and instead to account for each separate lease component and the nonlease components associated with that lease component as a single lease component. The nonlease components must be closely related to the elements of the lease to be recognized as a single lease component. For lease agreements between related parties, lease and nonlease components must be separated.~~An entity shall classify each separate lease component at the commencement date. An entity shall not reassess the lease classification after the commencement date unless the contract is modified and the modification is not accounted for as a separate contract.~~ *(Staff Note – This guidance in this paragraph is from ASC 842-10-15-37 and 42A and was suggested by IPs, with modification to clarify when the lessor and lessee are related parties or when the nonlease components are significant pieces of the contract.)*

Modification

17. An entity shall account for a modification to a contract as a separate contract (that is, separate from the original contract) when both of the following conditions are present: *(Staff Note – Guidance for paragraphs 17-18 are from 842-10-25-(8-10) and provide updated guidance for lease modification.)*

a. The modification grants the lessee an additional right of use not included in the original lease (for example, the right to use an additional asset).

b. The lease payments increase commensurate with the standalone price for the additional right of use, adjusted for the circumstances of the particular contract. For example, the standalone price for the lease of one floor of an office building in which the lessee already leases other floors in that building may be different from the standalone price of a similar floor in a different office building, because it was not necessary for a lessor to incur costs that it would have incurred for a new lessee.

18. An entity shall account for initial direct costs, lease incentives and any other payments made to or by the entity in connection with a modification to a lease in the same manner as those items would be accounted for in connection with a new lease.

Accounting and Reporting by Lessees

19. All leases shall be considered operating leases, which means that rental expense is recognized over the lease term, without recognition of a right-to-use asset or lease liability. Rent on operating leases, reflecting all lease considerations in paragraph 20, shall be charged to expense on a straight-line basis over the lease term. Statutory accounting rejects the recognition of a right-to-use lease asset and the associated lease liabilities. *(Staff Note – Paragraph updated with suggestions from IP comments.)*

20. The consideration in the contract for a lessee includes all of the following payments that will be made during the lease term:

a. Any fixed payments (for example, monthly service charges) or in substance fixed payments, less any incentives paid or payable to the lessee.

b. Any other variable payments that depend on an index or a rate, initially measured using the index or rate at the commencement date.

~~12. All leases shall be considered operating leases. Rent on an operating lease shall be charged to expense over the lease term as it becomes payable, except as provided in paragraphs 13 and 14.~~ *(Staff Note – This language was incorporated into the new SSAP.)*

~~13. As discussed in *FASB Technical Bulletin 85-3, Accounting for Operating Leases with Scheduled Rent Increases*, the effects of scheduled rent increases normally shall be recognized on a straight-line basis over the lease term.~~*(Staff Note – Straight line information is included in the new version and the reference to the FASB Technical Bulletin has been superseded.)*

~~14. Lease agreements may also include incentives for the lessee to sign the lease, such as an up-front cash payment to the lessee, payment of costs for the lessee (such as moving expenses), or the assumption by the lessor of the lessee's preexisting lease. As discussed in *FASB Technical Bulletin 88-1, Issues Relating to Accounting for Leases: Time Pattern of the Physical Use of the Property in an Operating Lease; Lease Incentives in an Operating Lease; Applicability of Leveraged Lease Accounting to Existing Assets of the Lessor; Money-Over-Money Lease Transactions; Wrap Lease Transactions*, incentives paid~~

~~to or payments made on behalf of the lessee shall be considered reductions of minimum lease payments (i.e., the payments that the lessee is obligated to make or can be required to make in connection with the leased properties.) These incentives shall be recognized over the lease term on a straight-line basis unless the use of another systematic and rational allocation basis is more representative of the time pattern in which the leased property is physically employed. The lessee's immediate recognition of expenses or losses (e.g., moving costs, losses on subleases, write-offs of leasehold improvements) shall not be changed by this guidance.~~

~~17.~~21. A lessee should recognize contingent rental expense (in annual periods as well as in interim periods) prior to the achievement of the specified target that triggers the contingent rental expense, provided that achievement of that target is considered probable. Previously recorded rental expense should be reversed into income at such time that it is probable that the specified target will not be met. *(Staff Note – Paragraphs 21-23 are from the prior SSAP as it agrees to GAAP in 842-10-55-26.)*

~~15.~~22. For the early termination or non-use of leased property, plant or equipment benefits, the lessee shall recognize liabilities, initially measured at fair value. Liabilities for costs to terminate a contract before the end of its term shall be recognized when the entity terminates the contract in accordance with the contract terms (i.e., gives written notice of termination or negotiated termination with the lessor).

23. Liabilities for costs that will continue to be incurred under a contract for its remaining term without economic benefit shall be recognized as the cease-date (the date the entity ceases using the right conveyed by the contract – i.e., the right to use a leased property). The fair value of the liability at the cease-use date shall be determined based on the remaining lease rentals, adjusted for the effects of any prepaid or deferred items recognized under the lease, and reduced by estimated sublease rentals that could be reasonably obtained for the property, even if the entity does not intend to enter into a sublease. Remaining lease rentals shall not be reduced to an amount less than zero.

24. An entity shall determine the lease term as the noncancellable period of the lease, together with all of the following: *(Staff Note – Paragraphs 24-26 are from 842-10-30-(1-3) and provide guidance on lease terms and purchase options. For this version of the SSAP No. 22R, this has been moved to the Accounting and Reporting by Lessees section for better clarity.)*

a. Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option.

b. Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

c. Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the lessor.

25. A lessee shall reassess the lease term or a lessee option to purchase the underlying asset only if and at the point in time that any of the following occurs: *(Staff Note – This guidance is from 842-10-35-1 and clarifies when a lessee must reassess the arrangements of the lease.)*

a. There is a significant event or a significant change in circumstances that is within the control of the lessee that directly affects whether the lessee is reasonably certain to exercise or not to exercise an option to extend or terminate the lease or to purchase the underlying asset.

b. There is an event that is written into the contract that obliges the lessee to exercise (or not to exercise) an option to extend or terminate the lease.

c. The lessee elects to exercise an option even though the entity had previously determined that the lessee was not reasonably certain to do so.

d. The lessee elects not to exercise an option even though the entity had previously determined that the lessee was reasonably certain to do so.

26. At the commencement date, an entity shall include the periods described in paragraph 24~~38~~ in the lease term having considered all relevant factors that create an economic incentive for the lessee (that is, contract-based, asset-based, entity-based and market-based factors). Those factors shall be considered together, and the existence of any one factor does not necessarily signify that a lessee is reasonably certain to exercise or not to exercise an option.

~~16.~~27. Maintenance costs incurred by the lessee for maintenance on the leased item that do not increase the value and enhance the usefulness of the leased asset shall be expensed when incurred pursuant to *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* (SSAP No. 19). Reimbursable deposits shall be reflected as nonadmitted assets. Deposits paid to the lessor, reimbursable when the lessee incurs costs for lease maintenance activities, shall be recorded as nonadmitted assets. When the amount on deposit is less than probable of being returned, the deposit shall be recognized as an additional lease expense. *(Staff Note – Paragraph 27 was retained from the original SSAP and includes information specific to statutory accounting for maintenance costs.)*

Accounting and Reporting by Lessors

~~18.~~28. The definition of property, plant and equipment for lessors is defined in paragraph 3~~6~~ and is the same as for lessees. All leases, except leveraged leases as defined in paragraph ~~34~~42~~65~~, shall be considered operating leases and accounted for by the lessor as follows: *(Staff Note – The language in this paragraph was retained from the prior SSAP and clarifies specific treatment that is applicable to statutory accounting.)*

a. The leased property, plant or equipment shall be included in the same balance sheet category it would be had the property, plant or equipment not been leased. The property, plant or equipment shall be depreciated following the lessor's normal depreciation policies for such assets;

b. Rental income shall be reported as investment income as it becomes receivable according to the provisions of the lease. ~~However, as discussed in paragraphs 13 and 14 of this statement, r~~Rentals may be recognized before they become due, if rentals vary from the straight-line basis. The guidance in *SSAP No. 34—Investment Income Due and Accrued* shall be applied to the receivable balance; and

c. Initial direct costs shall be charged to expense when incurred and shall not be deferred and allocated over the lease term. Initial direct costs are those incremental costs that the lessor has incurred in directly evaluating, negotiating, administering~~,~~ and closing a lease transaction.

~~19. The sale of property, plant or equipment subject to an operating lease, or of property, plant or equipment that is leased by or intended to be leased by the third-party purchaser to another party, shall not be treated as a sale if the seller or any party related to the seller (related party is defined in *SSAP No. 25—*~~

~~*Affiliates and Other Related Parties* (SSAP No. 25)) retains substantial risks of ownership in the leased property, plant or equipment.~~

29. If the terms of a variable payment amount other than those in paragraph 20.b. relate to a lease component, even partially, the lessor shall not recognize those payments before the changes in facts and circumstances on which the variable payment is based occur (for example, when the lessee's sales on which the amount of the variable payment depends occur). When the changes in facts and circumstances on which the variable payment is based occur, the lessor shall allocate those payments to the lease and nonlease components of the contract. *(Staff Note – The guidance in paragraphs 29-30 are from 842-10-15-(40-42) as modified by ASU 2018-20 and provide further guidance for any arrangements that include variable payments.)*

~~20.~~30. Contingent rental income shall be recognized as revenue when the changes in the factor(s) on which the contingent lease payments is (are) based actually occur.

Sale-Leaseback Transactions

~~21.~~31. Sale-leaseback transactions involve the sale of property, plant or equipment by the owner and a lease of the property, plant or equipment back to the seller. ~~Sale-leaseback transactions involve the sale of property by the owner and a lease of the property back to the seller.~~ Sale-leaseback accounting is a method of accounting in which the seller-lessee records the sale and~~,~~ removes all property, plant or equipment and related liabilities from its balance sheet. The definition of property, plant and equipment eligible for sale-leaseback treatment is in paragraph 3~~6~~. As noted in paragraph 3~~6~~, ~~N~~non-depreciable assets, including investments and premium receivables~~ and assets such as premium receivable~~, do not meet the definition of property, plant or equipment, are not allowed to be included in lease transactions, and therefore, are not allowed to be included in sale-leaseback transactions. ~~Non-admitted a~~Assets that do not meet the definition of property, plant and equipment in paragraph 3~~6~~ may only be used in sale-leaseback transactions as permitted practices with regulatory approval. *(Staff Note – This paragraph has been added back for this draft and includes added detail to the description of assets allowed for sale-leaseback treatment in the draft. The extra detail came from discussion with regulators.)*

~~22.~~32. A sale of property, plant or equipment that is accompanied by a leaseback of all or any part of the property, plant or equipment for all or part of its *remaining* economic life shall be accounted for by the buyer-lessor and seller-lessee as a purchase and operating lease and a sale and an operating lease, respectively, unless the sale-leaseback includes sale of nonadmitted assets to a related party. If the transaction involves a sale of nonadmitted assets to a related party, the transaction shall be accounted for by the deposit method detailed in paragraph 37~~48~~.

~~23. When applying sale-leaseback accounting, the sale and gains and losses thereon, shall be recognized in accordance with paragraphs 2 and 3 of *FASB Statement No. 28, Accounting for Sales with Leasebacks* (refer to Exhibit A, paragraphs 46-49), except for sale-leaseback transactions involving real estate that are settled entirely in cash.~~

~~27.~~33. Sale-leaseback accounting shall be used by a seller-lessee only if a sale-leaseback transaction includes all of the following:

a. A normal leaseback~~ as described in paragraph 44~~. A normal leaseback is a lessee-lessor relationship that involves active use of the property by the seller-lessee in consideration for payment of rent, including contingent rentals that are based on future operations of the seller-lessee. The phrase active use of the property by the seller-lessee refers to use of the property during the lease term in the seller-lessee's trade or business, provided that subleasing of the leased property is minor.~~b. Payment terms and provisions that adequately demonstrate the buyer-lessor's initial and continuing investment in the property~~~~, plant and equipment.~~ ~~(refer to Exhibit A, paragraphs 50-58).~~

~~c. The existence of a leaseback (that is, a seller-lessee's right to use the underlying asset for a period of time) does not, in isolation, prevent the buyer-lessor from obtaining control of the asset.~~

~~d.~~b. Admitted assets, if the buyer-lessor is a related party, or either admitted or nonadmitted assets if the buyer-lessor is not a related party. For purposes of this paragraph, related parties include those identified in SSAP No. 25 and entities created for the purpose of buying and leasing nonadmitted assets for the reporting entity and/or its affiliates.

34. Under sale-leaseback accounting, ~~A~~any profit ~~or loss~~ on the sale shall be deferred and amortized in proportion to the related gross rental charged to expense over the lease term, with the exception of a sale of real estate settled entirely in cash.

~~24.~~35. A sale of real estate, settled entirely in cash, that is accompanied by a leaseback of all or any part of the property, plant or equipment for all or part of its remaining economic life shall be accounted for by the buyer-lessor and seller-lessee as a purchase and operating lease and a sale and an operating lease, respectively. The sale and gain ~~or loss~~ shall be recognized directly to special surplus funds and subsequently amortized to unassigned funds (surplus) over the lease term. *(Staff Note – This paragraph was from the original SSAP and includes guidance specific to statutory accounting.)*

Deposit Method and Financing Method

36. The deposit method is used when the transaction involves a sale-leaseback of nonadmitted assets to a related party. To the extent that leases between related parties are, in substance, arms-length transactions the guidance in this statement shall be applied. The determination of whether related party leases qualify as arms-length transactions is addressed in SSAP No. 25. *(Staff Note – This language was retained from the prior version of the SSAP and covers items specific to statutory accounting.)*

37. If a sale-leaseback transaction is accounted for by the deposit method, lease payments decrease and collections on the buyer-lessor's note, if any, increase the seller-lessee's deposit account. The ~~property, plant or equipment~~ sale-leaseback assets identified in paragraph 31 and any related debt continue to be included in the seller-lessee's balance sheet, and the seller-lessee continues to depreciate the ~~property, plant or equipment~~ sale-leaseback assets. A seller-lessee that is accounting for any transaction by the deposit method shall recognize a loss if at any time the net carrying amount of the ~~property, plant or equipment~~ sale-leaseback assets exceeds the sum of the balance in the deposit account, the fair value of the unrecorded note receivable and any debt assumed by the buyer. *(Staff Note – Paragraphs 37 to 41 were retained from the prior version of the SSAP with minor changes to incorporate guidance that was included in footnotes and to remove outdated references. These paragraphs contain information specific to statutory accounting.)*

38. If a sale-leaseback transaction is accounted for by the deposit method and then subsequently qualifies for sales recognition under paragraph 33, the transaction is accounted for using sale-leaseback accounting, and the gain or loss is recognized in accordance with the provisions of paragraph 34 of this statement. In addition, the leaseback is classified and accounted for in accordance with this statement as if the sale had been recognized at the inception of the lease. The change in the related lease accounts that would have been recorded from the inception of the lease had the transaction initially qualified for sale-

leaseback accounting is included in computing the gain or loss recognized in accordance with paragraph 34 of this statement.

39. A sale-leaseback transaction that does not qualify for sale-leaseback accounting nor the deposit method~~, the transaction~~ ~~because of any form of continuing involvement by the seller-lessee other than a normal leaseback (excluding transactions discussed in paragraph 48)~~ shall be accounted for by the financing method. Under this method the seller-lessee shall not derecognize the transferred asset and shall account for any amounts received as a financial liability and the buyer-lessor shall not recognize the transferred asset and shall account for the amounts paid as a receivable. ~~If the transfer of the asset qualifies as a sale then the financing method of accounting will be used.. The provisions or conditions described in paragraphs 54-55 of this section are examples of continuing involvement for the purpose of applying paragraphs 51-52.~~

40. If a sale-leaseback transaction is reported as under the~~a~~ financing method, lease payments, exclusive of an interest portion, decrease and collections on the buyer-lessor's note increase the seller-lessee's liability account with a portion of the lease payments being recognized under the interest method. The seller-lessee reports the sales proceeds as a liability, continues to report the sale-leaseback assets identified in paragraph 31 ~~real estate or the real estateproperty, plant or and equipment~~ as an asset~~,~~ and continues to depreciate the ~~property, plant or equipment~~ sale-leaseback assets.

41. If a sale-leaseback transaction accounted for under the~~as a~~ financing method subsequently qualifies ~~for sales recognition~~ under ~~this statement and SSAP No. 40R~~paragraph 33, the transaction is then recorded using sale-leaseback accounting, and the cumulative change in the related balance sheet accounts is included in the computation of the gain recognized in accordance with the provisions of paragraph 34 of this statement. In addition, the leaseback is classified and accounted for as an operating lease as if the sale had been recognized at the inception of the lease. The change in the related lease accounts from the inception of the lease to the date the sale is recognized is included in the gain recognized in accordance with paragraph 34 of this statement.

~~30. A sale-leaseback transaction that does not qualify for sale-leaseback accounting because of any form of continuing involvement by the seller-lessee other than a normal leaseback shall be accounted for by the deposit method or as a financing (refer to Exhibit A, paragraphs 42 and 45), whichever is appropriate under FAS 66. If the criteria of paragraph 27.d. is not met, the sale-leaseback shall be accounted for by the deposit method under FAS 66. The provisions or conditions described in paragraphs 31-33 of this section are examples of continuing involvement for the purpose of applying paragraphs 26-33.~~

~~31. Paragraphs 25-39 and 41-43 of FAS 66 describe forms of continuing involvement by the seller-lessee with the leased property that result in the seller-lessee not transferring the risks or rewards of ownership to the buyer-lessor. Two examples of continuing involvement specified in those paragraphs that are frequently found in sale-leaseback transactions are provisions or conditions in which:~~

a. ~~The seller-lessee has an obligation or an option[2] to repurchase the property or the buyer-lessor can compel the seller-lessee to repurchase the property.~~

~~[2] A right of first refusal based on a bona fide offer by a third party ordinarily is not an obligation or an option to repurchase. An agreement that allows the seller-lessee to repurchase the asset in the event no third-party offer is made is an option to repurchase.~~

~~b. The seller-lessee guarantees the buyer-lessor's investment or a return on that investment for a limited or extended period of time.~~

~~32. Other provisions or conditions that are guarantees and that do not transfer all of the risks of ownership shall constitute continuing involvement for the purpose of applying paragraphs 51-52 to sale-leaseback transactions and include, but are not limited to, the following:~~

~~a. The seller-lessee is required to pay the buyer-lessor at the end of the lease term for a decline in the fair value of the property, plant or equipment below the estimated residual value on some basis other than excess wear and tear of the property, plant or equipment levied on inspection of the property, plant or equipment at the termination of the lease.~~

~~b. The seller-lessee provides nonrecourse financing to the buyer-lessor for any portion of the sales proceeds or provides recourse financing in which the only recourse is to the leased asset.~~

~~c. The seller-lessee is not relieved of the obligation under any existing debt related to the property, plant or equipment.~~

~~d. The seller-lessee provides collateral on behalf of the buyer-lessor other than the property, plant or equipment directly involved in the sale-leaseback transaction, the seller-lessee or a related party to the seller-lessee guarantees the buyer-lessor's debt, or a related party to the seller-lessee guarantees a return of or on the buyer-lessor's investment.~~

~~e. The seller-lessee's rental payment is contingent on some predetermined or determinable level of future operations of the buyer-lessor. Paragraphs 48-55 distinguish between contingent rentals that are based on the future operations of the seller-lessee and those that are based on some predetermined or determinable level of future operations of the buyer-lessor.~~[3] ~~34. Generally, leveraged leases are those in which the lessor acquires, through the incurrence of debt (such that the lessor is substantially "leveraged" in the transaction), property, plant or equipment with the intentions to lease the asset(s) to the lessee. Leveraged leases are defined as those leases that meet the criteria set forth in paragraph 42.a.-d. (and the related paragraphs to which 42 refers) of *FASB Statement No. 13, Accounting* for *Leases* (FAS 13). Leases which meet the preceding definition shall be accounted for in accordance with paragraphs 43-47 (and the related paragraphs to which 43-47 refer) of FAS 13. Pursuant to paragraph 46 of FAS 13, as updated by FSP FAS 13, any estimated residual value and all other important assumptions affecting estimated total net income shall be reviewed at least annually. The projected timing of income tax cash flows generated by the lease is an important assumption and shall be reviewed annually, or more frequently, if events or changes in circumstances indicate that a change in timing has occurred or is projected to occur. The lessor shall record its investment net of the nonrecourse debt. In cases where the asset being leased is a nonadmitted asset, any net leveraged lease asset shall be nonadmitted. However, leveraged leases involving commercial airplanes are admitted assets.~~

~~Initial and Continuing Investment~~

[3] ~~Paragraphs 26-33 distinguish between contingent rentals that are based on the future operations of the seller-lessee and those that are based on some predetermined or determinable level of future operations of the buyer-lessor.~~

~~60. The buyer's initial investment shall be adequate to demonstrate the buyer's commitment to pay for the property, plant or equipment and shall indicate a reasonable likelihood that the seller will collect the receivable. Lending practices of independent established lending institutions provide a reasonable basis for assessing the collectibility of receivables from buyers of real estate. Therefore, to qualify, the initial investment shall be equal to at least a major part of the difference between usual loan limits and the sales value of the property, plant or equipment.~~

~~61. The buyer's continuing investment in a real estate transaction shall not qualify unless the buyer is contractually required to pay each year on its total debt for the purchase price of the property, plant or equipment an amount at least equal to the level annual payment that would be needed to pay that debt and interest on the unpaid balance over no more than (a) 20 years for debt for land and (b) the customary amortization term of a first mortgage loan by an independent established lending institution for other real estate. For this purpose, contractually required payments by the buyer on its debt shall be in the forms specified in paragraph 58 as acceptable for an initial investment. Except as indicated in the following sentence, funds to be provided directly or indirectly by the seller (paragraph 59.c.) shall be subtracted from the buyer's contractually required payments in determining whether the initial and continuing investments are adequate. If a future loan on normal terms from an established lending institution bears a fair market interest rate and the proceeds of the loan are conditional on use for specified development of or construction on the property, the loan need not be subtracted in determining the buyer's investment.~~
~~Release Provisions~~

~~62. An agreement to sell property, plant or equipment (usually land) may provide that part or all of the property, plant or equipment may be released from liens securing related debt by payment of a release price or that payments by the buyer may be assigned first to released property, plant or equipment. If either of those conditions is present, a buyer's initial investment shall be sufficient both to pay release prices on property, plant or equipment released at the date of sale and to constitute an adequate initial investment on property, plant or equipment not released or not subject to release at that time in order to meet the criterion of an adequate initial investment for the property, plant or equipment as a whole.~~

~~63. If the release conditions described in paragraph 62 are present, the buyer's investment shall be sufficient, after the released property, plant or equipment is paid for, to constitute an adequate continuing investment on property, plant or equipment not released in order to meet the criterion of an adequate continuing investment for the property, plant or equipment as a whole (paragraph 61).~~

~~64. For real estate, If if the amounts applied to unreleased portions do not meet the initial and continuing-investment criteria as applied to the sales value of those unreleased portions, profit shall be recognized on each released portion when it meets the criteria in SSAP No. 40R, paragraph 19 as if each release were a separate sale.~~

Leveraged Leases for Lessors

42. A lessor shall record its investment in a leveraged lease. Generally, leveraged leases are those in which the lessor acquires, through the incurrence of debt (such that the lessor is substantially "leveraged" in the transaction), property, plant or equipment with the intentions to lease the asset(s) to the lessee. The net of the balances of the following accounts as measured in accordance with this guidance shall represent the lessor's initial and continuing investment in leveraged leases: *(Staff Note – This paragraph is from 842-50-25-1, and the definition of a leveraged lease was retained from the original paragraph 34.)*

a. Rentals receivable

b. Investment-tax-credit receivable

c. Estimated residual value of the leased asset

d. Unearned and deferred income.

43. A lessor shall initially measure its investment in a leveraged lease net of the nonrecourse debt. The net of the balances of the following accounts shall represent the initial and continuing investment in leveraged leases: *(Staff Note – This paragraph is from 842-50-30-1 and provides information on the valuation of leveraged leases.)*

a. Rentals receivable, net of that portion of the rental applicable to principal and interest on the nonrecourse debt.

b. A receivable for the amount of the investment tax credit to be realized on the transaction.

c. The estimated residual value of the leased asset. The estimated residual value shall not exceed the amount estimated at lease inception except if the lease agreement includes a provision to escalate minimum lease payments either for increases in construction or acquisition cost of the leased property, plant or equipment or for increases in some other measure of cost or value (such as general price levels) during the construction or preacquisition period. In that case, the effect of any increases that have occurred shall be considered in the determination of the estimated residual value of the underlying asset at lease inception.

d. Unearned and deferred income consisting of both of the following:

i. The estimated pretax lease income (or loss), after deducting initial direct costs, remaining to be allocated to income over the lease term.

ii. The investment tax credit remaining to be allocated to income over the lease term.

44. The investment in leveraged leases minus deferred taxes arising from differences between pretax accounting income and taxable income shall represent the lessor's net investment in leveraged leases for purposes of computing periodic net income from the leveraged lease. Given the original investment and using the projected cash receipts and disbursements over the term of the lease, the rate of return on the net investment in the years in which it is positive shall be computed. The rate is that rate that, when applied to the net investment in the years in which the net investment is positive, will distribute the net income to those years and is distinct from the interest rate implicit in the lease. In each year, whether positive or not, the difference between the net cash flow and the amount of income recognized, if any, shall serve to increase or reduce the net investment balance. The use of the term years is not intended to preclude application of the accounting prescribed in this paragraph to shorter accounting periods. *(Staff Note – This paragraph is from 842-50-35-2 and details tax issues with leveraged leases.)*

45. The pretax lease income (or loss) and investment tax credit elements shall be allocated in proportionate amounts from the unearned and deferred income included in the lessor's net investment. The tax effect of the pretax lease income (or loss) recognized shall be reflected in tax expense for the year. The tax effect of the difference between pretax accounting income (or loss) and taxable income (or loss) for the year shall be charged or credited to deferred taxes. *(Staff Note – Paragraphs 68-69 are from 842-50-35-(4-5).)*

46. If, at any time during the lease term the application of the method prescribed in this section would result in a loss being allocated to future years, that loss shall be recognized immediately. This situation might arise in circumstances in which one of the important assumptions affecting net income is revised.

47. The projected timing of income tax cash flows generated by the leveraged lease is an important assumption and shall be reviewed annually, or more frequently, if events or changes in circumstances indicate that a change in timing has occurred or is projected to occur. The income effect of a change in the income tax rate shall be recognized in the first accounting period ending on or after the date on which the legislation effecting a rate change becomes law. *(Staff Note – This paragraph is from 842-50-35-9)*

48. The lessor shall record its investment net of the nonrecourse debt. In cases where the asset being leased is a nonadmitted asset, any net leveraged lease asset shall be nonadmitted. However, leveraged leases involving commercial airplanes are admitted assets. *(Staff Note – This paragraph is retained from the prior versions of the SSAP. The comment on nonrecourse debt is covered by 842-51-25-1 and the remaining items are specific to statutory accounting.)*

~~35. This statement applies to arms-length transactions. To the extent that leases between related parties are, in substance, arms-length transactions the guidance in this statement shall be applied. The determination of whether related party leases qualify as arms-length transactions is addressed in SSAP No. 25~~

Disclosures

~~36.~~49. The following disclosures shall be made in the financial statements of lessees: *(Staff Notes – Paragraphs 73-74, guidance for disclosures was retained from the prior SSAP and are specific to statutory accounting.)*

a. A general description of the lessee's leasing arrangements including, but not limited to, the following:

  i. Rental expense for each period for which an income statement is presented, with separate amounts for minimum rentals, contingent rentals, and sublease rentals. Rental payments under leases with terms of a month or less that were not renewed need not be included;

  ii. The basis on which contingent rental payments are determined;

  iii. The existence and terms of renewal or purchase options and escalation clauses; and

  iv. Restrictions imposed by lease agreements, such as those concerning dividends, additional debt~~,~~ and further leasing;~~.~~

  v. Identification of lease agreements that have been terminated early or for which the lessee is no longer using the leased property, plant or equipment benefits, and the liability recognized in the financial statements under these agreements.

b. For leases having initial or remaining ~~noncancelable~~ lease terms in excess of one year:

i. Future minimum rental payments required as of the date of the latest balance sheet presented, in the aggregate and for each of the five succeeding years; and

ii. The total of minimum rentals to be received in the future under noncancelable subleases as of the date of the latest balance sheet presented.

c. For sale-leaseback transactions:

i. A description of the terms of the sale-leaseback transaction, including future commitments~~,~~ or obligations~~, provisions, or circumstances that require or result in the seller-lessee's continuing involvement~~; and

ii. For those accounted for as deposits, (a) the obligation for future minimum lease payments as of the date of the latest balance sheet presented in the aggregate and for each of the five succeeding years and (b) the total of minimum sublease rentals, if any, to be received in the future under noncancelable subleases in the aggregate and for each of the five succeeding years.

iii. For those accounted for using the financing method, it is required to disclose the information in i. as well as the ~~right-of-use assets~~financing obligation and lease liabilities.

~~37.~~50. When leasing is a significant part of the lessor's business activities in terms of revenue, net income, or assets, the following information with respect to leases shall be disclosed in the financial statements:

a. For operating leases:

i. The cost and carrying amount, if different, of property, plant or equipment on lease or held for leasing by major classes of property, plant or equipment according to nature or function, and the amount of accumulated depreciation in total as of the date of the latest balance sheet presented;

ii. Minimum future rentals on noncancelable leases as of the date of the latest balance sheet presented, in the aggregate and for each of the five succeeding years;

iii. Total contingent rentals included in income for each period for which an income statement is presented; and

iv. A general description of the lessor's leasing arrangements.

b. For leveraged leases:

i. A description of the terms including the pretax income from the leveraged leases. For purposes of presenting the investment in a leveraged lease in the lessor's balance sheet, the amount of related deferred taxes shall be presented separately (from the remainder of the net investment);

ii. Separate presentation (from each other) shall be made of pretax income from the leveraged lease, the tax effect of pretax income, and the amount of investment tax credit recognized as income during the period; and

iii. When leveraged leasing is a significant part of the lessor's business activities in terms of revenue, net income, or assets, the components of the net investment balance in leveraged leases shall be disclosed.

~~38. Companies shall disclose the effect on the balance sheet and the income statement resulting from a change in lease classification under paragraph 3, for leases that at inception would have been classified differently had the guidance in paragraph 3 been in effect at the inception of the original lease.~~

~~39.~~51. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

52. This statement rejects *ASU 2016-02, Leases*. For statutory accounting, leases are treated as operating leases for lessees and rejects the treatment as financing leases specified in 842-10-25 and rejects the recognition of the right to use assets and related liabilities. For statutory accounting, specific guidance is adopted on sale leaseback transactions, specific guidance from lessors, leveraged leases from sections 842-40 and 842-50, respectively. The financing method is rejected for statutory accounting but adopted for instances where a sale-leaseback transaction fails sale accounting. The guidance within *INT 02-15: EITF 00-11: Lessors' Evaluation of Whether Leases of Certain Integral Equipment Meet the Ownership Transfer Requirements of FASB Statement 13* applied to leases with inception between January 1, 2003 and January 1, 2020. With adoption of substantive revisions to SSAP No. 22R this guidance is nullified.

a. Accounting Standards Codification (ASC) 420-10-25 paragraphs 11-13 and ASC 420-10-30 paragraph 8 regarding the recognition of costs to terminate an operating lease before the end of the term and costs that will continue to be incurred under the contract for its remaining term without economic benefit are adopted. Other provisions of ASC 420 are rejected in SSAP No. 24.

b. *ASU 2014-05, Service Concession Arrangements* (Adopted with modification to only exclude service concession arrangements from the lease definition.)

c. *ASU 2017-10, Determining the Customer of the Operation Services* (Adopted with modification to clarify the customer in the previously adopted service concession arrangement definition.)

d. *ASU 2018-01, Land Easement Practical Expedient for Transition to Topic 842* (Rejected in its entirety.)

e. *ASU 2018-10, Codification Improvements to Topic 842, Leases* (Rejected in its entirety.)

f. *ASU 2018-11, Leases (Topic 842), Targeted Improvements* (Rejected in its entirety.)

g. *ASU 2018-20, Leases (Topic 842), Narrow-Scope Improvements for Lessors* (Rejected for statutory accounting, except for paragraph 842-10-15-(40-42) as it was modified by ASU 2018-20.)

h. *ASU 2019-01, Leases (Topic 842), Codification Improvements* (Rejected in its entirety.)

~~40. This statement rejects FAS 13, as amended and interpreted, except for certain of the guidance on operating leases, sale-leaseback transactions and leveraged leases (i.e., paragraphs 15, 16.(b., c., d.), 19.(a., b.), 23.(b., c.), 36, 37, 39.c. and, 42-47). A complete list of all FASB Statements, Interpretations~~

~~and Technical Bulletins adopted and rejected in this statement is as follows:~~*(Staff Note – This guidance is superseded by Topic 842)*

~~a.~~ *(Staff Note – a. through c. have been moved to paragraph 52.)*

~~b.~~

~~c.~~

~~d. *FASB Statement No. 13, Accounting for Leases*, [paragraphs 15, 16.(b., c., d.), 19.(a., b.), 23.(b., c.), 36, 37, 39.c., 42-47 adopted; all other paragraphs rejected];~~

~~e. *FASB Statement No. 22, Changes in the Provisions of Lease Agreements Resulting from Refundings of Tax-Exempt Debt (an amendment of FASB Statement No. 13)* [rejected in its entirety];~~

~~f. *FASB Statement No. 23, Inception of the Lease (an amendment of FASB Statement No. 13)* [paragraph 10 adopted; all other paragraphs rejected];~~

~~g. *FASB Statement No. 27, Classification of Renewals or Extensions of Existing Sales-Type or Direct Financing Leases (an amendment of FASB Statement No. 13)* [rejected in its entirety];~~

~~h. *FASB Statement No. 28, Accounting for Sales with Leasebacks (an amendment of FASB Statement No. 13)* [adopted in its entirety, except guidance on capital leases is not applicable other than those leases that qualify as leveraged leases and modifications for sale-leaseback transactions involving real estate settled entirely in cash];~~

~~i. *FASB Statement No. 29, Determining Contingent Rentals (an amendment of FASB Statement No. 13)* [paragraphs 8 and 11 adopted; all other paragraphs rejected];~~

~~j. *FASB Statement No. 98, Accounting for Leases:*~~

- ~~*Sale-Leaseback Transactions Involving Real Estate*~~
- ~~*Sales-Type Leases of Real Estate*~~
- ~~*Definition of the Lease Term*~~
- ~~*Initial Direct Costs of Direct Financing Leases*~~

~~*(an amendment of FASB Statements No. 13, 66 and 91 and a rescission of FASB Statement No. 26 and Technical Bulletin No. 79-11)* (paragraphs 1-13, 17-22.a., b., d., and e. adopted, paragraph j. adopted with modification to exclude references to sales-type lease classification criterion, paragraphs 27, 30, 31, adopted with modification to reference applicable statements of statutory accounting principles and reject guidance associated with capital leases; all other paragraphs rejected);~~

~~k. *FASB Statement No. 109, Accounting for Income Taxes* [paragraphs 256-258 adopted; all other paragraphs addressed in *SSAP No. 101—Income Taxes* (SSAP No. 101)];~~

~~l. *FASB Statement No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of* FASB *Statement No. 13 and Technical Corrections* [paragraph 9.c.c. adopted; all other paragraphs rejected];~~

~~m. *FASB Interpretation No. 19, Lessee Guarantee of the Residual Value of Leased Property (an* interpretation *of FASB Statement No. 13)* [rejected in its entirety];~~

~~n. *FASB Interpretation No. 21, Accounting for Leases in a Business Combination (an interpretation of FASB Statement No. 13)* [rejected in its entirety];~~

~~o. FASB Interpretation No. 23, Leases of Certain Property Owned by a Governmental Unit or Authority *(an interpretation of FASB Statement No. 13)* [rejected in its entirety];~~

~~p. *FASB Interpretation No. 24, Leases Involving Only Part of a Building (an interpretation of FASB Statement No. 13)* [rejected in its entirety];~~

~~q. *FASB Interpretation No. 26, Accounting for Purchase of a Leased Asset by the Lessee during the Term of the Lease (an interpretation of FASB Statement No. 13)* [rejected in its entirety];~~

~~r. *FASB Interpretation 27, Accounting for a Loss on a Sublease (an interpretation of FASB* Statement *No. 13 and APB Opinion No. 30)* [adopted in its entirety];~~

~~s. *FASB Technical Bulletin 79-10, Fiscal Funding Clauses in Lease Agreements* [rejected in its entirety];~~

~~t. *FASB Technical Bulletin 79-12, Interest Rate Used in Calculating the Present Value of Minimum Lease Payments* [rejected in its entirety];~~

~~u. *FASB Technical Bulletin 79-13, Applicability of FASB Statement No. 13 to Current Value Financial Statements* [rejected in its entirety];~~

~~v. *FASB Technical Bulletin 79-14, Upward Adjustment of Guaranteed Residual Values* [rejected in its entirety];~~

~~w. *FASB Technical Bulletin 79-15, Accounting for Loss on a Sublease Not Involving the Disposal of a Segment* [adopted in its entirety];~~

~~x. *FASB Technical Bulletin 79-16(R), Effect of a Change in Income Tax Rate on the Accounting for Leveraged Leases* [adopted in its entirety];~~

~~y. *FASB Technical Bulletin 79-17, Reporting Cumulative Effect Adjustment from Retroactive Application of FASB Statement No. 13* [rejected in its entirety];~~

~~z. FASB *Technical Bulletin 79-18, Transition Requirement of Certain FASB Amendments and Interpretations of FASB Statement No. 13* [rejected in its entirety];~~

~~aa. *FASB Technical Bulletin 85-3, Accounting for Operating Leases with Scheduled Rent Increases* [adopted in its entirety];~~

~~bb. *FASB Technical Bulletin 86-2, Accounting for an Interest in the Residual Value of a Leased Asset:*~~

- ~~*Acquired by a Third Party or*~~
- ~~*Retained by a Lessor That Sells the Related Minimum Rental Payments*~~

~~[adopted in its entirety];~~

~~cc. *FASB Technical Bulletin 88-1, Issues Related to Accounting for Leases*:~~

- ~~*Time Pattern of the Physical Use of the Property in an Operating Lease*~~
- ~~*Lease Incentives in an Operating Lease*~~
- ~~*Applicability of Leveraged Lease Accounting to Existing Assets of the Lessor*~~
- ~~*Money-Over-Money Lease Transactions*~~
- ~~*Wrap Lease Transactions*~~

~~[paragraphs 1-12 adopted; all other paragraphs rejected];~~

~~dd. *FASB Staff Position 13-2: Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction* [adopted in its entirety];~~

~~ee. *FASB* Emerging *Issues Task Force No. 85-16, Leveraged Leases* [adopted in its entirety];~~

~~ff. *FASB Emerging Issues Task Force No. 86-17, Deferred Profit on Sale-Leaseback* Transaction *with Lessee Guarantee of Residual Value* [rejected in its entirety];~~

~~gg. *FASB Emerging Issues Task Force No. 86-33, Tax Indemnifications in Lease Agreements* [adopted in its entirety];~~

~~hh. *FASB Emerging Issues Task Force No. 86-43, Effect of a Change in Tax Law or Rates on Leveraged Leases* [adopted in its entirety];~~

~~ii. *FASB Emerging Issues Task Force No. 87-7, Sale of an Asset Subject to a Lease and Nonrecourse Financing: "Wrap Lease Transactions"* [rejected in its entirety];~~

~~jj. *FASB Emerging Issues Task Force No. 87-8, Tax Reform Act of 1986:Issues Related to the Alternative Minimum Tax [Issue No. 10 adopted];*~~

~~kk. *FASB Emerging Issues Task Force No. 88-10, Costs Associated with Lease Modification or Termination*, previously adopted in its entirety in SSAP No. 22, has been nullified with the adoption of ASC 420-10-25 paragraphs 11-13 and ASC 420-10-30 paragraph 8;~~

~~ll. *FASB Emerging Issues Task Force No. 88-21, Accounting for the Sale of Property Subject to* the *Seller's Preexisting Lease* [rejected in its entirety];~~

~~mm. *FASB Emerging Issues Task Force No. 89-16, Consideration of Executory Costs in Sale-Leaseback Transactions* [adopted in its entirety];~~

~~nn. *FASB Emerging Issues Task Force No. 90-14, Unsecured Guarantee by Parent of Subsidiary's Lease Payments in a Sale-Leaseback Transaction* [adopted in its entirety];~~

~~oo. *FASB Emerging Issues Task Force No. 90-15, Impact of Nonsubstantive Lessors,* Residual *Value Guarantees, and Other Provisions in Leasing Transactions* [rejected in its entirety];~~

~~pp. *FASB Emerging Issues Task Force No. 90-20, Impact of an Uncollateralized Irrevocable Letter of Credit on a Real Estate Sale-Leaseback Transaction* [adopted in its entirety];~~

~~qq. *FASB Emerging Issues Task Force No. 92-1, Allocation of Residual Value or First-Loss Guarantee to Minimum Lease Payments in Leases Involving Land and Building(s)* [rejected in its entirety];~~

~~rr. *FASB Emerging Issues Task Force No. 93-8, Accounting for the Sale and Leaseback of an Asset That Is Leased to Another Party* [adopted in its entirety];~~

~~ss. *FASB Emerging Issues Task Force No. 95-17, Accounting for Modifications to an Operating Lease That Do Not Change the Lease Classification* [adopted in its entirety];~~

~~tt. *FASB Emerging Issues Task Force No. 96-21, Implementation Issues in Accounting for Leasing Transactions involving Special-Purpose Entities* [rejected in its entirety];~~

~~uu. *FASB Emerging Issues Task Force No. 98-9, Accounting for Contingent Rent* (adopted with modification);~~

~~vv. *FASB Emerging Issues Task Force No. 00-11, Lessors' Evaluation of Whether Leases of Certain Integral Equipment Meet the Ownership Transfer Requirements of FASB Statement 13* [adopted with modifications to GAAP references];~~

~~ww. *FASB Emerging Issues Task Force No. 08-3: Accounting by Lessees for Maintenance Deposits* (adopted with modification) to require reimbursable deposits to be reflected as nonadmitted assets.~~

Effective Date and Transition

53. This statement is effective for years beginning January 1, 2001. The substantive revisions documented in Issue Paper 16X—Leases are effective for all new leases entered into, and for existing leases reassessed due to a change in terms and conditions under paragraph 11, on or after January 1, 2020. Earlier adoption is permitted. The guidance in paragraph 34 regarding commercial airplanes was originally contained within INT 00-02: Accounting for Leveraged Leases Involving Commercial Airplanes Under SSAP No. 22—Leases and was effective March 13, 2000. The guidance in paragraph 5 was originally contained within *INT 04-20: EITF 01-8: Determining Whether an Arrangement Contains a Lease* and was effective March 13, 2005. Guidance in paragraph 27 related to maintenance costs incurred by lessee was previously included within *INT 09-05: EITF 08-3: Accounting by Lessees for Maintenance Deposits* and was effective for periods beginning September 21, 2009. The guidance in paragraphs 17 and 18 was originally contained within *INT 00-27: EITF 98-9: Accounting for Contingent Rent* and was effective September 11, 2000. *(Staff Note – Language suggested by IPs on 2-13-19. The second and all subsequent sentences are from the old SSAP No. 22R.)*

~~41. This statement is effective for years beginning January 1, 2001. The provisions of this statement shall be applied to all new leases entered into, or for existing leases which are renewed, on or after January 1, 2001. The guidance in paragraph 3 was originally contained within *INT 02-15: EITF 00-11: Lessors' Evaluation of Whether Leases of Certain Integral Equipment Meet the Ownership Transfer Requirements of FASB Statement 13* and should be applied to (a) leases for which lease inception occurs after January 1, 2003, and (b) leases modified after January 1, 2003, that meet the criteria in paragraph 9 of FAS 13 to be considered as new agreements. The guidance in paragraphs 4-11 was originally contained within *INT 04-20: EITF 01-8: Determining Whether an Arrangement Contains a Lease* and was effective March 13, 2005. Guidance in paragraph 16 related to maintenance costs incurred by lessee was previously included within *INT 09-05: EITF 08-3: Accounting by Lessees for Maintenance Deposits* and was effective for periods beginning September 21, 2009. The guidance in paragraphs 17 and 18 was originally~~

~~contained within *INT 00-27: EITF 98-9: Accounting for Contingent Rent* and was effective September 11, 2000. The guidance in paragraph 34 regarding commercial airplanes was originally contained within *INT 00-02: Accounting for Leveraged Leases Involving Commercial Airplanes Under SSAP No. 22—Leases* and was effective March 13, 2000.~~

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 22—Leases*
- *Issue Paper No. 16X—Leases*

(Staff Note – Exhibit A is proposed for deletion in its entirety for SSAP No. 22R.)

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

Issue: VOSTF – Bank Loan Referral

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue: This agenda item has been drafted to consider the June 2016 referral from the Valuation of Securities (E) Task Force pertaining to the guidance for bank loans in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. The referral requests that the Working Group consider the proposed amendment to the P&P Manual. Although some aspects of the proposed amendment are consistent with key aspects of the definition of a bank loan in *SSAP No. 26R—Bonds*, the proposed details in the P&P Manual include specific structures that are identified as bank loans. The intent of this agenda item is to review and determine whether the example structures are consistent with the intent of the regulators on what should be captured in SSAP No. 26R. *(The referral is captured as an addendum to this Form A, with the key aspects captured below.)*

Part Two – Filing with the SVO

Section 1. General Definitions Used in This Manual

The following definitions are intended to have relevance only for this Manual. No suggestion is intended that these definitions have any relevance to any other NAIC publication.

Bank Loan means an Obligation that is a Term Loan or a Revolving Credit Facility (including a Borrowing Base Loan) made by a bank or non-bank financial institution and extended as a Bilateral Loan or as a Syndicated Loan including a Leveraged Loan and a DIP Financing, acquired by an insurer in a Syndication, by Assignment or as a Participation as each such capitalized term is defined below.

Assignment means and refers to the sale and transfer of the rights and obligations of a lender (as assignor) under an existing loan agreement to an insurer as a new lender (and as assignee) pursuant to an Assignment and Acceptance Agreement which effects a novation under contract law so the insurer becomes the direct creditor of and is in contractual privity with the borrower having the sole right to enforce rights under the loan agreement.

Bilateral Loan means a loan made by a bank or other financial institution between that lender and the borrower.

Borrowing Base Loan means a Revolving Credit Facility where the amount borrowed is the lesser of a specified amount or the amount of a borrowing base comprised of eligible accounts receivable and eligible inventory of the borrower.

DIP Financing means a loan made by a bank, other financial institution or by an insurer to a borrower that is a debtor-in-possession while the borrower is in bankruptcy made in reliance on a super-priority lien and other legal and collateral protections afforded the lender by bankruptcy rules and regulations under the U.S. Bankruptcy Code; as more particularly defined in Part Three, Section 3 of this Manual.

Leveraged Loan means a loan made by a bank or other financial institution to borrowers assigned credit rating provider (CRP) credit ratings of BB/Ba or below or the NAIC Designation equivalent by the SVO.

Participation means and refers to a sale of an interest in a loan by a lender to an insurer (the participant) pursuant to a Participation Agreement which places the insurer in a direct contractual relationship only with the lender who retains record title to the loan, remains liable to perform under the loan agreement and has the exclusive right to deal with and enforce remedies against the borrower and where the insurer does not become a party to or acquire the right to enforce the loan agreement.

Revolving Credit Facility means a bank or other financial institution commitment to lend a specified maximum amount over which may be drawn at any time throughout the term of the loan and which provides for the re- borrowing of repaid amounts and is payable in one payment at the end of the term of the loan.

Syndication means and refers to a syndicate organized by a lead bank or other financial institution where other banks and financial institutions commit to lend a proportion of the total amount of money needed by the borrower by making separate loans to the borrower so the insurer and each other lender is in a direct contractual relationship to the borrower.

Syndicated Loan means a loan acquired by an insurer in a Syndication.

Term Loan means a loan made by a bank or other financial institution providing the borrower an agreed upon amount over a defined time period with payment due at or by the end of the term where amounts borrowed and repaid cannot be reborrowed.

The following is the section pertaining to DIP Financing:

d) DIP Financing

(i) Definitional Attributes

DIP financings are post-petition loans made to a company that has filed for protection under Chapter 11 of the U.S. Bankruptcy Code (Code). A copy of the court order approving such financing must accompany loans made pursuant to Sections 364(b), (c) or (d) of the Code that are submitted to the SVO. The submission should also include a complete set of documentation pertaining to the loan and, if so requested by the SVO staff, a legal opinion or analysis of the DIP lender's status with regard to the debtor's pre-petition creditors.

(ii) General Methodology

When assessing the credit quality of a DIP Financing, the SVO shall assess: 1) the factors that led the debtor to file for bankruptcy and the challenges the debtor must meet to emerge from bankruptcy; 2) the structural elements of the financing; 3) the size of the DIP financing as a percentage of the debtor's pre-petition debt; and 4) the collateral coverage for the DIP Financing.

(iii) General Assessment Criteria

- The causes of the debtor's filing and the challenges facing the debtor are assessed by reference to the debtor's financial condition and capital structure prior to the filing, the viability of the debtor's business model, the likelihood of emerging as a going concern and attracting financing to fully repay the DIP financing when the debtor emerges, and the potential for full repayment of the DIP Financing if the debtor is not successful in its reorganization.

- Structural elements of the DIP Financing include interest rates, repayment and prepayment terms, representations and warranties, covenants and events of default; whether the DIP Financing is advanced on the basis of eligible collateral or against attained milestones; the nature and extent of liens granted; collateral protection under first or second liens; the nature and mix of collateral; and whether collateral can be readily converted to cash.

- As a general principle, the smaller the DIP Financing in relation to prepetition debt, the less of a burden debt service is likely to be on the company during reorganization.

- The SVO shall assess collateral coverage on the basis of various sources of information to arrive at conservative collateral values based on asset quality and proximity to cash.

Existing Authoritative Literature:

SSAP No. 26R—Bonds provides the statutory accounting guidance for bonds, including what is captured in scope.

3. Bonds shall be defined as any securities representing a creditor relationship, whereby there is a fixed schedule for one or more future payments. This definition includes:

f. Fixed-income instruments specifically identified:

i. Certifications of deposit that have a fixed schedule of payments and a maturity date in excess of one year from the date of acquisition;

ii. **Bank loans issued directly by a reporting entity or acquired through a participation, syndication or assignment**;

iii. Hybrid securities, excluding: surplus notes, subordinated debt issues which have no coupon deferral features, and traditional preferred stocks.

iv. Debt instruments in a certified capital company (CAPCO) (INT 06-02)

The definition of a Bank Loan is captured in the glossary to SSAP No. 26R:

Bank Loan – Fixed-income instruments, representing indebtedness of a borrower, made by a financial institution. Bank loans can be issued directly by a reporting entity or acquired through an assignment, participation or syndication:

- **Assignment** – A bank loan assignment is defined as a fixed-income instrument in which there is the sale and transfer of the rights and obligations of a lender (as assignor) under an existing loan agreement to a new lender (and as assignee) pursuant to an Assignment and Acceptance Agreement (or similar agreement) which effects a novation under contract law, so the new lender becomes the direct creditor of and is in contractual privity with the borrower having the sole right to enforce rights under the loan agreement.

- **Participation –** A bank loan participation is defined as a fixed-income investment in which a single lender makes a large loan to a borrower and subsequently transfers (sells) undivided interests in the loan to other entities. Transfers by the originating lender may take the legal form of either assignments or participations. The transfers are usually on a nonrecourse basis, and the originating lender continues to service the loan. The participating entity may or may not have the right to sell or transfer its participation during the term of the loan, depending on the terms of the participation agreement. Loan Participations can be made on a parri-passu basis (where each participant shares equally) or a senior subordinated basis (senior lenders get paid first and the subordinated participant gets paid if there are sufficient funds left to make a payment).

- **Syndication –** A bank loan syndication is defined as a fixed-income investment in which several lenders share in lending to a single borrower. Each lender loans a specific amount to the borrower and has the right to repayment from the borrower. Separate debt instruments exist between the debtor and the individual creditors participating in the syndication. Each lender in a syndication shall account for the amounts it is owed by the borrower. Repayments by the borrower may be made to a lead lender that then distributes the collections to the other lenders of the syndicate. In those circumstances, the lead lender is simply functioning as a servicer and shall not recognize the aggregate loan as an asset. A loan syndication arrangement may result in multiple loans to the same borrower by different lenders. Each of those loans is considered a separate instrument.

SSAP No. 21—Other Admitted Assets provides statutory accounting guidance for collateral loans, including provisions that must be met for admittance:

Collateral Loans

4. Collateral loans are unconditional obligations for the payment of money secured by the pledge of an investment[1] and 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 outstanding principal balance on the loan and any related accrued interest shall be recorded as an admitted asset subject to the following limitations:

a. Loan Impairment—Determination as to the impairment of a collateral loan shall be based on current information and events. When it is considered probable that any portion of amounts due under the contractual terms of the loan will not be collected the loan is considered impaired. The impairment shall be measured based on the fair value of the collateral less estimated costs to obtain and sell the collateral. The difference between the net value of the collateral and the recorded asset shall be written off in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5R);

b. Nonadmitted Asset—In accordance with *SSAP No. 20—Nonadmitted Assets*, collateral loans secured by assets that do not qualify as investments shall be nonadmitted. Further, any amount of the loan outstanding which is in excess of the permitted relationship of fair value of the pledged investment to the collateral loan shall be treated as a nonadmitted asset.

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

Staff Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, classified as nonsubstantive, and expose this agenda item with a request of comments on the proposed referral response to the VOSTF. Particularly, this exposure requests comments on the staff recommendation not to include Borrowing Base Loans, DIP financing and Revolving Credit Facility in the P&P Manual as bank loans. As detailed below, NAIC staff has noted that borrowing base loans and DIP financing should be more appropriately classified as collateral loans, subject to the guidance in *SSAP No. 21—Other Admitted Assets*, rather than reported as a "bank loan" in scope of SSAP No. 26R. (NAIC staff identifies that an NAIC designation is currently not reported for collateral loans on Schedule BA.) Because of these differences in accounting classification, NAIC staff does not recommend expanding the recently adopted definition of bank loans in SSAP No. 26R (Agenda item 2013-36) to encompass items already included in SSAP No. 21.

To avoid confusion regarding the appropriate accounting treatment, NAIC staff recommends a referral response to the Task Force suggesting revisions to identify that the accounting and reporting of the noted investments shall follow the guidance in the AP&P Manual, which would classify the Borrowing Base Loan and DIP Financing as collateral loans. (It is noted that the proposed P&P Manual guidance indicates that the definitions are for the P&P Manual only, but NAIC staff notes that the reference to "bank loans" would imply that the structures are permitted within SSAP No. 26R.) NAIC staff notes that the proposed guidance for the P&P Manual should also be expanded to include "direct issuances" of bank loans to be consistent with the guidance adopted in SSAP No. 26R.

Key elements for discussion:

- Borrowing Base Loan – This loan appears to be a collateral loan backed by accounts receivable or inventory subject to the guidance in SSAP No. 21. Pursuant to that guidance, collateral loans secured by

[1] Investment defined as those assets listed in Section 3 of Appendix A-001: *Investments of Reporting Entities*.

assets that do not qualify as investments shall be nonadmitted. Neither accounts receivable nor inventory would qualify as an investment that supports admittance under SSAP No. 21.

- DIP Financing – This loan has been made to a company in bankruptcy, which may also be supported by collateral. As payment of the loan would be contingent on the company emerging from a going concern and attracting financing to repay the DIP loan, it seems that this lending structure should be restricted to a "collateral loan" classification, as defined in SSAP No. 21, with admittance limited to the qualifying investments securing the loan.

- Revolving Credit Facility – This structure should be clarified to indicate that a commitment to provide lending is not an asset that can be recognized on the financial statements. Rather, only the actual loaned amount would be considered an asset that could be recognized.

Staff Review Completed by: Julie Gann – January 2018

Status:

On March 24, 2018, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed this agenda item with a request for comments on the proposed referral response to the Valuation of Securities (E) Task Force on its draft guidance for bank loans. This response suggests revisions to indicate that investments shall follow the guidance in the *Accounting Practices and Procedures Manual*, which would classify borrowing base loans and debtor in possession (DIP) financings as collateral loans.

On August 4, 2018, the Statutory Accounting Principles (E) Working Group deferred discussion of this agenda item and directed NAIC staff to conduct further analysis on borrowing base loans and debtor-in-possession financing.

On April 6, 2019, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 21—Other Admitted Assets*, as detailed below, to clarify that a security in scope of another SSAP does not get reclassified as a "collateral loan" because it is also secured with collateral. After considering comments on these proposed revisions, an assessment will occur on a referral response to the Valuation of Securities (E) Task Force. If these revisions are incorporated, it is anticipated that the referral response will request revisions to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* to reference the guidance.

Collateral Loans

4. Collateral loans are unconditional obligations[FN] for the payment of money secured by the pledge of an investment[1] and 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 outstanding principal balance on the loan and any related accrued interest shall be recorded as an admitted asset subject to the following limitations:

   a. Loan Impairment—Determination as to the impairment of a collateral loan shall be based on current information and events. When it is considered probable that any portion of amounts due under the contractual terms of the loan will not be collected the loan is considered impaired. The impairment shall be measured based on the fair value of the collateral less estimated costs to obtain and sell the collateral. The difference between the net value of the collateral and the recorded asset shall be written off in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5R);

[1] Investment defined as those assets listed in Section 3 of *Appendix A-001—Investments of Reporting Entities*.

b. Nonadmitted Asset—In accordance with *SSAP No. 20—Nonadmitted Assets*, collateral loans secured by assets that do not qualify as investments shall be nonadmitted. Further, any amount of the loan outstanding which is in excess of the permitted relationship of fair value of the pledged investment to the collateral loan shall be treated as a nonadmitted asset.

New Footnote: For purposes of determining a collateral loan in scope of this statement, a collateral loan does not include investment securities captured in scope of other statements. For example, SSAP No. 26R includes securities (as defined in that statement) representing a creditor relationship whereby there is a fixed schedule for one or more future payments. Securities captured in SSAP No. 26R that are also secured with collateral shall continue to be captured within scope of SSAP No. 26R.

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

Issue: SSAP No. 37 – Participation Agreement in a Mortgage Loan

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue: This agenda item has been drafted to clarify statutory accounting guidance for a participation agreement in a mortgage loan. The guidance permitting a "participation agreement" was adopted in 2017 and intended to allow ownership in a single mortgage loan agreement with a sole borrower when the insurer is not named on the original mortgage loan agreement. With a participation agreement, the insurer would acquire the mortgage loan via an assignment or participation agreement between the selling lender and any co-lenders.

This guidance for acquiring mortgages through a "participation agreement" was adopted at the same time as the revisions to identify "participants" in mortgage loans. (A participant in a mortgage is defined when there is more than one lender identified on the loan documents as providing funds to a sole borrower.) Although the guidance for a "participant" in a mortgage loan is explicit that the guidance pertains to mortgages issued to a "sole borrower," and there is explicit guidance in SAP No. 37 that identifies that investments that reflect involvement in a "mortgage loan fund" are not considered mortgage loans, it appears that the "participation agreement" language is being used as a reference to incorporate ownership interests in pool / funds of mortgages as SSAP No. 37 (Schedule B) mortgage loans.

This agenda item incorporates minimal revisions to the "participant agreement" language to expressly indicate that the participation agreement must pertain to a sole borrower in a single mortgage loan agreement. Consistent with existing guidance in SSAP No. 37, investments that reflect ownership in a mortgage loan fund is not in scope of SSAP No. 37. Investments in a "pool of mortgages" shall be reported on Schedule BA.

Existing Authoritative Literature:

SSAP No. 37–Mortgage Loans

2. A mortgage loan is <u>**defined as a debt obligation that is not a security**</u>, which is secured by a mortgage on real estate. In addition to mortgage loans directly originated, a mortgage loan also includes mortgages acquired through assignment, syndication or participation[1]. <u>**Investments that**</u>

[1] Examples of agreements intended to be captured within this statement:

a. Reporting entity is a "participant" <u>**in a single mortgage loan agreement**</u> that identifies more than one lender (which includes the reporting entity) <u>**providing funds to a sole borrower**</u> with the real estate collateral securing all lenders identified in the agreement. For these agreements, each lender is incorporated directly into the loan documents. The key differentiating characteristic of a mortgage loan provided under a group "mortgage loan participation agreement" rather than a solely-owned mortgage loan is that no one lender of the lending group may unilaterally foreclose on the mortgage. With these agreements, the lenders must foreclose on the mortgage loan as a group.

b. Reporting entity has a "participation agreement" to invest in mortgages issued by another entity. <u>**Although the reporting entity is not named on the original mortgage loan agreement, the original issuer sells a portion of the mortgage loan to an incoming participant lender (co-lender) and the sale is documented by an assignment or participation agreement between the selling lender and the co-lender**</u>. With these agreements, the co-lender acquires an undivided participation interest in the loan and will receive direct interest in the amount of their participation in the right to repayment of the loan and the collateral given to secure the loan. The financial rights and obligations of the lenders in these agreements shall be similar to those in a direct loan.

reflect "participating mortgages," "mortgage loan fund," or the "securitization of assets" are not considered mortgage loans within scope of this SSAP.

a. A security is a share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

i. It is either represented by an instrument issued in bearer or registered form, or if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.

ii. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

iii. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Agenda item 2016-39 expanded the scope of SSAP No. 37, with the intent to clarify that mortgage loans would include co-lending agreements when the insurer is directly named on the loan documentation (as a "participant") and when they are not named on the loan documents, but acquire the interest through a sale (in a "participation agreement"). Although the guidance in SSAP No. 37 is explicit that investments that reflect "mortgage loan funds" are not intended to be in scope, it seems that some are referencing the guidance for a "participation agreement" to captured interests in mortgage loan funds / pools of mortgages.

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

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

Staff Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose minimal revisions to *SSAP No. 37—Mortgage Loans* to further clarify that a mortgage loan acquired through "participation agreement" is limited to a single mortgage loan agreement with a sole borrower.

SSAP No. 37–Mortgage Loans

2. A mortgage loan is defined as a debt obligation that is not a security, which is secured by a mortgage on real estate. In addition to mortgage loans directly originated, a mortgage loan also includes mortgages acquired through assignment, syndication or participation[2]. Investments that

[2] Examples of agreements intended to be captured within this statement:

a. Reporting entity is a "participant" in a single mortgage loan agreement that identifies more than one lender (which includes the reporting entity) providing funds to a sole borrower with the real estate collateral securing all lenders identified in the agreement. For these agreements, each lender is incorporated directly into the loan documents. The key differentiating characteristic of a mortgage loan provided under a group "mortgage loan participation agreement" rather than a solely-owned mortgage loan is that no one lender of the lending group may unilaterally foreclose on the mortgage. With these agreements, the lenders must foreclose on the mortgage loan as a group.

b. Reporting entity has a "participation agreement" to invest in a single mortgage agreement ~~mortgages~~(sole borrower) originally issued by another entity. Although the reporting entity is not named on the original mortgage loan agreement, the original issuer sells a portion of the mortgage loan to an incoming participant lender (co-lender) and the sale is documented by an assignment or participation agreement between the selling lender and the co-lender. With these agreements, the co-lender acquires an undivided reflect "participating mortgages," "mortgage loan fund," or the "securitization of assets" are not considered mortgage loans within scope of this SSAP.

a. A security is a share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

i. It is either represented by an instrument issued in bearer or registered form, or if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.

ii. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

iii. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

Staff Review Completed by:
Julie Gann, NAIC Staff – June 2018

Status:
On August 4, 2018, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed proposed revisions to *SSAP No. 37—Mortgage Loans*, as detailed above, to clarify that a mortgage loan acquired through a mortgage loan participation agreement is limited to a single mortgage loan agreement with a sole borrower.

On November 15, 2018, the Statutory Accounting Principles (E) Working Group exposed new revisions to *SSAP No. 37—Mortgage Loans*, to clarify that mortgage loans acquired through a participation agreement are limited to single mortgage loan agreements and exclude "bundled" mortgage loans. These revisions intend to prevent inadvertent restrictions when there may be more than one lender / borrower, but clarify that structures that reflect more than one mortgage loan agreement are not in scope of SSAP No. 37.

November 15, 2018 Exposure:

SSAP No. 37–Mortgage Loans

2. A mortgage loan is defined as a debt obligation that is not a security, which is secured by a mortgage on real estate. In addition to mortgage loans directly originated, a mortgage loan also includes mortgages acquired through assignment, syndication or participation[2]. Investments that reflect "participating mortgages," "mortgage loan fund," "bundled mortgage loans[3]," or the "securitization of assets" are not considered mortgage loans within scope of this SSAP.

a. A security is a share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

i. It is either represented by an instrument issued in bearer or registered form, or if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.

participation interest in the loan and will receive direct interest in the amount of their participation in the right to repayment of the loan and the collateral given to secure the loan. The financial rights and obligations of the lenders in these agreements shall be similar to those in a direct loan.

ii. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

iii. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

[2] Examples of agreements intended to be captured within this statement:

a. Reporting entity is a "co-lender~~participant~~" in a single mortgage loan agreement that identifies more than one lender (which includes the reporting entity) ~~providing funds to a sole borrower~~ with the real estate collateral securing all lenders identified in the agreement. For these single mortgage loan agreements, each lender is incorporated directly into the loan documents. The key differentiating characteristic of a mortgage loan provided under a group "mortgage loan co-lending ~~participation~~ agreement" rather than a solely-owned mortgage loan is that no one lender of the lending group may unilaterally foreclose on the mortgage. With these agreements, the lenders must foreclose on the mortgage loan as a group.

b. Reporting entity has a "participation agreement" to invest in a single mortgage agreement ~~mortgages(sole borrower)~~ originally issued by another entity. Although the reporting entity is not named on the original mortgage loan agreement, the original issuer sells a portion of the mortgage loan to an incoming participant lender ~~(co-lender)~~ and the sale is documented by an assignment of a participation interest or participation agreement between the selling lender and the ~~co-lender~~participant. With these agreements, the participant~~co-lender~~ acquires an undivided participation interest in the single mortgage loan and will have rights related ~~receive direct interest in the amount of their participation in the right~~ to repayment of the loan based on its pro-rata share of the single mortgage loan~~and the collateral given to secure the loan~~. The financial rights and obligations of the ~~lenders~~ participants in ~~these agreements~~ shall be similar to those in a direct loan.

[3] The scope of this SSAP is limited to single mortgage loan agreements. Although single mortgage loan agreements can potentially have more than one lender (e.g., co-lenders / participations) and more than one borrower (such as in a tenancy-in-common arrangement), the concept of a "single mortgage loan" does not include arrangements in which a reporting entity acquires more than one mortgage in a sole transaction. (For example, if a reporting entity was to acquire an interest in a "bundle" of mortgage loans with various unrelated borrowers and collateral, this agreement would be outside of the scope of this SSAP.)

On April 6, 2019, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 37—Mortgage Loans*, to incorporate both regulator and interested parties' comments, as shown below. These revisions incorporate minor technical edits and footnote 3 guidance recommended by interested parties and incorporate additional language to footnote 2 to clarify requirements of participating mortgages. The provisions for participation agreements clarify that such agreements should provide the same rights and obligations as if the holder acquired the mortgage loan directly.

Spring 2019 National Meeting Exposure:

SSAP No. 37–Mortgage Loans – Revisions from the prior exposure are shaded.

2. A mortgage loan is defined as a debt obligation that is not a security, which is secured by a mortgage on real estate. In addition to mortgage loans directly originated, a mortgage loan also includes mortgage loans acquired or obtained through assignment, syndication or participation[2]. Investments that reflect "participating mortgages," "mortgage loan fund," "bundled mortgage loans[3]," or the "securitization of assets" are not considered mortgage loans within scope of this SSAP.

a. A security is a share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

i. It is either represented by an instrument issued in bearer or registered form, or if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.

ii. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

iii. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

[2] Examples of agreements intended to be captured within this statement:

a. Reporting entity is a “co-lender~~participant~~” in a single mortgage loan agreement that identifies more than one lender (which includes the reporting entity) ~~providing funds to a sole borrower~~ with the real estate collateral securing all lenders identified in the agreement. For these single mortgage loan agreements, each lender is incorporated directly into the loan documents. The key differentiating characteristic of a mortgage loan provided under a group “mortgage loan co-lending ~~participation~~ agreement” rather than a solely-owned mortgage loan is that no one lender of the lending group may unilaterally foreclose on the mortgage. With these agreements, the lenders must foreclose on the mortgage loan as a group.

b. Reporting entity has a “participation agreement” to invest in a single mortgage loan. ~~agreement mortgages(sole borrower) originally issued by another entityAlthough t~~The reporting entity is not an original lender named as a payee on the ~~original~~ mortgage loan~~agreement~~, but the original lender ~~issuer~~ sells a portion of the mortgage loan to the reporting entity ~~an incoming participant lender (co-lender) and the sale is documented by~~ through an assignment of a participation interest under the participation agreement. ~~or participation agreement between the selling lender and the co-lenderparticipant. With these agreements, the participantco-lender~~ Under a participation agreement, the reporting entity acquires an undivided ~~participation~~ interest in the single mortgage loan proceeds to be received by the original lender. Under a participation agreement, single mortgage loan proceeds include the periodic mortgage loan principal and interest payments received by the original lender, and all rights and proceeds received in the foreclosure of a mortgage, deed of trust, deed in lieu of foreclosure, or other similar proceeding by the original lender. The amount of the proceeds to be received by the reporting entity is based on the ratio of its participation interest to the then-outstanding single mortgage loan balance. To qualify as a mortgage loan under the scope of this statement, the reporting entity must have a signed participation agreement with the original lender named in the mortgage loan, ~~and will have rights related receive direct interest in the amount of their participation in the right to repayment of the loan based on its pro-rata share of the single mortgage loanand the collateral given to secure the loan. T~~the financial rights and obligations of the reporting entity under the participation agreement are the same as the original lender, the reporting entity’s participation interest in the single mortgage loan proceeds must be pari-passu with the original lender named on the mortgage loan agreement, and the participation agreement must be properly and promptly recorded. ~~lenders participants in these agreements shall be similar to those in a direct loan.~~

Footnote 2b is also shown clean:

b. Reporting entity has a “participation agreement” to invest in a single mortgage loan. The reporting entity is not an original lender named as a payee on the mortgage loan, but the original lender sells a portion of the mortgage loan to the reporting entity through an assignment of a participation interest under the participation agreement. Under a participation agreement, the reporting entity acquires an undivided interest in the single mortgage loan proceeds to be received by the original lender. Under a participation agreement, single mortgage loan proceeds include the periodic mortgage loan principal and interest payments received by the original lender, and all rights and proceeds received in the foreclosure of a mortgage, deed of trust, deed in lieu of foreclosure, or other similar proceeding by the original lender. The amount of the proceeds to be received by the reporting entity is based on the ratio of its participation interest to the then-outstanding single mortgage loan balance. To qualify as a mortgage loan under the scope of this statement, the reporting entity must have a signed participation agreement with the original lender named in the mortgage loan, the financial rights and obligations of the reporting entity under the participation agreement are the same as the original lender, the reporting entity’s participation interest in the single mortgage loan proceeds must be pari-passu with the original lender named on the mortgage loan agreement, and the participation agreement must be properly and promptly recorded.

[3] The scope of this SSAP is limited to single mortgage loan agreements. Although single mortgage loan agreements can potentially have more than one lender (e.g., co-lenders / participations) and more than one borrower (such as in a tenancy-in-common arrangement), the concept of a “single mortgage loan” does not include arrangements in which a reporting entity acquires more than one mortgage loan in a sole transaction. (For example, if a reporting entity was to acquire an interest in a “bundle” of mortgage loans with various unrelated

borrowers and collateral, this agreement would be outside of the scope of this SSAP. However, a bundle of mortgage loans does not include a “bulk purchase” where the reporting entity’s interest in each mortgage loan is legally separate and divisible and the purchase just facilitates the acquisitions of multiple single mortgage loan agreements.)

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

Issue: Affiliate Transactions

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue: This agenda item has been drafted to consider revisions to statutory accounting principles to clarify "affiliate" reporting, when underlying investments continue to reflect "affiliate" transactions. Although this design could be constructed in a variety of ways, the following scenario provides a simple example:

- Reporting entity holds affiliated securities (e.g., bonds).
- Reporting entity transfers affiliated securities to "independent" trustee in a *SSAP No. 43R—Loan-backed and Structured Securities* arrangement.
- Reporting entity acquires securities issued from the SSAP No. 43R structure, backed by the affiliated securities held in the trust.
- With this design, instead of reporting affiliated investments, the reporting entity attempts to report an investment in an "independent" issuer, although the insurer continues to only have direct recourse against the affiliated assets held in trust. (Per SSAP No. 43R, the insurer only has direct recourse to the assets held in trust, and the sponsor may have no financial obligation for the security.)

Since it is likely not possible to detail the variety of ways investments could be repackaged to appear unrelated when affiliate risk is still held by the entity, this agenda item proposes the inclusion of principal concepts in *SSAP No. 25—Affiliates and Other Related Parties*. These concepts intend to highlight that despite the inclusion of an unrelated intermediary, transactions that involve affiliates, or risks of an affiliate (e.g., affiliate debt issuances) shall be reported as a related party transaction or an investment in an affiliate for statutory accounting principles.

Existing Authoritative Literature:

***SSAP No. 25—Affiliates and Other Related Parties*:** This SSAP provides guidance for all transactions involving related parties and affiliates, regardless if the transaction would also be captured in a specific SSAP. As identified in this SSAP, related party transactions are subject to abuse, and require specialized accounting rules and increased regulatory scrutiny.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Agenda item 2016-40: Definition of LBSS, was considered by the Statutory Accounting Principles (E) Working Group to improve the definition, and what is captured in scope, for loan-backed and structured securities. This agenda item was ultimately disposed without statutory accounting revisions. Disposal was supported by industry, as industry identified that the proposed definition and scope changes would likely result with unintended consequences and inconsistent application. With the action to dispose, the Working Group directed NAIC staff to research specific elements on the application of SSAP No. 43R and subsequently report findings so that the Working Group could consider whether clarifying revisions are necessary. Although that research is still pending, NAIC staff has been made aware of situations in which SSAP No. 43R structures have been used to circumvent affiliate reporting.

In response to the initial exposure (December 2016) of agenda item 2016-40 and the proposed revisions to SSAP No. 43R, comments from industry were received. Although these comments addressed several aspects, the comments specifically addressed the requirements of SSAP No. 25, and noted that industry was not aware of any abuse associated with SSAP No. 25 involving structured finance transactions:

Excerpt from the May 19, 2017 Interested Parties' Comment letter:

> We are aware that many insurers have engaged in related party transactions that involve structured finance securities over the past several years. Related party securitizations have been used by insurers for many important and substantive business reasons, such as to reduce risk for a specific insurance company, share risks among various insurance/non-insurance entities, and to provide related party insurance companies the opportunity to share in investment income for certain higher yielding assets. Additionally, related party securitizations have been entered into by insurers to transfer varied amounts of risk to outside third parties while at the same time spreading the risk among related party insurance and non-insurance entities. These transactions are substantive in that they have reduced risk and improved the related Risk-Based Capital for insurers. **We do not believe SAPWG's intent was to prevent such transactions from occurring; rather, to prevent insurers from circumventing the guidance in SSAP No. 25 by entering into a related party transaction such as a structured finance transaction. We believe SSAP No. 25 is very clear about the requirements for related party transactions to be arm's length and that inflation of surplus must be deferred, for example. We are not aware of any abuse associated with SSAP No. 25 when related to structured finance transactions. As a result, we do not believe additional guidance is necessary.**

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

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

Staff Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions as follows:

1) Revisions to *SSAP No. 25—Affiliates and Other Related Parties* to clarify the continued application of SSAP No. 25, as well as an "affiliated" classification, when a transaction is in substance a related party transaction, even if there is a non-related intermediary.

2) Revisions to *SSAP No. 26R—Bonds*, *SSAP No. 32—Preferred Stock* and *SSAP No. 43R—Loan-backed and Structured Securities* to identify that investment transactions are subject to the principal provisions of SSAP No. 25.

In proposing these revisions, NAIC staff believes they are consistent with the industry comments received in May 2017 on the applicability of SSAP No. 25 for investments captured in scope of SSAP No. 43R. Furthermore, with the identification of situations that appear to circumvent the SSAP No. 25 provisions through the use of a SSAP No. 43R structure, it is appropriate to further clarify the guidance to prevent future occurrences.

Proposed Revisions to SSAP No. 25:

1. Related party transactions are subject to abuse because reporting entities may be induced to enter transactions that may not reflect economic realities or may not be fair and reasonable to the reporting entity or its policyholders. As such, related party transactions require specialized accounting rules and increased regulatory scrutiny. This statement establishes statutory accounting principles and disclosure requirements for related party transactions.

2. This statement shall be followed for all related party transactions even if the transaction is also governed by other statutory accounting principles. Furthermore, this statement shall be followed in all transactions which involve unrelated parties as intermediaries between related parties. In determining whether a transaction is a related party transaction, consideration shall be given to the substance of the

agreement, and the parties whose actions or performance materially impact the insurance reporting entity under the transaction. For example, an investment acquired from a non-related intermediary, in which the investment return is predominantly contingent on the performance of a related party, shall be considered an affiliated investment. As a general principle, it is erroneous to conclude that the mere inclusion of a non-related intermediary eliminates the requirement to assess and properly identify the related party transaction in accordance with the provisions of this statement. It is also erroneous to conclude that the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to assess and identify the investment transaction as a related party / affiliated arrangement.

3. If a company receives the stock of an affiliated company as a capital contribution rather than through a purchase, the transaction shall be accounted for according to *SSAP No. 25—Affiliates and Other Related Parties* (SSAP No. 25)*, SSAP No. 95—Nonmonetary Transactions* (SSAP No. 95), or *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* (SSAP No. 97), based on the details of each transaction. The statutory purchase method within *SSAP No. 68—Business Combinations* (SSAP No. 68) is not applicable for stock received as a capital contribution.

Proposed Revisions to *SSAP No. 26R—Bonds:*

5. Investments within the scope of this statement issued by a related party, or acquired through a related party transaction, are also subject to the provisions and disclosure requirements of *SSAP No. 25—Affiliates and Other Related Parties*. Investments within the scope of this statement meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement and SSAP No. 25.

Proposed Revisions to *SSAP No. 32—Preferred Stock*

2. Investments in preferred stock of subsidiaries, controlled or affiliated entities, including preferred stock interests of certified capital companies (CAPCO) per *INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)* are included within the scope of this statement. In addition to the provisions of this statement, preferred stock investments in SCA are also subject to the provisions of SSAP No. 25 and SSAP No. 97.

9. Preferred stocks meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement, SSAP No. 25 and SSAP No. 97.

Proposed Revisions to *SSAP No. 43R—Loan-backed and Structured Securities:*

2. Loan-backed securities are defined as securitized assets not included in structured securities, as defined below, for which the payment of interest and/or principal is directly proportional to the payments received by the issuer from the underlying assets, including but not limited to pass-through securities, lease-backed securities, and equipment trust certificates.

3. Structured securities are defined as loan-backed securities which have been divided into two or more classes for which the payment of interest and/or principal of any class of securities has been allocated in a manner which is not proportional to payments received by the issuer from the underlying assets.

4. Loan-backed securities are issued by special-purpose corporations or trusts (issuer) established by a sponsoring organization. The assets securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee until the issuer's obligation has been fully satisfied. The investor only has direct recourse to the issuer's assets, but may have secondary recourse to third parties through insurance or guarantee for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying assets. Some sponsors do guarantee the performance of the underlying assets.

a. In determining whether a loan-backed structured is an affiliated investment, consideration shall be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security. For example, although a loan-backed security may be acquired from a non-related issuer, if the assets held in trust predominantly[FN] reflect assets issued by affiliates of the insurance reporting entity, and the insurance reporting entity only has direct recourse to the assets held in trust, the transaction shall be considered an affiliated investment, and the transaction shall also subject to the accounting and reporting provisions in SSAP No. 25.

New Footnote: In applying this guidance, a reporting entity is not required to complete a detailed review of the assets held in trust to determine the extent, if any, the assets were issued by related parties. Rather, this guidance is a principle concept intended to prevent situations in which affiliated debt is knowingly captured in a SSAP No. 43R structure and recorded as a "non-affiliated" investment because of the involvement of a non-related trustee or SSAP No. 43R security issuer. As identified in SSAP No. 25, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party / affiliated arrangement.

5. Investments within the scope of this statement are also subject to the provisions and disclosure requirements of *SSAP No. 25—Affiliates and Other Related Parties* if the SSAP No. 43R transaction is a related party / affiliated entity arrangement[FN]. Loan-backed and structured securities meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement and SSAP No. 25.

New Footnote: As discussed in paragraph 4a, a SSAP No. 43R security may still be considered a related party transaction even if the asset trustee or security issuer is a non-related party.

Proposed Revisions to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*

5. Investments in the ventures defined in paragraphs 2-4 meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement. Investments in joint ventures, partnerships, and limited liability companies shall be reported in Other Invested Assets in the financial statements.

6. Investments in these ventures, except for joint ventures, partnerships and limited liability companies with a minor ownership interest[FN], shall be reported using an equity method as defined in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* (SSAP No. 97), paragraphs 8.b.i. through 8.b.iv. A reporting entity whose shares of losses in a SSAP No. 48 entity exceeds its investment in the SSAP No. 48 entity shall disclose the information required by SSAP No. 97, paragraph 35.a.

New Footnote: With the identification of whether the reporting entity has a minor ownership interest, reporting entities must also identify whether the investment is an affiliate transaction. Pursuant to the concepts reflected in SSAP No. 25, consideration shall be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security. For example, if the underlying assets within a SSAP No. 48 entity represent assets issued by an affiliate, then the SSAP No. 48 entity shall be considered an affiliate investment, with the transaction subject to the accounting and reporting provisions of SSAP No. 25. As identified in SSAP No. 25, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party / affiliated arrangement.

Staff Review Completed by:
Julie Gann, NAIC Staff – December 2018

Status:
On April 6, 2019, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed the above revisions to *SSAP No. 25—Affiliates and Other Related Parties*, *SSAP No. 26R—Bonds*, *SSAP No. 32—Preferred Stock*, *SSAP No. 43R—Loan-backed and Structured Securities*, and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* to clarify the application of SSAP No. 25, as well as an "affiliated" classification, when a transaction is in substance a related party transaction, even if the transaction is conducted through a non-related intermediary.

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

Issue: *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts*

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue: This agenda item has been drafted to consider *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts* for statutory accounting. The FASB issued ASU 2018-12 in August 2018 to improve the existing recognition, measurement, presentation and disclosure requirements for long-duration contracts issued by an insurance entity. The revisions captured in the ASU are summarized as follows:

1. **<u>Update Assumptions:</u>** The ASU requires assumptions to be updated, and eliminates the U.S. GAAP provisions for risk of adverse deviation and premium deficiency testing. (Under current U.S. GAAP, the liability would include a provision for risk of adverse deviation, and locked assumptions would be unlocked if a premium deficiency was to arise.)

    a. Cash Flow Assumptions – The ASU requires entities to review, and if there is a change, update the assumptions used to measure cash flows at least annually. Changes in the liability estimate from the changes in cash flow assumptions shall be recognized through net income.

    b. Discount Rate Assumptions – The ASU requires entities to update the discount rate assumption at each reporting date. The discount rate is required to reflect an upper-medium grade (low-credit risk) fixed-income instrument yield. (This generally reflects a single "A" rate.) Change in the discount rate shall be recognized through other comprehensive income.

2. **<u>Market Risk Benefits:</u>** The ASU requires all market risk benefits associated with deposit (or account balance contracts) to be measured at fair value. (This provision eliminates the "insurance-accrual method" from U.S. GAAP.)

    a. A market risk benefit is defined as "a contract or contract feature in a long-duration contract issued by an insurance entity that protects the contract holder from other-than-nominal capital market risk and exposes the insurance entity to other-than-nominal capital market risk."

    b. Market risk benefits can be present in both general account or separate account products, and intend to capture situations in which an insurance entity is insuring a possible shortfall (caused by market performance) between a policyholder's account balance and a guaranteed amount. (Noted products in the ASU include guaranteed minimum death benefits in general account indexed products with crediting rates that may go negative or guaranteed minimum lifetime withdrawal benefits in fixed income annuities.)

    c. With the guidance for market risk benefits, under U.S. GAAP, entities will no longer have to assess whether a market risk benefit is an embedded derivative subject to bifurcation. All market risk benefits will be captured under the insurance standard (ASC Topic 944) and will be excluded from the derivative guidance (ASC Topic 815).

3. **<u>Deferred Acquisition Costs:</u>** The ASU requires that deferred acquisition costs be amortized over a constant basis over the expected life of the contract.
    a. Deferred acquisition costs are required to be written off when actual experience in excess of expected experience (that is, for unexpected contract terminations), but are not subject to impairment assessments. (Impairment assessment is not required as there is no measurement uncertainty associated with deferred acquisition costs.)

    b. Under U.S. GAAP, the amortization pattern of deferred acquisition costs will no longer be impacted by investment performance or changes in expected future liability cash flows.

4. **<u>Disclosures:</u>** The ASU requires new disclosures, predominantly in the form of rollforwards, to enable users to evaluate the amount, timing and uncertainty of cash flows arising from long-duration contracts.

    a. The ASU requires disaggregated rollforwards of beginning to ending balance of the liability for future policy benefits, policyholder account balances, market risk benefits, separate account liabilities and deferred acquisition costs.

    b. The ASU requires an insurance entity to disclose information about significant inputs, judgments, assumptions, and methods used in measurement, including changes in those inputs, judgments, and assumptions and the effect of those changes on measurement.

ASU 2018-12 is effective for public entities Jan. 1, 2021. For nonpublic entities, the ASU is effective for Dec. 31, 2022. The ASU includes different transition provisions as follows:

- For the liability for future policyholder benefits and deferred acquisition costs, insurance entities should apply the amendments to contracts in force as of the beginning of the earliest period presented on the basis of their existing carrying amounts, adjusted for the removal of any related amounts in accumulated other comprehensive income. Insurance entities are permitted to apply the amendments retrospectively (with a cumulative catch-up adjustment to the opening balance of retained earnings), using actual historical experience information as of contract inception. (Estimates of historical experience may not be substituted for actual historical experience.) If electing retrospective application, it must be applied entity-wide for the same contract issue year, and all subsequent contract issue years. (Meaning, it must be used to all products and contracts issued in the first year in which retrospective application will be applied, and all subsequent products and contracts issued in later years.)

- For market risk benefits, insurance entities should apply the amendments retrospectively as of the beginning of the earliest year presented. An insurance entity may use hindsight in instances in which assumptions in a prior period are unobservable or otherwise unavailable and cannot be independently substantiated. The difference between fair value and the carrying value at the transition date, excluding the effect of changes in the instrument-specific credit risk, requires an adjustment to the opening balance of retained earnings.

Existing Authoritative Literature:

The key changes reflected in ASU 2018-12 revised U.S. GAAP guidance previously <u>rejected</u> for statutory accounting. (In a couple instances, the prior U.S. GAAP guidance was not reviewed for SAP - as the guidance was not Board Directed, or was still pending SAP review.)

References from Appendix D – Cross-Reference to SAP:

U.S. GAAP	SAP Accounting Provisions
FAS 60, Accounting and Reporting by Insurance Entities	Rejected in SSAP No. 40R, SSAP No. 50, SSAP No.

	51R, SSAP No. 52, SSAP No. 53, SSAP No. 54R, SSAP No. 57, SSAP No. 59 and SSAP No. 71
FAS 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments	Rejected in SSAP No. 50, SSAP No. 51R, SSAP No. 52 and SSAP No. 71
FSP FAS 97-1, Situations in Which Paragraphs 17(b) and 20 of FAS 97 Permit or Require Accrual of an Unearned Revenue Liability	Not Board Directed
SOP 95-1, Accounting for Certain Insurance Activities of Mutual Life Insurance Enterprises	Rejected in SSAP No. 51R and SSAP No. 52
SOP 03-1, Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts	Rejected in SSAP No. 56
SOP 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchange of Insurance Contracts	Rejected in SSAP No. 71
SOP 00-3, Accounting by Insurance Enterprises for Demutualizations and Formations of Mutual Insurance Holding Companies and for Certain Long-Duration Participating Contracts	Pending SAP
AICPA Practice Bulletin 8, Application of FAS 97 to Insurance Enterprises	Rejected in SSAP No. 51R and SSAP No. 52R

Other U.S. GAAP revised as a result of the ASU include:

- *FAS 133, Accounting for Derivative Instruments and Hedging Activities* (and related DIGs) – The framework of FAS 133 was adopted with modification in *SSAP No. 86—Derivatives*. The revisions from ASU 2018-12 indicate that contracts with market risk benefits do not need to be bifurcated as embedded derivatives, as the guidance in ASU 2018-12 requires market risk benefits to be measured at fair value. The ASU revisions also delete or revise related implementation guidance for assessing whether embedded derivatives shall be bifurcated under U.S. GAAP. **This guidance will not impact the FAS 133 guidance adopted with modification, as SSAP No. 86 specifies that embedded derivatives shall not be separated from the derivative instrument.**

- *FAS 130, Other Comprehensive Income* – FAS 130 was rejected as not applicable under statutory accounting. The revisions from ASU 2018-12 modify FAS 130 to specify the additional components (e.g., changes in discount rate assumptions) that are recognized through OCI. These modifications will not impact the prior statutory accounting decision to reject FAS 130 for statutory accounting.

The following relevant SAP guidance is noted:

- ***SSAP No. 51—Life Contracts*:** This SSAP establishes statutory accounting principles for income recognition and policy reserves for life contracts. This SSAP identifies that policy reserves shall be established as required in *Appendix A-820, Minimum Life and Annuity Reserves* and *Appendix A-822, Asset Adequacy Analysis Requirements* or the *Valuation Manual.*

- ***SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses:*** This SSAP establishes statutory accounting principles for recording liabilities for unpaid claims and claim adjustment expenses for life insurance contracts and accident and health contracts. (It also addresses unpaid losses and LAE for property and casualty contracts.) Pursuant to the guidance in paragraph 12, for each line of business, and for all lines of business in the aggregate, management shall record its best estimate of its liabilities for unpaid claims, unpaid losses and loss/claim adjustment expenses. This guidance identifies that management shall follow the concept of conservatism when determining estimates, but there is not a specific requirement to include a provision for adverse deviation in claims. With the revisions reflected in ASU 2018-12, the U.S. GAAP guidance has been revised to specify that the assumptions used in determining a liability for future policy benefits shall not include a provision for the risk of adverse deviation. Prior to these revisions, the guidance in ASC 944-40-30-7 specifically stated that the assumptions shall include a provision for the risk of adverse deviation. *(Note, as detailed in the proposed statutory accounting modifications, reference to the old U.S. GAAP guidance for adverse deviation is included in the Preamble and is proposed to be deleted.)*

- ***SSAP No. 71—Policy Acquisition Costs and Commissions*:** This SSAP establishes statutory accounting principles for policy acquisition costs and commissions. Pursuant to SSAP No. 71, all policy acquisition costs and commissions shall be expensed when incurred. Although the ASU is streamlining the amortization of capitalized deferred acquisition costs, this revision will not impact statutory accounting. *(Note, as detailed in the proposed statutory accounting modifications, reference to the old U.S. GAAP guidance is included in the Preamble and is proposed to be modified to reflect the new guidance.)*

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): In 2008, the FASB undertook an insurance contracts project jointly with the International Accounting Standards Board (IASB). In 2013, after considering comments from the exposure of a 2010 Discussion Draft and a 2013 Proposed Update, the FASB decided to separate from the IASB project, and instead focus on targeted improvements to existing U.S. GAAP concepts. The decision to focus on targeted-improvements to existing U.S. GAAP guidance, with the continued limitation of the guidance to insurance companies, was strongly supported by commenters in lieu of introducing a completely new accounting model that would apply to all entities that issued "insurance contracts."

Staff Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose proposed revisions as follows:

- Modifications to paragraph 20 of the Preamble to update the applicable U.S. GAAP guidance.

- Rejection of ASU 2018-12 for statutory accounting in the following SSAPs:
  - *SSAP No. 50–Classifications of Insurance or Managed Care Contracts*
  - *SSAP No. 51R—Life Contracts*
  - *SSAP No. 52—Deposit-Type Contracts*
  - *SSAP No. 56—Separate Accounts*
  - *SSAP No. 71—Policy Acquisition Costs and Commissions*
  - *SSAP No. 86—Derivatives*

- Consider new SAP disclosures to capture reconciliations of liabilities for life contracts.

Staff Note – These are pending discussion with industry and AICPA representatives. If disclosures are incorporated, they are not expected to be effective until 2021 or 2022 to mirror the GAAP effective date.

- Rollforward of the liability for future policy benefits.
- Rollforward of the liability for policyholder's account balances (excluding separate accounts)
- Rollforward of market risk benefits

(Since acquisition costs are expensed as incurred, revisions are not proposed to capture rollforward information on acquisition costs.)

Staff Review Completed by:
Julie Gann, NAIC Staff – August 20, 2018

Proposed Revisions to Statutory Accounting:

Preamble:

20. The objectives of GAAP reporting differ from the objectives of SAP. U.S. GAAP is designed to meet the varying needs of the different users of financial statements. SAP is designed to address the concerns of regulators, who are the primary users of statutory financial statements. As a result, U.S. GAAP stresses measurement of emerging earnings of a business from period to period, (i.e., matching revenue to expense), while SAP stresses measurement of ability to pay claims in the future. This difference is illustrated by the fact that statutory policy reserves are intentionally established on a conservative basis emphasizing the long-term nature of the liabilities. Under U.S. GAAP, the experience expected by each company, ~~with provision for the risk of adverse deviation,~~ is used to determine the reserves it will establish for its policies. U.S. GAAP reserves may be more or less than the statutory policy reserves. In addition, another primary difference is that U.S. GAAP has recognized certain assets which, for statutory purposes, have been either nonadmitted or immediately expensed. For example, policy acquisition costs are expensed as incurred under SAP since the funds so expended are no longer available to pay future liabilities. Insurance company financial statements prepared in accordance with U.S. GAAP defer qualifying costs incurred in the successful acquisition of new or renewal insurance contracts ~~business~~ and amortize them over the ~~premium recognition period~~expected life of the insurance contract.

SSAP No. 50–Classifications of Insurance or Managed Care Contracts

46. This statement rejects the GAAP classifications (i.e., short-duration and long-duration) found in *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts, FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises, FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, and *FASB Statement No. 120, Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long Duration Participating Contracts.*

SSAP No. 51R—Life Contracts

51. This statement incorporates the requirements of Appendices A-225, A-235, A-585, A-620, A-641, A-695, A-812, A-815, A-817, A-820, A-821, A-822, A-830, the Actuarial Standards Board *Actuarial Standards of Practice,* and the actuarial guidelines found in Appendix C of this Manual.

52. This statement rejects *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts, FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises, FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments, FASB Statement 120, Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain*

Long-Duration Participating Contracts, AICPA *Practice Bulletin No. 8, Application of FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses From the Sale of Investments, to Insurance Enterprises,* the AICPA *Audit and Accounting Guide—Audits of Stock Life Insurance Companies,* AICPA *Statement of Position 95-1, Accounting for Certain Activities of Mutual Life Insurance Enterprises* relating to accounting and reporting for policy reserves for short and long duration contracts, and *FASB Interpretation No. 40, Applicability of Generally Accepted Accounting Principles to Mutual Life Insurance and Other Enterprises, an interpretation of FASB Statements No. 12, 60, 97, and 113.*

SSAP No. 52—Deposit-Type Contracts

23. This statement incorporates the requirements of Appendices A-235, A-695, A-820, A-822, the Actuarial Standards Board *Actuarial Standards of Practice*, and the actuarial guidelines found in Appendix C of this Manual.

24. This statement rejects *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts,* *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises*, *FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, *FASB Statement 120, Accounting and Reporting by Mutual Life Insurance* Enterprises *and by Insurance Enterprises for Certain Long-Duration Participating Contracts*, AICPA *Practice Bulletin No. 8, Application of FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses From the Sale of Investments, to Insurance Enterprises,* the AICPA *Audit and Accounting Guide—Audits of Stock Life Insurance Companies*, AICPA *Statement of Position 95-1, Accounting for Certain Activities of Mutual Life Insurance Enterprises* relating to accounting and reporting for policy reserves for short and long duration contracts, and *FASB Interpretation No. 40, Applicability of Generally Accepted Accounting Principles to Mutual Life Insurance and Other Enterprises, an interpretation of FASB Statements No. 12, 60, 97, and 113*.

SSAP No. 56—Separate Accounts

40. This statement rejects *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts,* AICPA *Statement of Position 03-1, Accounting and Reporting by* Insurance Enterprises *for Certain Nontraditional Long-Duration Contracts and for Separate Accounts* (SOP 03-1). The disclosure elements included within this SSAP are derived from the criteria for separate account reporting under SOP 03-1; however, this SSAP does not restrict separate account reporting pursuant to the criteria established in SOP 03-1.

41. This statement incorporates the requirements of Appendices A-200, A-250, A-255, A-270, A-585, A-588, A-620, A-695, A-812, A-820, A-821, A-822 the Actuarial Standards Board *Actuarial Standards of Practice*, and the actuarial guidelines found in Appendix C of this Manual.

SSAP No. 71—Policy Acquisition Costs and Commissions

(Note – The modifications also update the title for ASU 2010-26 to reflect the nature of the ASU and not the ASC Topic / Subtopic in which the revisions were reflected.)

6. This statement rejects *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts, ASU 2010-26, Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts,* *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises, FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments,* and *Statement of Position 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts*~~ and *ASU 2010-26, Financial Services – Insurance (Topic 944)*~~.

SSAP No. 86—Derivatives

61. This statement adopts revisions to ASC 815-20 as reflected within *ASU 2013-10, Derivatives and Hedging, Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a benchmark interest rate for Hedge Accounting Purposes*. These revisions define a benchmark interest rate, clarify what can be used in the U.S. for a benchmark interest rate, and eliminate the prior restriction on using different benchmark rates for similar hedges.

62. This statement adopts U.S. GAAP guidance for determining whether short sales are considered a derivative instrument including the regular-way security trade exception. The adopted GAAP guidance includes ASC 815-10-55-57 through 59 and 815-10-15-15 through 17. As a result, short sales shall generally be accounted for in accordance with *SSAP No. 103R—Short Sales*. Contracts that may resemble "short sales" but do not meet the criteria may be in scope of SSAP No. 86 as forward contracts.

63. This statement adopts with modification *ASC Topic 815-45: Weather Derivatives.* Weather derivatives are within the scope of SSAP No. 86 and shall be accounted and reported as other derivatives. The guidance in this statement does not apply to contracts written by insurance entities that entitle the holder to be compensated only if, as a result of an insurable event, the holder incurs a liability or there is an adverse change in the value of a specific asset or liability for which the holder is at risk.

64. This statement rejects revisions to ASC 815-15, as reflected within *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts*. Pursuant to the ASU, market risk benefits are excluded from the U.S. GAAP embedded derivative bifurcation requirements. However, under SSAP No. 86, embedded derivatives shall not be separated from the host contract.

~~64.~~65. This statement rejects *ASU 2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities*, and *ASU 2016-03, Intangibles—Goodwill and Other, Business Combinations, Consolidation, Derivatives and Hedging*.

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 reject *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts* in *SSAP No. 50—Classifications of Insurance or Managed Care Contracts, SSAP No. 51R—Life Contracts, SSAP No. 52—Deposit-Type Contracts, SSAP No. 56—Separate Accounts, SSAP No. 71—Policy Acquisition Costs and Commissions and SSAP No. 86—Derivatives.* Revisions also modify paragraph 20 of the Preamble to update the applicable U.S. GAAP guidance. With the exposure, comments are requested on whether new disclosure reconciliations of liabilities should be captured for statutory accounting.

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

Issue: Update Reporting Deposit-Type Contracts

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue: This agenda item has been drafted in response to questions identified by the Financial Stability (EX) Task Force in developing liquidity disclosure changes to the 2019 life blank, and the noted inability to fully identify and assess deposit-type contracts - (particularly guaranteed investment contracts) - within the statutory financial statements. From information received, it appears that in some instances deposit-type contracts are being reported along with life contracts in Exhibit 5 – Aggregate Reserves for Life Contracts or in Exhibit 6 – Aggregate Reserves for Accident and Health Contracts, rather than in Exhibit 7 – Deposit-Type Contracts.

This issue has been raised as payout requests for deposit-type contracts are significantly different than payouts generated by an insured event (mortality or morbidity). The Task Force identified that information on liabilities, particularly those that can be called with little or no surrender penalty, must be known to properly complete liquidity assessments.

After various discussions, it is anticipated that guaranteed investment contracts (GICs) are reported as a life contract or accident and health contract (and not a deposit-type contract) for one of the following reasons:

- The GIC was a “supplemental” contract formed from the proceeds of a life / A&H insurance contract.
- The GIC, although absent mortality or morbidity risk, was written on a life / A&H insurance “paper”.
- The state insurance department has approved the GIC to be classified as a life / A&H insurance contract.
- Contracts may be designed as GICs, but could potentially have mortality / morbidity components, which qualifies the contract to be reported as a life or A/H insurance contract.

The purpose of this agenda item is to solicit information regarding the reporting of GICs (and other deposit-type contracts) as life or A/H contracts in the reporting exhibits, and consider revisions to statutory accounting and reporting instructions to ensure that information regarding all GICs can be separately identifiable and aggregated from the financial statements.

Existing Authoritative Literature:

SSAP No. 50—Classifications of Insurance or Managed Care Contracts

5. **Insurance contracts providing any protection against death, disability, accident or illness in which the reporting entity assumes mortality or morbidity risk shall be classified as life or accident and health contracts, as applicable**. Managed care contracts provide defined health care services to subscribers, members or policyholders, collectively referred to hereafter as subscribers, in return for fixed, periodic premiums (usually paid monthly) that are generally due at or before the beginning of the coverage period and shall be classified as health contracts. Contracts which insure against damage to property by an insured peril or damage or injury to the insured or third parties, generally over a fixed/limited period of time, shall be classified as property and casualty contracts. **Contracts in which the reporting entity does not assume any mortality, morbidity, health benefit costs incurred, or casualty risk and which act exclusively as investment vehicles shall be**

classified as deposit-type contracts. Such classification shall be made at the inception of the contract and shall not change.

14. Supplementary contracts with life contingencies are a type of agreement between the insurance company and either the insured or the beneficiary, usually to provide for full or partial settlement of the amount payable upon the termination of an original contract. Generally, the proceeds are paid over the lifetime of one or more beneficiaries. **This differs from a supplementary contract without life contingencies under which the proceeds are paid over a definite period without regard to the life of the beneficiary**.

Deposit-Type Contracts

43. Deposit-type contracts do not incorporate insurance risk. Contracts issued by insurers that do not incorporate risk from the death or disability of policyholders (mortality or morbidity risk) are more comparable to financial or investment instruments issued by other financial institutions than to insurance contracts.

44. **Deposit-type contracts shall include contracts without any life or disability contingencies, including, but not limited to, certain types of the following policy categories**:

a. Supplemental contracts

b. Lottery payouts

c. Structured settlements

d. Guaranteed interest contracts

e. Income settlement options

f. Dividend and coupon accumulations

g. Annuities certain

h. Premium and other deposit funds

i. Funding Agreements without well-defined class-based (e.g. age, gender) annuity purchase rates defining either specific or maximum purchase rate guarantees (see SSAP No. 15, paragraph 19, paragraph 20 of this statement and *SSAP No. 52—Deposit-Type Contracts*, paragraph 21.)

45. Under deposit-type contracts, the policyholder may assume all, some, or none of the investment risk, depending on the contract terms. Amounts can be deposited in lump sum, or periodically as allowed by the policy contract. Deposit-type contracts would include annuities certain, whose income payments have no reference to life contingencies and benefits are paid over a specified period (i.e., 10 years, 20 years, etc.).

SSAP No. 51R—Life Contracts

Policy Reserves

15. Statutory policy reserves shall be established for all unmatured contractual obligations of the reporting entity arising out of the provisions of the insurance contract. **Where separate benefits are included in a contract, a reserve for each benefit shall be established as required in Appendix A-820.** These statutory policy reserves have historically been calculated as the excess of the present value of future benefits to be paid to or on behalf of policyholders less the present value of future net premiums. For policies issued on or after the operative date of the *Valuation Manual*, these formulaic calculations will be supplemented for some policies with more advanced deterministic and stochastic reserve methodologies to better reflect company experience, possible economic conditions and inherent policy

risks. Statutory policy reserves meet the definition of liabilities as defined in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5R). The actuarial methodologies referred to in paragraph 16 meet the criteria required for reasonable estimates in SSAP No. 5R.

16. The reserving methodologies and assumptions used in computation of policy reserves shall meet the provisions of Appendices A-820 and A-822. Policies written prior to the operative of the *Valuation Manual* shall additionally follow the actuarial guidelines found in Appendix C of this Manual. Policies written on or after operative of the *Valuation Manual* shall additionally follow the *Valuation Manual* and be subject to the actuarial guidelines referenced therein. Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.

Supplemental Benefits

40. In addition to the basic policy benefit, the insurance contract may provide supplemental benefits. Supplemental benefits include, but are not limited to, accidental death benefits and waiver of premium benefits. If the terms of the contract provide for these benefits, appropriate reserves shall be established in accordance with the applicable standards within the *Accounting Practices and Procedures Manual*.

SSAP No. 52—Deposit-Type Contracts

2. As discussed in SSAP No. 50, deposit-type contracts are those contracts that do not subject the reporting entity to any risks arising from policyholder mortality or morbidity. A mortality or morbidity risk is present if, under the terms of the contract, the reporting entity is required to make payments or forego required premiums contingent upon the death or disability (in the case of life and disability insurance contracts) or the continued survival (in the case of annuity contracts) of a specific individual or group of individuals.

3. Deposit-type contracts frequently grant policyholders significant discretion over the amount and timing of deposits and withdrawals. Reporting entities are frequently granted significant discretion over amounts that accrue to or that are assessed against policyholders.

4. Due to the absence of mortality and/or morbidity risk and the discretionary characteristics noted in paragraph 3, the accounting principles for income recognition and policy reserves for deposit-type contracts differ from the accounting for life contracts set forth in *SSAP No. 51R—Life Contracts,* accident and health contracts established in *SSAP No. 54R—Individual and Group Accident and Health Contracts*, and credit insurance contracts as discussed in *SSAP No. 59—Credit Life and Accident and Health Insurance Contracts*.

5. Categories of contracts that may not subject the reporting entity to risks arising from policyholder mortality or morbidity include, but are not limited to, certain types of the following policy categories:

a. Supplemental contracts

b. Lottery payouts

c. Structured settlements

d. Guaranteed interest contracts

e. Income settlement options

f. Dividend and coupon accumulations

g. Annuities certain

h. Premium and other deposit funds

Income Recognition

6. Contracts issued by a reporting entity that do not incorporate mortality or morbidity risk shall not be accounted for as insurance contracts. Amounts received as payments for such contracts shall not be reported as revenues but shall be recorded directly to an appropriate policy reserve account.(INT 00-03)

Policy Reserves

7. Statutory policy reserves shall be established for all contractual obligations of the reporting entity arising out of the provisions of the contract. Where separate benefits are included in a contract, a reserve for each benefit shall be established as required in Appendix A-820. Statutory policy reserves meet the definition of liabilities as defined in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5R). The actuarial methodologies referred to in paragraph 8 meet the criteria required for reasonable estimates in SSAP No. 5R.

8. The reserving methodologies and assumptions used in computation of policy reserves shall meet the provisions of Appendices A-820 and A-822, and the actuarial guidelines found in Appendix C of this Manual. Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.

9. The policy reserve for contracts without life contingencies where the future benefits are fixed and guaranteed (e.g., certain supplemental contracts, lottery payouts, structured settlements, guaranteed interest contracts, income settlement options, annuities certain, and unmatured coupon accumulations) shall be based on the present value of the future guaranteed benefits discounted at the valuation interest rate. The policy reserve for all other contracts (e.g., certain premium and other deposit funds, and dividend and matured coupon accumulations) shall be based on the accumulated amounts paid plus an income accumulation based on the contract provisions, less any withdrawals and applicable surrender charges.

10. Statutory policy reserves for those group annuity contracts or other contracts that, in whole or in part, establish the insurer's obligations by reference to a segregated portfolio of assets not owned by the insurer shall be established in accordance with the guidance in Appendix A-695. Statutory policy reserves for those contracts with nonlevel premiums or benefits, or contracts with secondary guarantees shall be established in accordance with the guidance in Appendix A-830. Statutory policy reserves for those group life contracts utilizing a separate account that meet the requirements outlined in paragraph 1 of Appendix A-200 shall be computed in accordance with the guidance in that appendix.

11. Policy reserves shall be increased for reinsurance assumed and decreased for reinsurance ceded as further described in *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Agenda Item 2018-28: Updates to Liquidity Disclosures, and proposed revisions to *SSAP No. 51R—Life Contracts*, *SSAP No. 52—Deposit-Type Contracts* and *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*, were adopted by the SAPWG during the Fall 2018 National Meeting. This agenda item was developed in response to Financial Stability (Ex) Task Force recommendations to enhance existing disclosures on annuity actuarial reserves and deposit-type liabilities.

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

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

Staff Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose this agenda item with a request for comments on why GICs, or other deposit-type contracts, are reported in Exhibit 5 – Life Contracts or Exhibit 6 – Accident and Health Contract,

instead of Exhibit 7 – Deposit Type Contracts. With exposure, a referral will be sent to the Life Actuarial Task Force to inform them of the inquiry and request their comments. Although NAIC staff recommends delaying revisions to statutory accounting or reporting instructions until better knowing why these classifications occur, it is anticipated that clarification may be considered to ensure that separate reserve recognition, which is already required in SSAP No. 51R, requires separate reporting on the appropriate exhibit.

Staff Review Completed by:
Julie Gann, NAIC Staff – January 2019

Status:
On April 6, 2019, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed this agenda item with a request for comments on why guaranteed investment contracts (GICs), or other deposit-type contracts, are reported in Exhibit 5 – Life Contracts or Exhibit 6 – Accident and Health Contract, instead of Exhibit 7 – Deposit Type Contracts. With exposure, the Working Group directed a referral to the Life Actuarial (A) Task Force to inform them of the exposure and request comments.

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

Issue: SCA Loss Tracking – Accounting Guidance

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue:
This agenda item has been drafted to clarify the accounting guidance for SCA losses that result in zero or negative equity in an SCA. Agenda item 2018-09 - SCA Loss Tracking clarified the reporting guidance for SCA losses that result in zero, or negative, equity in an SCA. When reviewing that agenda item, it was identified that there could be uncertainty on the existing provisions that require a negative SCA reporting amount (rather than a zero reporting value). The intent of this agenda item is to clarify the instances that require a negative SCA value and ensure the accounting guidance in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* for these instances is clear.

Existing Authoritative Literature:

SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets

Guarantees
16. A guarantee contract is a contract that contingently requires the guarantor to make payments (either in cash, financial instruments, other assets, shares of its stock, or provision of services) to the guaranteed party based on changes in the underlying that is related to an asset, a liability, or an equity security of the guaranteed party. Commercial letters of credit and loan commitments, by definition, are not considered guarantee contracts. Also excluded from the definition are indemnifications or guarantees of an entity's own performance, subordination arrangements or a noncontingent forward contract. This definition could include contingent forward contracts if the characteristics of this paragraph are met.

19. With the exception of the provision for guarantees made to/or on behalf of a wholly-owned subsidiaries in paragraph 18.f. and "unlimited" guarantees in 18.g., this guidance does not exclude guarantees issued as intercompany transactions or between related parties from the initial liability recognition requirement. Thus, unless the guarantee is provided on behalf of a wholly-owned subsidiary or considered "unlimited," guarantees issued between the following parties are subject to the initial recognition and disclosure requirements:

a. Guarantee issued either between parents and their subsidiaries or between corporations under common control;

b. A parent's guarantee of its subsidiary's debt to a third party; and

c. A subsidiary's guarantee of the debt owed to a third party by either its parent or another subsidiary of that parent.

20. At the inception of a guarantee, the guarantor shall recognize in its statement of financial position a liability for that guarantee. Except as indicated in paragraph 22, the objective of the initial measurement of the liability is the fair value[1] of the guarantee at its inception.

[1] As practical expedients, when a guarantee is issued in a standalone arm's-length transaction, the liability recognized at the inception of the guarantee should be the premium received or receivable by the guarantor. When a guarantee is issued as part of a transaction with multiple elements, the liability recognized at the inception of the guarantee should be an estimate of the guarantee's fair value. In that

21. The issuance of a guarantee obligates the guarantor (the issuer) in two respects: (a) the guarantor undertakes an obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur (the noncontingent aspect) and (b) the guarantor undertakes a contingent obligation to make future payments if those triggering events or conditions occur (the contingent aspect). Because the issuance of a guarantee imposes a noncontingent obligation to stand ready to perform in the event that the specified triggering event occurs, the provisions of paragraph 8 should not be interpreted as prohibiting the guarantor from initially recognizing a liability for that guarantee even though it is not probable that payments will be required under that guarantee.

22. In the event that, at the inception of the guarantee, the guarantor is required to recognize a liability under paragraph 8 for the related contingent loss, the liability to be initially recognized for that guarantee shall be the greater of (a) the amount the satisfies the fair value objective as discussed in paragraph 20 or (b) the contingent liability amount required to be recognized at inception of the guarantee by paragraph 8. For many guarantors, it would be unusual for the contingent liability under (b) to exceed the amount that satisfies the fair value objective at the inception of the guarantee.

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

13. On at least a quarterly basis, the procedures set forth below shall be followed by a reporting entity in applying an equity method of accounting (as described in paragraphs 8.b.i. through 8.b.iv.), as applicable, to investments in SCA entities:

   e. For entities subject to 8.b.i., 8.b.iii. and 8.b.iv. a reporting entity's share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by an equity method plus advances made by the investor. The reporting entity shall discontinue applying an equity method when the investment (including advances) is reduced to zero[2] and shall not provide for additional losses unless the reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee (guaranteed obligations meeting the definition of liabilities in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* shall be recorded as liabilities). If the investee subsequently reports net income, the reporting entity shall resume applying an equity method only after its share of that net income equals the share of net losses not recognized during the period that an equity method was suspended;

Disclosures

34. All SCA investments within the scope of this statement (except paragraph 8.b.i. entities) shall include disclosure of the SCA balance sheet value (admitted and nonadmitted) as well as information received from the NAIC in response to the SCA filing (e.g., date and type of filing, NAIC valuation amount, whether resubmission of filing is required). This disclosure shall include an aggregate total of all SCAs (except paragraph 8.b.i. entities) with detail of the aggregate gross value under this statement with the admitted and nonadmitted amounts reflected on the balance sheet. (As noted in paragraph 4, joint ventures, partnerships and limited liability companies are accounted for under the guidance in SSAP No. 48. As such, those entities are not subject to this disclosure.)

   a. For all periods presented, a reporting entity whose shares of losses in an SCA exceeds its investment in the SCA shall disclose its share of losses. (This is required regardless of a guarantee or commitment of future financial support to the SCA.) This disclosure shall include the following:

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circumstance, guarantors should consider what premium would be required by the guarantor to issue the same guarantee in a standalone arm's-length transaction.

[2] Refer to the additional guidance related to discontinuance of an equity method in paragraphs 15-17 and *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee* and *EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses.*

i. The reporting entity's accumulated share of the SCA losses not recognized during the period that the equity method was suspended;

ii. The reporting entity's share of the SCA's equity, including negative equity;

iii. Whether a guaranteed obligation or commitment for financial support exists; and

iv. The SCA's reported value.

This disclosure shall apply beginning in the period the SCA's equity initially falls below zero and shall continue to be disclosed as long as the SCA investment is in a deficit position. Additionally, the reporting entity shall detail in a narrative disclosure whether losses in the SCA have impacted other investments as required by INT 00-24: *EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee* and *EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses.*

SCA Loss Tracking [FN1]

1 SCA Entity	2 Reporting Entity's Share of SCA Net Income (Loss)	3 Accumulated Share of SCA Net Income (Losses)	4 Reporting Entity's Share of SCA's Equity, Including Negative Equity	5 Guaranteed Obligation / Commitment for Financial Support (Yes / No)	6 SCA Reported Value[FN2]
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NOTE: FN1 - This disclosure is only required for SCAs in which the reporting entity's share of losses exceed the investment in an SCA, (the SCA investment is in a negative equity position). This disclosure shall apply beginning in the period the investment in the SCA equity initially falls below zero and shall continue to be disclosed as long as the SCA investment is in a negative equity position. The disclosure is required whenever an investment in an SCA entity is in a negative equity position, and in the first year subsequent to the negative equity position in which a positive equity position has been attained.

FN2 - For Column 6, as detailed in SSAP No. 97, (unless the entity is subject to statutory adjustments under paragraph 9), once the reporting entity's share of losses equals or exceeds the investment in the SCA, the SCA shall be reported at zero, with discontinuation of the equity method, unless there is a guaranteed obligation or a commitment for future financial support. If there is a guaranteed obligation or a commitment for future financial support, the guarantee requirement shall be recognized pursuant to SSAP No. 5R, and the reporting entity shall report the investment in the SCA reflecting their share of losses as a contra-asset. *(Disclosure of the guarantee or commitment would be captured in Note 14 and is not duplicated in this disclosure.)*

SSAP No. 97, Exhibit C – Implementation Questions and Answers

7. **Q - Is it possible for an SCA investment valued using an equity method to be reported as a negative value?**

7.1 **A -** Yes, the equity method noninsurance SCA could have a negative equity. SSAP No. 97 paragraph 8.b.ii. relating to noninsurance SCA entities requires some assets to be reported as a negative value (nonadmitted) in paragraph 9. For example an 8.b.ii. SCA subsidiary that is only holding furniture, which is nonadmitted, would be reflected with negative equity to the extent the value of the nonadmitted asset(s) exceed(s) reported equity. It should be noted that although SSAP No. 97, paragraph 13.e. discusses some situations in which the equity method should be discontinued, this does not apply to SCA entities, which meet the requirements of paragraph 8.b.ii. In addition, SSAP No. 97, paragraph 13.e. lists some situations where the equity method would result in a valuation that is less than zero; examples are if reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee, in these cases, the valuation of the investment in subsidiary could be a negative value.

8. **Q - Paragraph 13.e. of SSAP No. 97, lists some situations where the equity method should be discontinued. If the equity method is discontinued, does the reporting entity cease tracking equity losses?**

8.1 **A -** No, the reporting entity does not cease tracking losses related to the investment in the SCA if an equity method is discontinued. If the equity method is discontinued, follow the guidance in paragraphs 15-17 and *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses* (INT 00-24).

8.2 INT 00-24 lists situations that might require the reporting entity to write down other investments in the SCA subsidiary, such as loans, because of continuing losses in the SCA investment. Paragraphs 15-17 provides guidance to assist in determining whether prior losses are being funded if the reporting entity purchases additional stock, etc. after suspending the equity method. Paragraphs 15-17 in INT 00-24 note that even if the equity method is not being applied, the investment should be tracked to determine if additional losses have to be applied to other items and to determine if the investment in the SCA has a future recovery.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):
The Statutory Accounting Principles (E) Working Group previously adopted agenda item 2018-09 – SCA Loss Tracking, which incorporated an additional disclosure to track an SCA's losses.

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

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

Staff Recommendation:
Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, as detailed below, to clarify the existing reporting requirements for an SCA in a loss position. Staff would also request comments from regulators and interested parties regarding additional situations that require negative reporting.

<u>Proposed Revisions:</u>

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

13. On at least a quarterly basis, the procedures set forth below shall be followed by a reporting entity in applying an equity method of accounting (as described in paragraphs 8.b.i. through 8.b.iv.), as applicable, to investments in SCA entities:

e. For entities subject to 8.b.i., 8.b.ii., 8.b.iii. and 8.b.iv. a reporting entity's share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by an equity method plus advances made by the investor. The reporting entity shall discontinue applying an equity method when the investment (including advances) is reduced to zero[3] and shall not provide for additional losses unless the situations in paragraph 13.e.i. or paragraph 13.e.ii. exist. ~~reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee (guaranteed obligations meeting the definition of liabilities in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5R) shall be recorded as liabilities).~~ If the investee subsequently reports net income, the reporting entity shall resume applying an equity method only after its share of that net income equals the share of net losses not recognized during the period that an equity method was suspended. ~~;~~ In situations in which negative equity is reported (paragraph 13.e.i. and paragraph 13.e.ii.), the book adjusted carrying value for the investment in the SCA shall reflect the reporting entity's negative equity value (reflecting the reporting entity's share of the SCA losses). (This would be reported as a contra-asset.)

i. In all instances in which the limited statutory adjustments required by paragraph 9 results in a negative equity valuation of the investment. (This would apply to 8.b.ii and 8.b.iv entities.)

ii. When the reporting entity has guaranteed obligations or committed further financial support to an SCA. Recognition of the negative equity in the SCA is in addition to the guarantee liability required under SSAP No. 5R. (This applies to all SCA entities.)

Staff Review Completed by:
Fatima Sediqzad - NAIC Staff
July 2018

Status:
On August 4, 2018, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, as shown above, to clarify the existing reporting requirements for when the reporting entity has a negative equity valuation in an SCA investment.

On November 15, 2018, the Statutory Accounting Principles (E) Working Group re-exposed this agenda item and directed NAIC staff to work with interested parties and research applicable U.S. GAAP guidance to consider revisions to existing guidance that requires negative subsidiary, controlled and affiliated (SCA) entity reporting when there is a guarantee or commitment to provide financial support.

On April 6, 2019, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, as detailed below, to revise the existing reporting requirements for when a reporting entity has a negative value in an SCA investment when the reporting entity has provided a financial commitment or guarantee. The illustration from the existing *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method*

[3] Refer to the additional guidance related to discontinuance of an equity method in paragraphs 15-17 and *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee* and *EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses.*

Losses has also been moved to SSAP No. 97, in its entirety, as a new exhibit. This INT provides examples of how losses in an SCA shall be applied to other investments once the SCA equity investment has been halted at zero.

Spring 2019 National Meeting Exposure:

SSAP No. 97—Subsidiary, Controlled and Affiliated Entities:

13. On at least a quarterly basis, the procedures set forth below shall be followed by a reporting entity in applying an equity method of accounting (as described in paragraphs 8.b.i. through 8.b.iv.), as applicable, to investments in SCA entities:

e. For entities subject to 8.b.i., 8.b.ii., 8.b.iii. and 8.b.iv. a reporting entity's share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by an equity method plus advances made by the investor. The reporting entity shall discontinue applying an equity method when the investment (including advances) is reduced to zero[4] and shall not provide for additional losses, while still continuing to track the amount of unreported equity method losses, until any future equity method income can be reported. If the ~~unless the~~ reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee, such as ~~(~~guaranteed obligations meeting the definition of liabilities in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5R), they shall be recorded as liabilities~~)~~. If the entire loss is recognized under SSAP No. 5R, it does not also need to be recognized under SSAP No. 97. However, if there is a guarantee or commitment, and the entire loss is not recognized under SSAP No. 5R, the reporting entity shall not stop at zero, and shall recognize a negative value of the SCA. If the investee subsequently reports net income, the reporting entity shall resume applying an equity method only after its share of that net income equals the share of net losses not recognized during the period that an equity method was suspended;

Footnote 2: Refer to the additional guidance related to discontinuance of an equity method in paragraphs 15-17 and *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee* and *EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses*. As detailed in INT 00-24, a reporting entity's share of losses in an SCA shall be applied to other investments held in the SCA once the SCA (common stock) investment has been reduced to zero.

EXHIBIT F – ILLUSTRATION OF THE APPLICATION OF INT 00-24

XYZ Investment in ABC Company

1. ABC Company is a life insurance company, formed January 2, 20X1 to sell health insurance in the state of New York. On January 2, 20X1, XYZ Insurance Company invested $500,000 in ABC, and purchased 100,000 shares of common stock at par, and 40,000 shares of preferred stock at par. ABC Preferred stock is non-voting, 5% cumulative.

2. XYZ determined it has obtained a controlling interest in ABC as XYZ owns 50% of the voting interests of ABC. XYZ accounted for its investment in ABC Insurance Company under the statutory equity method of accounting. The following table is selected information from the financial statements of ABC Insurance Company.

20X1 – 20X4

	1/2/20X1	12/31/20X1	12/31/20X2	12/31/20X3	12/31/20X4
Capital and Surplus:					
Common stock, $1 par, 200,000 shares issued and outstanding	$ 200,000	$ 200,000	$ 200,000	$ 200,000	$ 200,000
Preferred stock, $10 par, 100,000 shares issued and outstanding	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Surplus Notes			$ 500,000	$ 500,000	$ 500,000
Unassigned Funds (Surplus)		$ 130,000	($ 180,000)	($ 630,000)	($1,430,000)
Total Capital and Surplus	$1,200,000	$1,330,000	$1,520,000	$ 1,070,000	$ 270,000

20X5 – 20X9

	12/31/20X5	12/31/20X6	12/31/20X7	12/31/20X8	12/31/20X9
Capital and Surplus:					
Common stock, $1 par, 200,000 shares issued and outstanding	$ 200,000	$ 200,000	$ 200,000	$ 200,000	$ 200,000
Preferred stock, $10 par, 100,000 shares issued and outstanding	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Surplus Notes	$ 500,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Unassigned Funds (Surplus)	($1,980,000)	($1,830,000)	($1,280,000)	($ 430,000)	$ 820,000
Total Capital and Surplus	($280,000)	$ 370,000	$ 920,000	$1,770,000	$3,020,000

3. At 1/2/20X1, XYZ recorded the following entry to record its investment in ABC:

Investment in ABC Common stock	$ 100,000	
Investment in ABC Preferred stock	$ 400,000	
Cash		$ 500,000

To record initial investment in ABC Insurance Company.

4. During the year ended 12/31/20X1, ABC had statutory net income before dividends of $200,000. At 12/31/20X1, ABC declared and paid a 5% preferred dividend, and a common stock dividend of $.10 per share. XYZ recorded the following entries:

Cash	$ 20,000	
Dividend Income		$ 20,000

To record preferred dividend income from ABC Insurance Company for 20X1.

Investment in ABC Common stock	$ 75,000	
Unrealized Gain/Loss		$ 75,000

To record 20X1 unrealized gain on investment in ABC Common. (($200,000 - $50,000) * 50%)

Cash	$ 10,000	
Unrealized Gain/Loss	$ 10,000	
Dividend Income		$ 10,000
Investment in ABC Common stock		$ 10,000

To record 20X1 dividend on ABC Common. (100,000 shares * $.10)

5. During the year ended 12/31/20X2, ABC issued an 8% surplus note of $500,000. XYZ purchased 100% of the surplus note. During that same year, ABC incurred a statutory net loss before dividends of $250,000. At 12/31/20X2, ABC declared and paid a 5% preferred dividend, and a common stock dividend of $.05 per share. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Investment in ABC Surplus Notes	$ 500,000	
Cash		$ 500,000

To record investment in ABC Insurance Company surplus notes.

Cash	$ 20,000	
Dividend Income		$ 20,000

To record preferred dividend income from ABC Insurance Company for 20X2.

Unrealized Gain/Loss	$ 150,000	
Investment in ABC Common stock		$ 150,000

To record 20X2 unrealized loss on investment in ABC Common. (($-250,000 - $50,000) * 50%)

Cash	$ 5,000	
Unrealized Gain/Loss	$ 5,000	
Dividend Income		$ 5,000
Investment in ABC Common stock		$ 5,000

To record 20X2 dividend on ABC Common. (100,000 shares * $.05)

6. During the year ended 12/31/20X3, ABC Insurance Company incurred a statutory net loss before dividends of $400,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Dividends Receivable	$ 20,000	
Dividend Income		$ 20,000

To record preferred dividend income from ABC Insurance Company for 20X3.

Unrealized Gain/Loss	$ 182,000	
Investment in ABC Preferred stock		$ 172,000
Investment in ABC Common stock		$ 10,000

To record 20X3 unrealized loss on investment in ABC Common and Preferred.

Total net loss and preferred stock dividend ($450,000).
Common stock component reduces the Investment in ABC Common stock component to $0. (20,000 * 50%)

Total net loss and preferred dividend (-$400,000 - $50,000)	$450,000
Less amount used to reduce common stock investment to $0	20,000
Amount remaining to be allocated to investment in preferred	430,000
XYZ ownership % of preferred	40%
ii. XYZ reduction in investment in preferred	$172,000

7. During the year ended 12/31/20X4, ABC Insurance Company incurred a statutory net loss before dividends of $750,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Dividends Receivable	$ 20,000	
Dividend Income		$ 20,000

To record preferred dividend income from ABC Insurance Company for 20X4.

Unrealized Gain/Loss	$ 458,000	
Investment in ABC Preferred stock		$ 228,000
Investment in ABC Surplus note		$ 230,000

To record 20X4 unrealized loss on investment in ABC Preferred and Surplus Notes.

Total net loss and preferred stock dividend ($800,000).
Common stock component reduces the Investment in ABC Preferred stock component to $0. (570,000 * 40%)
Preferred stock component calculated as:

Total net loss and preferred dividend (-$750,000 - $50,000)	$800,000
Less amount used to reduce preferred stock investment to $0	570,000
Amount remaining to be allocated to investment in surplus note	230,000
XYZ ownership % of surplus note	100%
iii. XYZ reduction in investment in ABC Surplus Notes	$230,000

8. During the year ended 12/31/20X5, ABC Insurance Company incurred a statutory net loss before dividends of $500,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Dividends Receivable	$ 20,000	
Dividend Income		$ 20,000

To record preferred dividend income from ABC Insurance Company for 20X5.

Unrealized Gain/Loss	$ 270,000	
Investment in ABC Surplus note		$ 270,000

To record 20X5 unrealized loss on investment in ABC Surplus Notes.

Total ABC net loss and preferred stock dividend (-$500,000 - $50,000).	
Surplus Note component calculated as:	
Total net loss and preferred dividend (-$500,000 - $50,000)	$550,000
XYZ ownership % of ABC Surplus Note	100%
	$550,000
Amount of unrealized loss recognized in 20X5	$270,000
iv. Amount of unrealized loss suspended	$280,000

9. Since XYZ has not guaranteed any liabilities of ABC, the reduction they would recognize is limited to their remaining investment in ABC Surplus Notes. Therefore, they would only recognize a 20X5 unrealized loss on their investment in ABC of $270,000.

10. During the year ended 12/31/20X6, ABC Insurance Company realigned their marketing efforts and modified the products they were selling. ABC also issued an additional 8% surplus note of $500,000. This surplus note was purchased by an unaffiliated third party. During the year ended 12/31/X6, ABC Insurance Company had statutory net income before dividends of $200,000. ABC Insurance Company did not declare any dividends on common stock, but declared and paid current and dividends in arrears on preferred. XYZ recorded the following entries:

Cash	$ 80,000	
Dividends Receivable		$ 60,000
Dividend Income		$ 20,000

To record preferred dividend income from ABC Insurance Company for 20X6, and receipt of preferred dividends receivable for 20X3, 20X4 and 20X5.

11. XYZ did not record any change in their investment in ABC Surplus Notes, ABC Preferred or ABC Common, since ABCs' net income after preferred dividends did not exceed the losses accumulated during the period that XYZ suspended recording unrealized losses.

12. The following amounts were tracked:

Total ABC net income and preferred stock dividend ($200,000 - $50,000).	
Surplus Note component calculated as:	
Total net income and preferred dividend ($200,000 - $50,000)	$150,000
XYZ ownership % of ABC Surplus Note	50%
Amount of unrealized loss suspended in 20X5	$ 75,000
Remaining amount of unrealized loss suspended	$280,000
	$205,000

13. During the year ended 12/31/20X7, ABC Insurance Company had statutory net income before dividends of $600,000. At 12/31/20X7, ABC declared and paid a 5% preferred dividend. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Cash	$ 20,000	
Dividend Income		$ 20,000

To record preferred dividend income from ABC Insurance Company for 20X7.

Investment in ABC Surplus Notes	$ 70,000	
Unrealized Gain/Loss		$ 70,000

To record 20X7 unrealized gain on investment in ABC Surplus Notes.

Total ABC net income and preferred stock dividend ($600,000 - $50,000).
Surplus Note component calculated as:

Total net income and preferred dividend ($600,000 - $50,000)	$550,000
XYZ ownership % of ABC Surplus Note	50%
	$275,000
Remaining amount of unrealized loss suspended in 20X5	$205,000
v. 20X7 amount of unrealized gain on investment in ABC Surplus Note	$ 70,000

14. During the year ended 12/31/20X8, ABC Insurance Company had statutory net income before dividends of $900,000. At 12/31/20X8, ABC declared and paid a 5% preferred dividend. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Cash	$ 20,000	
Dividend Income		$ 20,000

To record preferred dividend income from ABC Insurance Company for 20X8.

Total ABC net income and preferred stock dividend ($900,000 - $50,000).
Surplus Note component calculated as:

Total net income and preferred dividend ($900,000 - $50,000)	$850,000
XYZ ownership % of ABC Surplus Note	50%
vi. 20X8 amount of unrealized gain on investment in ABC Surplus Note	$425,000

Investment in ABC Surplus Notes	$ 425,000	
Unrealized Gain/Loss		$ 425,000

To record 20X8unrealized gain on investment in ABC Surplus Notes.

15. During the year ended 12/31/20X9, ABC Insurance Company had statutory net income, before interest on surplus notes and dividends, of $1,400,000. The Commissioner approved one year's interest payment on the surplus notes. At 12/31/20X9, ABC declared and paid a 5% preferred dividend, and a $.10 dividend per share on Common stock. XYZ recorded the following entries:

Cash	$ 20,000	
Dividend Income		$ 20,000

To record preferred dividend income from ABC Insurance Company for 20X9.

Cash	$ 40,000	
Interest Income		$ 40,000

To record surplus notes interest income from ABC Insurance Company for 20X9. ($500,000 * 8%)

Investment in ABC Surplus Notes	$ 5,000	
Investment in ABC Preferred Stock	$ 400,000	
Investment in ABC Common Stock	$ 130,000	
Unrealized Gain/Loss		$ 535,000

To record 20X9 unrealized gain on investment in ABC Common, Preferred and Surplus Notes. Components computed as follows:

Total Net Income net of preferred stock dividend and interest on surplus notes ($1,400,000 - $50,000 - $80,000)	$ 1,270,000
Less amount needed to restore investment in surplus notes	($ 10,000)
Amount available for preferred stock and common stock investment restoration	$ 1,260,000
Amount needed to restore preferred stock component	($ 1,000,000)
Amount available to restore common stock component	$ 260,000

Surplus Notes component ($10,000 * 50%)	$ 5,000
Preferred Stock component ($1,000,000 * 40%)	$ 400,000
vii. Common stock component ($260,000 * 50%)	$ 130,000

Cash	$ 10,000	
Unrealized Gain/Loss	$ 10,000	
Dividend Income		$ 10,000
Investment in ABC Common stock		$ 10,000

To record 20X9 dividend on ABC Common. (100,000 shares * $.10)

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

Issue: Prepayments to Service and Claims Adjusting Providers

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue:
This agenda item seeks to address a regulator inquiry regarding prepayments to providers of claims and adjusting services in which the service provider is prepaid by the insurer. While the initial inquiry for this agenda item was a prepaid roadside assistance provider, the accounting issues are relevant to other providers of claims and adjusting services as well.

The prepayments can take a variety of forms and the provider can take on a variety of duties, but in the example provided, the roadside assistance provider was being prepaid a flat fee for a minimum number of vehicles/ policies regardless of claims incurred or sales. The provider additionally received a flat fee per vehicle if actual sales exceed the negotiated minimum number of vehicles. The provider, who is not an insurer, was contracted to provide roadside assistance and administer and settle claims using only the prepaid amounts. So, to use a health care analogy, the provider accepts a "capitated" payment to administer and settle claims.

Roadside assistance is a common feature or rider to many automobile insurance policies that has been available for several years. Roadside assistance provides towing and other services such as jumpstarting car batteries, unlocking doors and gas refills for the insured. Discussions with industry representatives indicate that in most cases, roadside assistance providers may have rates that are negotiated, but providers are not typically prepaid. Rather, when the insured calls for assistance negotiated rate providers are dispatched and subsequently paid at negotiated rates as the claims for assistance are incurred. This agenda item is focused on prepayments to providers.

To provide a fictional numeric example, the minimum annual payment to the provider was for 50,000 vehicles at $10 per vehicle, with additional payments per vehicle required if sales exceed the initial fees. The provider in this example, was also responsible for administering claims and dispatching service in exchange for the "capitated" fee. Therefore, the roadside assistance provider would not bill the insurer further when claims are incurred.

The guidance in *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*, paragraphs 4 and 5 (excerpted in the Authoritative Literature section) are relevant to the timing of claims recognition and payment of loss adjustment expenses. The guidance provides that claims are recognized when incurred. The existing guidance indicates that paying a third party in advance to adjust claims in the future does not decrease the claims adjustment liability. The claim adjustment liability is only reduced when the claim has been adjusted, not when it is prepaid. In accordance with *SSAP No. 64—Offsetting and Netting of Assets and Liabilities*, prepayments to a third party do not meet the right of offset requirements.

The statutory accounting and reporting questions at issue are how the direct writer accounts for and reports the prepaid claims and adjusting expenses initially and subsequently. The existing guidance notes that claim adjusting expenses are not reduced for payments to third parties. The guidance in SSAP No. 55 indicates liabilities shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to managed care providers. The prepaid expenses under consideration may include a prepayment for claims administration and or a prepayment for the claims.

In reviewing the annual statement instructions for the Underwriting and Expense Exhibit, Part 3, and the related instructions for property and casualty expenses, the initial prepayment to the provider seems be consistent with miscellaneous underwriting expense.

For policies that purchase the coverage and incurred a claim, it seems appropriate to reclassify a proportionate percentage of the initial prepayment to claims incurred and loss adjustment expenses as losses are incurred and adjusted. However, it would be inappropriate to allocate claims expense and claims adjusting expenses to policies that did not purchase the coverage and inappropriate to allocate the costs of the provider to claims or claims adjusting expenses prior to incurring the claims. Therefore, in the event of prepayment to a third-party provider, some of the costs may remain in miscellaneous adjusting expense.

Existing Authoritative Literature:

- *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses,* paragraphs 4 and 5 includes the following:

  SUMMARY CONCLUSION

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

  5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims adjustment expenses on non-capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third-party administrators, etc. The liability for claims adjustment expenses on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers.

  General

  10. The liability for claim reserves and claim liabilities, unpaid losses, and loss/claim adjustment expenses shall be based upon the estimated ultimate cost of settling the claims (including the effects of inflation and other societal and economic factors), using past experience adjusted for current trends, and any other factors that would modify past experience. These liabilities shall not be discounted unless authorized for specific types of claims by specific SSAPs, including SSAP No. 54R and *SSAP No. 65—Property and Casualty Contracts*.

The guidance in SSAP No. 55, paragraph 5 was incorporated from *INT 02-21: Accounting for Prepaid Loss Adjustment Expenses and Claim Adjustment Expenses*, which was nullified when the guidance was moved to SSAP No. 55.

- *SSAP No. 64—Offsetting and Netting of Assets and Liabilities* provides the following:

  2. Assets and liabilities shall be offset and reported net only when a valid right of setoff exists except as provided for in paragraphs 3 and 4. A right of setoff is a reporting entity's legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying an amount that the other party owes to the reporting entity against the debt[INT 09-08]. A valid right of setoff exists only when all the following conditions are met:

  a. Each of the two parties owes the other determinable amounts. An amount shall be considered determinable for purposes of this provision when it is reliably estimable by both parties to the agreement;

  b. The reporting party has the right to set off the amount owed with the amount owed by the other party;

  c. The reporting party intends to setoff; and

  d. The right of setoff is enforceable at law.

- *Property and Casualty Annual Statement Instructions Underwriting and Investment Exhibit Part 3 – Expenses* provides the following:

  A company that pays any affiliated entity (including a managing general agent) for the management, administration, or service of all or part of its business or operations shall allocate these costs to the appropriate expense classification items (salaries, rent, postage, etc.) as if these costs had been borne directly by the company. Management, administration, or similar fees should not be reported as a one-line expense. The company may estimate these expense allocations based on a formula or other reasonable basis.

  A company that pays any non-affiliated entity (including a managing general agent) for the management, administration, or service of all or part of its business or operations shall allocate these costs to the appropriate expense classification item as follows:

  a. Payments for claims handling or adjustment services are allocated to Loss Adjustment Expenses (Column 1) in the Underwriting and Investment Exhibit, Part 3. If the total of such expenses incurred equals or exceeds 10% of the total incurred Loss Adjustment Expenses (Line 25, Column 1), the company shall allocate these costs to the appropriate expense classification items as if these costs had been borne directly by the company. If such expenses are less than 10% of the total, they may be reported on Line 1 of Column 1.

  b. Payments for services other than claims handling or adjustment services are allocated to the appropriate expense classification items as if these costs had been borne directly by the company, if the total of such fees paid equals or exceeds 10% of the total incurred Other Underwriting Expenses (Line 25, Column 2). If the total is less than 10%, the payments may be reported on Line 2 if the fees are calculated as a percentage of premiums, or on Line 3 if the fees are not calculated as a percentage of premiums.

  The total management and service fees incurred attributable to affiliates and non-affiliates is reported in the footnote to the Underwriting and Investment Exhibit, Part 3 of the annual statement, and the method(s) used for allocation shall be disclosed in the Notes to the Financial Statements. The company shall use the same allocation method(s) on a consistent basis. Refer to *SSAP No. 70—Allocation of Expenses* for accounting guidance.

  Exclude from investment expenses brokerage and other related fees, to the extent they are included in the actual cost of a bond upon acquisition. Refer to *SSAP No. 26R—Bonds* for accounting guidance.

Include all other internal costs or costs paid to an affiliated company related to origination, purchase or commitment to purchase bonds.

For the purpose of establishing uniformity in classifications of expenses in reporting entities' statements and reports filed with the Insurance Departments, the company shall observe the instructions contained in the Appendix of these instructions for the Uniform Classification of Expenses.

Activity to Details of Write-ins Aggregated at Line 24 for Miscellaneous Expenses

> List separately each category of miscellaneous expenses for which there is no pre-printed line on Underwriting and Investment Exhibit, Part 3.

- *Property and Casualty Annual Statement Instructions Underwriting Appendix Instructions for Uniform Classifications of Expenses of Property and Casualty Insurers* provides the following:

1.1 Direct

Include: The Following Expenses When in Connection with the Investigation and Adjustment of Policy Claims:

<u>Independent Adjusters</u>: Fees and expenses of independent adjusters or settling agents

<u>Legal</u>: Fees and expenses of lawyers for legal services in the defense, trial, or appeal of suits, or for other legal services

<u>Bonds</u>: Premium costs of bonds

<u>Appeal Costs and Expenses</u>: Appeal bond premiums, charges for printing records, charges for printing briefs, court fees and incidental to appeals

<u>General Court Costs and Fees</u>: Entry fees and other court costs, and other fees not includible in Losses (Note: Interest and costs assessed as part of or subsequent to judgment are includible in Losses.)

<u>Medical Testimony</u>: Fees and expenses of medical witnesses of attendance or testimony at trials or hearings ("Medical" includes physicians, surgeons, chiropractors, chiropodists, dentists, osteopaths, veterinarians, and hospital representatives.)

<u>Expert Witnesses</u>: Fees and expenses of expert witnesses for attendance or testimony at trials or hearings

<u>Lay Witnesses</u>: Fees and expenses of lay witnesses for attendance or testimony at trials or hearings

<u>Services of Process</u>: Constables, sheriffs, and other fees and expenses for service of process, including subpoenas

<u>Transcripts of Testimony</u>: Stenographers' fees and fees for transcripts of testimony

<u>Medical Examinations</u>: Fees for medical examinations, fees for performing autopsies, fees for impartial examination, x-rays, etc., for the purpose of trial and determining questions of liability (This does not include fees for medical examinations, x-rays, etc., made to determine necessary treatment, or made solely to determine the extent or continuation of disability, or first aid charges, as such fees and charges are includible in Losses.)

<u>Miscellaneous</u>: Costs of appraisals, expert examinations, surveys, plans, estimates, photographs, maps, weather reports, detective reports, audits, credit or character reports, watchmen (Charges for hospital records and records of other kinds, notary fees, certified copies of certificates and legal documents, charges for Claim Adjustment Services by underwriting syndicates, pools, and associations)

Exclude: Compensation to employees (see Salaries)

Expenses of salaried employees (see Travel and Travel Items)

Items includible in Allowances to Managers and Agents

Payments to State Industrial Commissions (see Taxes, Licenses, and Fees)

Payments to claim adjusting organizations except where the expense is billed specifically to individual companies (see Boards, Bureaus, and Associations)

Cost of services of medical examiners for underwriting purposes (see Surveys and Underwriting Reports)

Salvage and subrogation recovery expense, rewards, lost and found advertising, expenses for disposal of salvage (Such expenses shall be deducted from salvage.)

Any expenses which by these instructions are includible elsewhere

Separation of Claim Adjustment Services:

The Statistical Plans filed by certain rating bureaus contain definitions of "Allocated Loss Adjustment Expenses" which exclude for rating purposes certain types of claim adjustment services as defined herein. For the lines of business thus affected, companies that are members of such rating bureaus shall maintain records necessary to the reporting of Claim Adjustment Services—Direct, as follows:

a. As defined in Statistical Plans

b. Other than as defined in Statistical Plans

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: June 2017 updates to the *AICPA Revenue Recognition Guide noted in Issue #9- 1: Considerations for applying the scope exception in FASB ASC 606-10-15-2 and 606-10-15-4 to Contracts within the Scope of ASC 944* contains some discussion on roadside assistance that is tangential but does not address the prepayments under discussion. The updates were issued in response to questions regarding Accounting Standards Update (ASU) *2016-20: Technical Corrections and Improvements to Topic 606, Revenue from Contracts from Customers*.

At issue was whether to bifurcate insurance contracts within the scope of *Topic 944, Financial Services—Insurance* that contain noninsurance elements and account for them within the scope of *Topic 606, Revenue from Contracts from Customers*. Roadside assistance provided with an automobile insurance policy was listed as an example of activities performed by an insurance entity, included in contracts within the scope of FASB Topic 944, that Financial Reporting Executive Committee (FinREC) believes generally should be considered fulfillment activities (that either mitigate risks to the insurer or contain costs related to services to fulfill the insurer's obligation) that are not within the scope of FASB Topic 606, but should be considered part of the insurance contract within the scope of FASB Topic 944. Roadside assistance was noted as mitigating the risk of a further accident or damage to the insured automobile.

Convergence with International Financial Reporting Standards (IFRS): During the development of *IFRS 17, Insurance Contracts*, the International Accounting Standards Board (IASB) had discussions regarding classification for the revenue which are not on point to roadside assistance prepayments. Similar to the AICPA issue noted above, the issue was whether roadside assistance sold as part of an insurance policy should be included within the scope of insurance contracts or whether it should be accounted for separately as fee for service. The IFRS 17 issued in May 2017 notes that some fixed-fee service contracts meet the definition of an insurance contract (for example, automobile roadside assistance) and IFRS 17 provides an option to use *IFRS 15, Revenue from Contracts with Customers* to account for as fee for service.

Staff Review Completed by:
Robin Marcotte, NAIC Staff - September 2018

Staff Recommendation:

NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 55 to provide guidance as follows:

1. **The initial prepayment for providers of claims adjusting expense and claim payment is recognized as a miscellaneous underwriting expense.**

2. **Subsequently, for direct policies that purchased the related insurance coverage which used the claims or adjusting services incur losses which are paid, a proportionate percentage of the initial provider prepayment amounts are reclassified from miscellaneous underwriting expense to claims adjustment expense and or claims expense, as applicable**

3. **To the extent that additional amounts are prepaid for direct policies that did not purchase services, the prepaid expenses shall remain in miscellaneous underwriting expenses.**

Note that NAIC staff envisions that additional annual statement instruction clarifications may be indicated after the Working Group finalizes guidance.

Proposed revisions to SSAP No. 55 recommended for November 2018 exposure:

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

a. Prepayments to third party administrators, management companies or other entities for unpaid losses/claims, except for capitated payments for manage care contracts, shall not reduce losses/claims and shall be initially reported as miscellaneous underwriting expenses. When incurred losses/claims are paid, claims prepayments to third party administrators, management companies or other entities (except for capitated payments for manage care contracts) are reclassified proportionately based on the losses/claims cost from miscellaneous underwriting expenses to loss/claim expenses paid. Flat fee minimum prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as miscellaneous underwriting expenses and not reclassified to loss/claim adjusting expenses.

b. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related to extra contractual obligations and bad-faith lawsuits.

5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims adjustment expenses on non-capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third-party administrators, etc. The liability for claims adjustment expenses on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers.

a. Prepayments to third party administrators, management companies or other entities, except for capitated payments for manage care contracts, for unpaid losses/ claims adjusting expenses shall be initially reported as miscellaneous underwriting expenses.

b. When incurred losses/claims adjusting expenses are paid, prepayments to third party administrators, management companies or other entities (except for capitated payments for manage care contracts) are reclassified proportionately based on the adjusting expenses from miscellaneous underwriting expenses to paid loss /claim adjusting expenses. Flat fee minimum prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as miscellaneous underwriting expenses and not reclassified to loss/claim adjusting expenses.

Status:
On November 15, 2018, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*, as shown above, to provide guidance clarifying that prepayments to providers of claims and adjusting services shall be recognized as miscellaneous underwriting expenses, with guidance for reclassification as claims adjustment expense or claims expense, as applicable, as claims are paid. During the November 2018 Working Group discussion, it was highlighted that the proposed treatment is different than recognizing a nonadmitted prepaid asset, as the amounts are not expected to be material. Comments were requested on this difference and if the amounts are expected to be material.

Spring 2019 National Meeting discussion:

NAIC staff recommends re-exposure of modified proposed language which was developed with interested parties input as illustrated below and in the agenda item. The interested parties responded to the request for comments and noted a preference to "nonadmit a prepaid asset" for prepaid loss and LAE, which is consistent with existing guidance, instead of the to the previously exposed "expense and reclassify as amounts are paid" approach. NAIC staff has proposed a modification to the interested parties' proposed language to exclude the reference to *SSAP No. 84—Health Care and Government Insured Plan Receivables* which is not currently referenced in SSAP No. 55. In addition, NAIC staff has recommended guidance regarding flat fee bundled payments which indicates nonadmission of prepaid amounts and allocation to expense categories as benefits or services are rendered.

On April 6, 2019, the Statutory Accounting Principles (E) Working Group exposed modified language, developed with interested parties' input as described above, which requires nonadmittance for prepaid loss and LAE. This guidance is consistent with existing statutory accounting principles and was revised from the previously exposed "expense and reclassify as amounts are paid" approach. In addition, guidance was exposed regarding flat fee bundled payments which indicates nonadmission of prepaid amounts and allocation to expense categories as benefits or services are rendered. The exposed language is illustrated below.

2019 Spring National Meeting exposure:

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

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

a. All prepayments (i.e., variable, fixed or bundled amounts) to third party administrators, management companies or other entities for unpaid claims, losses and losses/claims adjustment expenses, except for capitated payments for managed care contracts, shall not reduce losses/claims and shall be initially reported as a prepaid asset and nonadmitted in accordance with SSAP No. 29—*Prepaid Expenses*. When the benefit has been provided to the policyholder or claimant, the claims prepayments to third party administrators, management companies or other entities (except for capitated payments for managed care contracts), are reclassified proportionately from the prepaid nonadmitted asset to claims, losses or loss/claim expenses paid based on the amount of losses/claims cost incurred to provide the benefit.

b. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as miscellaneous underwriting expenses.

c. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related

5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims adjustment expenses on non-capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third-party administrators, etc. The liability for claims adjustment expenses on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers.

a. When the prepaid benefit as described in paragraph 4 has been provided to the policyholder or the claimant, the associated prepayments to third party administrators, management companies or other entities (except for capitated payments for managed care contracts) are reclassified proportionately from the prepaid nonadmitted asset to paid loss /claim adjusting expenses based on the amount of losses/claims cost incurred to provide the benefit. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as miscellaneous underwriting expenses.

This attachment illustrates the combined revisions exposed at the 2019 Spring National Meeting:

- **2019-09 SSAP No. 101 – Q/A Updates - TCJA** revisions to the *SSAP No. 101—Income Taxes* Implementation Q&A to update the guidance in response to the federal Tax Cuts and Jobs Act.

- **2019-10 SSAP No. 101 – Q/A Updates – DTA/DTL Offset** SSAP No. 101—Income Taxes Implementation Q&A to clarify the application of the deferred tax admittance calculation, particularly with regards to offsetting deferred tax liabilities. Agenda item 2019-10 has proposed revisions to paragraphs: 2.5- 2.7, 4.1, 4.2, 4.9, 4.13, 4.17, 4.18, 4.21, 4.24, 5.1 and 5.3.

Note that some of the revisions to paragraphs 4.18, 4.21,4.24 were affected by both agenda item 2019-09 and agenda item 2019-10.

For Summer National meeting discussion, effective date language has been proposed and as illustrated in the attached for paragraph 37 in SSAP No. 101 and for the beginning of the Implementation QA. In addition, the following minor typographical edits noted by interested parties' technical representative have been included:

- In the second line of footnote 30 on "is" should be "its" before "hypothetical"
- In 4.23 - "Except" should be "except"
- In line 1 of 4.34 "paragraph 4.11" should be "Question 4.11" as elsewhere
- Bottom of the table in 11.12 on - "(taxes paid at" should be "taxes paid at 21%)"

Statement of Statutory Accounting Principles No. 101

Income Taxes

STATUS

Type of Issue	Common Area
Issued	August 31, 2011
Effective Date	January 1, 2012
Affects	Supersedes SSAP No. 10 and SSAP No. 10R; Nullifies INT 00-21, INT 00-22, INT 01-19 and INT 01-20
Affected by	No other pronouncements
Interpreted by	INT 01-18; INT 06-12; INT 18-03
Relevant Appendix A Guidance	None

STATUS **1**

SCOPE OF STATEMENT **1**

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EXHIBIT A – IMPLEMENTATION QUESTIONS AND ANSWERS **14**

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for current and deferred federal and foreign income taxes and current state income taxes. This statement supersedes conclusions reached in *SSAP No. 10—Income Taxes* and *SSAP No. 10R—Income Taxes, A Temporary Replacement of SSAP No. 10*.

SUMMARY CONCLUSION

2. For purposes of accounting for federal and foreign income taxes, reporting entities shall adopt *FASB Statement No. 109, Accounting for Income Taxes* (FAS 109) with modifications for state income taxes[INT 18-03], the realization criteria for deferred tax assets, and the recording of the impact of changes in deferred tax balances. One objective of accounting for income taxes is to recognize the estimated amount of taxes payable or refundable for the current year as a tax liability or asset. A second objective is to recognize deferred tax liabilities and assets for the future tax consequences of events that have been recognized in a reporting entity's statutory financial statements or tax returns. However, the second objective is realistically constrained because (a) the tax payment or refund that results from a particular tax return is a joint result of all the items included in that return, (b) taxes that will be paid or refunded in future years are the joint result of events of the current or prior years and events of future years, and (c) information available about the future is limited. As a result, financial statements will recognize current and deferred income tax assets and liabilities in accordance with the provisions of this statement based upon estimates and approximations. For purposes of this statement, only adjusted gross deferred tax assets that are more likely than not (a likelihood of more than 50 percent) to be realized shall be considered in determining admitted adjusted gross deferred tax assets.

Current Income Taxes

3. "Income taxes incurred" shall include current income taxes, the amount of federal and foreign income taxes paid (recovered) or payable (recoverable) for the current year. Current income taxes are defined as:

a. Current year estimates (including quarterly estimates) of federal and foreign income taxes payable or refundable, based on tax returns for the current and prior years, except as addressed in paragraph 3.b., and tax loss contingencies (including related interest and penalties) for current and all prior years, computed in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5R) with the following modifications:

   i. The term "probable" as used in SSAP No. 5R shall be replaced by the term "more likely than not (a likelihood of more than 50 percent)" for federal and foreign income tax loss contingencies only.

   ii. For purposes of the determination of a federal and foreign income tax loss contingency, it shall be presumed that the reporting entity will be examined by the relevant taxing authority that has full knowledge of all relevant information.

   iii. If the estimated tax loss contingency is greater than 50% of the tax benefit originally recognized, the tax loss contingency recorded shall be equal to 100% of the original tax benefit recognized.

b. Amounts incurred or received during the current year relating to prior periods, to the extent not previously provided, as such amounts are deemed to be changes in accounting estimates as defined in *SSAP No. 3—Accounting Changes and Corrections of Errors* (SSAP No. 3).

c. In determining when tax loss contingencies associated with temporary differences should be included in current income taxes under paragraph 3.a., and therefore included in deferred taxes under paragraph 7, a reporting entity is not required to "gross-up" its current and deferred taxes until such time as an event has occurred that would cause a re-evaluation of the contingency and its probability of assessment, e.g., the IRS has identified the item as one which may be adjusted upon audit. Such an event could be the reporting entity's (or its affiliate or parent in a consolidated income tax return) receipt of a Form 5701, Proposed Audit Adjustment, or could occur earlier upon receipt of an Information Document Request. At such time, the company must reassess the probability of an adjustment, reasonably re-estimate the amount of tax contingency as determined in accordance with paragraph 3.a., make any necessary adjustment to deferred taxes, and re-determine the admissibility of any adjusted gross deferred tax asset as provided in paragraph 11.

4. State taxes (including premium, income and franchise taxes) shall be computed in accordance with SSAP No. 5R and shall be limited to (a) taxes due as a result of the current year's taxable basis calculated in accordance with state laws and regulations and (b) amounts incurred or received during the current year relating to prior periods, to the extent not previously provided as such amounts are deemed to be changes in accounting estimates. Property and casualty insurance companies shall report state taxes as other underwriting expenses under the caption "Taxes, licenses, and fees." Life and accident and health insurance companies shall report such amounts as general expenses under the caption "Insurance taxes, licenses, and fees, excluding federal income taxes." Other health entities shall report such amounts as general administration expenses under the caption "Taxes, licenses, and fees." State tax recoverables that are reasonably expected to be recovered in a subsequent accounting period are admitted assets. State taxes are reasonably expected to be recovered if the refund is attributable to overpayment of estimated tax payments, errors, carrybacks, or items for which the reporting entity has authority to recover under a state regulation or statute.

Deferred Income Taxes

5. Because tax laws and statutory accounting principles differ in their recognition and measurement of assets, liabilities, equity, revenues, expenses, gains, and losses, differences arise between:

a. The amount of taxable income and pretax statutory financial income for a year, and

b. The tax bases of assets or liabilities and their reported amounts in statutory financial statements.

6. A reporting entity's balance sheet shall include deferred income tax assets (DTAs) and liabilities (DTLs) related to the estimated future tax consequences of temporary differences and carryforwards, generated by statutory accounting, as defined in paragraph 11 of FAS 109.

7. A reporting entity's deferred tax assets and liabilities are computed as follows:

a. Temporary differences are identified and measured using a "balance sheet" approach whereby statutory and tax basis balance sheets are compared;

b. Temporary differences include unrealized gains and losses and nonadmitted assets but do not include asset valuation reserve (AVR), interest maintenance reserve (IMR), Schedule F penalties and, in the case of a mortgage guaranty insurer, amounts attributable to its statutory contingency reserve to the extent that "tax and loss" bonds have been purchased;

c. Total DTAs and DTLs are computed using enacted tax rates;

d. A DTL is not recognized for amounts described in paragraph 31 of FAS 109; and

e. Gross DTAs are reduced by a statutory valuation allowance adjustment if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of the gross DTAs will not be realized. The statutory valuation allowance adjustment[1], determined in a manner consistent with paragraphs 20-25 of FAS 109[2], shall reduce the gross DTAs to the amount that is more likely than not to be realized (the adjusted gross deferred tax assets).

8. Changes in DTAs and DTLs, including changes attributable to changes in tax rates and changes in tax status, if any, shall be recognized as a separate component of gains and losses in unassigned funds (surplus)[3]. Admitted adjusted gross DTAs and DTLs shall be offset and presented as a single amount on the statement of financial position.

Admissibility of Income Tax Assets

9. Current income tax recoverables shall include all current income taxes, including interest, reasonably expected to be recovered in a subsequent accounting period, whether or not a return or claim has been filed with the taxing authorities. Current income tax recoverables are reasonably expected to be recovered if the refund is attributable to overpayment of estimated tax payments, errors, carrybacks, as defined in paragraph 289 of FAS 109, or items for which the reporting entity has substantial authority, as that term is defined in Federal Income Tax Regulations.[(INT 06-12)]

10. Current income tax recoverables meet the definition of assets as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement.

11. The net admitted DTA shall not exceed the excess of the adjusted gross DTA, as determined under paragraph 7.e., over gross DTL. Adjusted gross DTAs shall be admitted based upon the three-component admission calculation at an amount equal to the sum of paragraphs 11.a., 11.b., and 11.c.:

[1] The statutory valuation allowance adjustment is utilized strictly to calculate the "adjusted gross DTA". (Admittance criteria in paragraph 11 are applied to the "adjusted gross DTA".) In determining the amount of adjusted gross DTA, the reporting entity shall consider reversal patterns of temporary differences to the extent necessary to support establishing or not establishing a valuation allowance adjustment, determined in accordance with paragraphs 228 and 229 of FAS 109. For purposes of this accounting statement, consideration of reversal patterns does not require scheduling beyond that necessary to support establishing or not establishing a valuation allowance adjustment. The application of the statutory valuation allowance adjustment in this statement shall not result in a statutory valuation allowance reserve within the statutory financial statements, but rather should result in a reduction of the gross DTA.

[2] For purposes of determining the amount of adjusted gross DTA and the amount admitted under paragraph 11, the admission calculation shall be made on a separate company, reporting entity basis. A reporting entity that files a consolidated federal income tax return with its parent should look to the amount of taxes it paid (or were allocated to it) as a separate legal entity in determining the admitted DTA under paragraph 11.a. Furthermore, the DTA under this paragraph may not exceed the amount that the reporting entity could reasonably expect to have refunded by its parent. The taxes paid by the reporting entity represent the maximum DTA that may be admitted under paragraph 11.a., although the amount could be reduced pursuant to the group's tax allocation agreement. The amount of admitted adjusted gross DTA under paragraph 11.b.i. is limited to the amount that the reporting entity expects to realize within the applicable realization period, on a separate company basis. The reporting entity must estimate its separate company taxable income and the tax benefit that it expects to receive from reversing deductible temporary differences in the form of lower tax payments to its parent. A reporting entity that projects a tax loss in the applicable realization period cannot admit a DTA related to the loss under paragraph 11.b., even if the loss could offset taxable income of other members in the consolidated group and the reporting entity could expect to be paid for the tax benefit pursuant to its tax allocation agreement.

[3] Changes in DTAs and DTLs due to changes to tax rates and tax status shall be recorded as a "change in net deferred income tax," excluding any change reflected in unrealized capital gains. Tax effects previously reflected in unrealized capital gains (to present unrealized gains and losses "net of tax") shall be re-measured for the change in the tax rate in the same reporting line. Changes in net deferred tax shall not include changes in nonadmitted DTAs, as changes in nonadmittance are reported on a separate reporting line.

a. Federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions[4], not to exceed three years, including any amounts established in accordance with the provision of SSAP No. 5R as described in paragraph 3.a. of this statement related to those periods.

b. If the reporting entity is subject to risk-based capital requirements or is required to file a Risk-Based Capital Report with the domiciliary state, the reporting entity shall use the *Realization Threshold Limitation Table – RBC Reporting Entities* (RBC Reporting Entity Table) in this component of the admission calculation. The RBC Reporting Entity Table's threshold limitations are contingent upon the ExDTA ACL RBC Ratio[5].

If the reporting entity is either a mortgage guaranty insurer or financial guaranty insurer that is not subject to risk-based capital requirements and is not required to file a Risk-Based Capital Report with the domiciliary state and the reporting entity meets the minimum capital and reserve requirements for the state of domicile, then the reporting entity shall use the *Realization Threshold Limitation Table – Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entities* (Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table) in this component of the admission calculation. The Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table's threshold limitations are contingent upon the following ratio: the numerator is equal to the sum of 1) surplus to policyholders, 2) less the amount of the admitted DTA in paragraph 11.a. (ExDTA Surplus) plus, 3) contingency reserves. The denominator is equal to the required amount of minimum aggregate capital required to be maintained under the applicable NAIC model law or state variation thereof based on the risk characteristics and the amount of insurance in force (Required Aggregate Risk Capital)[6].

If the reporting entity (1) is not subject to risk-based capital requirements, (2) is not required to file a Risk-Based Capital Report with the domiciliary state, (3) is not a mortgage guaranty or financial guaranty insurer, and (4) meets the minimum capital and reserve requirements, then the reporting entity shall use the *Realization Threshold Limitation Table – Other Non-RBC Reporting Entities* (Other Non-RBC Reporting Entity Table). The Other Non-RBC Reporting Entity Table's threshold limitations are

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[4] For example, under the Federal Internal Revenue Code, ordinary losses can be carried back two years for entities taxed as nonlife insurance companies, while capital losses for entities taxed both as nonlife and life insurance companies can be carried back three years. For losses arising in tax years after 2017, entities taxed as life insurance companies are not permitted to carryback ordinary losses.

[5] The December 31 Risk-Based Capital ratio is calculated based on the Authorized Control Level RBC for the current reporting period, which is in the process of being filed with the state of domicile, and computed without net deferred tax assets (ExDTA ACL RBC). The interim period (March 31, June 30, and September 30) ExDTA ACL RBC ratio numerator shall use the Total Adjusted Capital (TAC) with current quarter surplus ExDTA and current quarter TAC adjustments. The interim period denominator shall use the Authorized Control Level RBC as filed for the most recent calendar year.

[6] If the reporting entity is a mortgage guaranty insurer, this ratio is based on the requirements of Section 12 of the NAIC Mortgage Guaranty Insurance Model Law and state laws that, based on the risk characteristics and amount of insurance in force, require aggregate capital to be maintained in a risk-to-capital ratio of not less than 25 to 1. If the reporting entity is a financial guaranty insurer, this ratio is based on the requirements of Section 4C of the NAIC Financial Guaranty Insurance Model Guideline 1626 and state laws that require aggregate capital to be maintained based on the risk characteristics and amount of insurance in force.

contingent upon the ratio of adjusted gross DTA (Adjusted gross DTA less the amount of DTA admitted in paragraph 11.a.) to adjusted capital and surplus[7].

Realization Threshold Limitation Table – RBC Reporting Entities

ExDTA ACL RBC (%)	11.b.i.	11.b.ii.
Greater than 300%	3 years	15%
200 – 300%	1 year	10%
Less than 200%	0 years	0%

Realization Threshold Limitation Table – Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entities

(See paragraph 11.b.) Ex DTA Surplus plus Contingency Reserves/Required Aggregate Risk Capital (%)	11.b.i.	11.b.ii.
Greater than 115%	3 years	15%
100% to 115%	1 year	10%
Less than 100%	0 years	0%

Realization Threshold Limitation Table – Other Non-RBC Reporting Entities

Adjusted Gross DTA / Adjusted Capital & Surplus (%)	11.b.i.	11.b.ii.
Less than 50%	3 years	15%
50% to 75%	1 year	10%
Greater than 75%	0 years	0%

The reporting entity shall admit:

i. The amount of adjusted gross DTAs, after the application of paragraph 11.a.[8], expected to be realized within the applicable period (refer to the 11.b.i. column of the applicable Realization Threshold Limitation Table above; the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table, or the Other Non-RBC Reporting Entity Table) following the balance sheet date limited to the amount determined in paragraph 11.b.ii.

ii. An amount that is no greater than the applicable percentage (refer to the 11.b.ii. column of the applicable Realization Threshold Limitation Table above: the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table, or the Other Non-RBC Reporting Entity Table) of

[7] Consistent with the requirements of paragraph 11.b.ii., adjusted statutory capital and surplus used in this calculation component is based on statutory capital and surplus for the current reporting period excluding any net DTA, EDP equipment and operating system software and any net positive goodwill.

[8] Under the Federal Internal Revenue Code, entities taxed as life insurance companies are not permitted to carryback ordinary losses arising in tax years after 2017. As such, admittance of ordinary DTAs for such entities will be limited to paragraph 11.b. and paragraph 11.c. for reporting periods ending with and subsequent to December 31, 2017.

statutory capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for the current reporting period's statement filed with the domiciliary state commissioner adjusted to exclude any net DTAs, EDP equipment and operating system software and any net positive goodwill.(INT 01-18) For financial guaranty or mortgage guaranty non-RBC reporting entities, the amount of statutory capital and surplus utilized for this part of the calculation does not include contingency reserves.

c. The amount of adjusted gross DTAs, after application of paragraphs 11.a. and 11.b. that can be offset against existing gross DTLs. The reporting entity shall consider the character (i.e., ordinary versus capital) of the DTAs and DTLs such that offsetting would be permitted in the tax return under existing enacted federal income tax laws and regulations. Additionally, for purposes of this component, the reporting entity shall consider the reversal patterns of temporary differences; however, this consideration does not require scheduling beyond that required in paragraph 7.e.

12. In computing a reporting entity's admitted adjusted gross DTA pursuant to paragraph 11;

a. For purposes of paragraph 11.a., existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years, shall be determined in accordance with paragraphs 228 and 229 of FAS 109;

b. In determining the amount of federal income taxes that can be recovered through loss carrybacks, the amount and character (i.e., ordinary versus capital) of the loss carrybacks and the impact, if any, of the Alternative Minimum Tax shall be determined in accordance with the provisions of the Internal Revenue Code, and regulations thereunder;

c. The amount of carryback potential that may be considered in calculating the admitted adjusted gross DTAs of a reporting entity in paragraph 11.a. that files a consolidated income tax return with one or more affiliates, may not exceed the amount that the reporting entity could reasonably expect to have refunded by its parent; and

d. The phrases "reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years," "realized within one year of the balance sheet date" and "realized within three years of the balance sheet date" are intended to accommodate interim reporting dates and reporting entities that file on an other than calendar year basis for federal income tax purposes.

Realization of Tax Benefits and Tax Planning Strategies

13. Future realization of the tax benefit of an existing deductible temporary difference or carryforward ultimately depends on the existence of sufficient taxable income of the appropriate character (for example, ordinary income or capital gain) within the carryback, carryforward period available under the tax law. The following four possible sources of taxable income may be available under the tax law to realize a tax benefit for deductible temporary differences and carryforwards:

a. Future reversals of existing taxable temporary differences

b. Future taxable income exclusive of reversing temporary differences and carryforwards

c. Taxable income in prior carryback year(s) if carryback is permitted under the tax law

d. Tax-planning strategies in paragraph 14 that would, if necessary, be implemented to, for example:

i. Accelerate taxable amounts to utilize expiring carryforwards

ii. Change the character of taxable or deductible amounts from ordinary income or loss to capital gain or loss

iii. Switch from tax-exempt to taxable investments.

Evidence available about each of those possible sources of taxable income will vary for different tax jurisdictions and, and possibly, from year to year. To the extent evidence about one or more sources of taxable income is sufficient to support a conclusion that the reporting entity will realize the full or a partial amount of its adjusted gross deferred tax assets, other sources need not be considered. Consideration of each source is required, however, to determine the amount of the statutory valuation allowance adjustment that is recognized for gross deferred tax assets under paragraph 7.e.

14. In some circumstances, there are tax-planning strategies (including elections for tax purposes) that (a) are prudent and feasible, (b) a reporting entity ordinarily might not take, but would take to prevent an operating loss or tax credit carryforward from expiring unused, and (c) would result in realization of deferred tax assets. A reporting entity shall consider tax-planning strategies in determining the amount of the statutory valuation allowance adjustment necessary under paragraph 7.e. Consideration of tax planning strategies for the realization of deferred tax assets when determining admission under paragraph 11 is not required; however, such strategies shall not conflict with the tax planning strategies used when computing the statutory valuation allowance. Any significant potential expenses to implement a tax-planning strategy or any significant losses that would be recognized if that strategy were implemented (net of any recognizable tax benefits associated with those expenses or losses) shall reduce the amount of admission under paragraph 11.

15. When a prudent and feasible tax-planning strategy is contemplated, and management determines this strategy would more likely than not enable the reporting entity to realize the full or a partial amount of its adjusted gross deferred tax assets, paragraph 3 of this statement related to tax loss contingencies shall be applied in determining admissibility of deferred tax assets under paragraph 11 of this statement.

Intercompany Income Tax Transactions

16. In the case of a reporting entity that files a consolidated income tax return with one or more affiliates, income tax transactions (including payment of tax contingencies to its parent) between the affiliated parties shall be recognized if:

a. Such transactions are economic transactions as defined in *SSAP No. 25—Affiliates and Other Related Parties* (SSAP No. 25);

b. Are pursuant to a written income tax allocation agreement; and

c. Income taxes incurred are accounted for in a manner consistent with the principles of FAS 109, as modified by this statement.

17. Amounts owed to a reporting entity pursuant to a recognized transaction shall be treated as a loan or advance, and nonadmitted, pursuant to SSAP No. 25, to the extent that the recoverable is not settled within 90 days of the filing of a consolidated income tax return, or where a refund is due the reporting entity's parent, within 90 days of the receipt of such refund.

Intraperiod Tax Allocation

18. In accordance with paragraph 35 of FAS 109, a reporting entity's unrealized gains and losses shall be recorded net of any allocated DTA or DTL. The amount allocated shall be computed in a manner consistent with paragraph 38 of FAS 109.

19. Income taxes incurred shall be allocated to net income and realized capital gains or losses in a manner consistent with paragraph 38 of FAS 109. Furthermore, income taxes incurred or received during the current year attributable to prior years shall be allocated, to the extent not previously provided, to net income in accordance with SSAP No. 3 unless attributable, in whole or in part, to realized capital gains or losses, in which case, such amounts shall be apportioned between net income and realized capital gains and losses, as appropriate.

Interim Periods

20. Income taxes incurred in interim periods shall be computed using an estimated annual effective current tax rate for the annual period in accordance with the methodology described in paragraphs 19 and 20 of *Accounting Principles Board Opinion No. 28, Interim Financial Reporting*. Estimates of the annual effective tax rate at the end of interim periods are, of necessity, based on estimates and are subject to subsequent refinement or revision. If a reliable estimate cannot be made, the actual effective tax rate for the year-to-date may be the best estimate of the annual effective tax rate. If a reporting entity is unable to estimate a part of its "ordinary" income (or loss) or the related tax (or benefit) but is otherwise able to make a reliable estimate, the tax (or benefit) applicable to the item that cannot be estimated shall be reported in the interim period in which the item is reported.

Disclosures

21. Statutory financial statement disclosures shall be made in a manner consistent with the provisions of paragraphs 43-45 and 48 of FAS 109. However, required disclosures with regard to a reporting entity's GAAP valuation allowance shall be replaced with disclosures relating to the statutory valuation allowance adjustment and the nonadmittance of some portion or all of a reporting entity's DTAs. The financial statements shall include the disclosures required by paragraph 47 of FAS 109 for non-public companies. Paragraphs 22-28 describe the disclosure requirements as modified for the difference between the requirements of FAS 109 and those prescribed by this statement.

22. The components of the net DTA or DTL recognized in a reporting entity's financial statements shall be disclosed as follows:

a. The total of all DTAs (gross, adjusted gross, admitted and nonadmitted) by tax character;

b. The total of all DTLs by tax character;

c. The total DTAs nonadmitted as the result of the application of paragraph 11;

d. The net change during the year in the total DTAs nonadmitted;

e. The amount of each result or component of the calculation, by tax character of paragraphs 11.a., 11.b.i., 11.b.ii., and 11.c., and the ExDTA ACL RBC Ratio, the ExDTA Surplus plus Contingency Reserves/Required Aggregate Risk Capital Ratio, or the Adjusted Gross DTA/Adjusted Capital and Surplus Ratio used in the applicable *Realization Threshold Limitation Table* (the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table, or the Other Non-RBC Reporting Entity Table) in paragraph 11.b., as applicable; and

f. The impact of tax-planning strategies on the determination of adjusted gross DTAs and the determination of net admitted DTAs, by percentage and by tax character, and whether the tax-planning strategies include the use of reinsurance-related tax planning strategies.

23. To the extent that DTLs are not recognized for amounts described in paragraph 31 of FAS 109, the following shall be disclosed:

a. A description of the types of temporary differences for which a DTL has not been recognized and the types of events that would cause those temporary differences to become taxable;

b. The cumulative amount of each type of temporary difference;

c. The amount of the unrecognized DTL for temporary differences related to investments in foreign subsidiaries and foreign corporate joint ventures that are essentially permanent in duration if determination of that liability is practicable or a statement that determination is not practicable; and

d. The amount of the DTL for temporary differences other than those in paragraph 23.c. that is not recognized in accordance with the provisions of paragraphs 31 of FAS 109.

24. The significant components of income taxes incurred (i.e., current income tax expense) and the changes in DTAs and DTLs shall be disclosed. Those components would include, for example:

a. Current tax expense or benefit;

b. The change in DTAs and DTLs (exclusive of the effects of other components listed below);

c. Investment tax credits;

d. The benefits of operating loss carryforwards;

e. Adjustments of a DTA or DTL for enacted changes in tax laws or rates or a change in the tax status of the reporting entity; and

f. Adjustments to gross deferred tax assets because of a change in circumstances that causes a change in judgment about the realizability of the related deferred tax asset, and the reason for the adjustment and change in judgment.

25. Additionally, to the extent that the sum of a reporting entity's income taxes incurred and the change in its DTAs and DTLs is different from the result obtained by applying the federal statutory rate to its pretax net income, a reporting entity shall disclose the nature of the significant reconciling items.

26. A reporting entity shall also disclose the following:

a. The amounts, origination dates and expiration dates of operating loss and tax credit carryforwards available for tax purposes;

b. The amount of federal income taxes incurred in the current year and each preceding year, which are available for recoupment in the event of future net losses; and

c. The aggregate amount of deposits admitted under Section 6603 of the Internal Revenue Service Code.

27. For any federal or foreign income tax loss contingencies as determined in accordance with paragraph 3.a. for which it is reasonably possible that the total liability will significantly increase within 12 months of the reporting date, the reporting entity shall disclose an estimate of the range of the reasonably possible increase or a statement that an estimate of the range cannot be made.

28. If a reporting entity's federal income tax return is consolidated with those of any other entity or entities, the following shall be disclosed:

a. A list of names of the entities with whom the reporting entity's federal income tax return is consolidated for the current year; and

b. The substance of the written agreement, approved by the reporting entity's Board of Directors, which sets forth the manner in which the total combined federal income tax for all entities is allocated to each entity which is a party to the consolidation. (If no written agreement has been executed, give an explanation of why such an agreement has not been executed.) Additionally, the disclosure shall include the manner in which the entity has an enforceable right to recoup federal income taxes in the event of future net losses which it may incur or to recoup its net losses carried forward as an offset to future net income subject to federal income taxes.

29. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

30. This statement adopts the provisions of FAS 109 except as modified in paragraph 2 of this statement which results in paragraphs 29-30, 36-37, 39, 41-42, 46, and 49-59 of FAS 109 being rejected, inasmuch as they are not applicable to reporting entities subject to this statement or are inconsistent with other statutory accounting principles. Paragraph 47 of FAS 109 is adopted with modification to provide for the disclosures required for non public reporting entities. This statement rejects *ASU 2016-16, Intra-Entity Transfers of Assets Other than Inventory*.

31. This statement rejects *ASU 2015-17 Balance Sheet Classification of Deferred Taxes*, *FASB Interpretation No. 18, Accounting for Income Taxes in Interim Periods…an interpretation of APB Opinion No. 28* and *FIN 48: Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*.

32. The following lists FASB Staff Positions that are adopted or rejected by this statement:

a. *FASB Staff Position FAS 109-1, Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004* is adopted in its entirety.

b. FASB *Staff Position FAS 109-2, Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004* is rejected in its entirety.

c. *FASB Staff Position FIN 48-2, Effective Date of FIN 48 for Certain Nonpublic Enterprises* is rejected in its entirety.

d. *FASB Staff Position FIN 48-3, Effective Date of FIN 48 for Certain Nonpublic Enterprises* is rejected in its entirety.

33. The following lists Accounting Principles Board Opinions that are adopted or rejected by this statement:

a. *Accounting Principles Board Opinion No. 2, Accounting for the "Investment Credit,"* paragraphs 9-15 are adopted with modification to utilize the cost reduction method only and rejects all other paragraphs;

b. *Accounting Principles Board Opinion No. 4 (Amending No. 2), Accounting for the "Investment Credit,"* is rejected in its entirety;

c. *Accounting Principles Board Opinion No. 10, Omnibus Opinion—1966,* paragraph 6 is adopted;

d. *Accounting Principles Board Opinion No. 23, Accounting for Income Taxes—Special Areas,* paragraphs 1-3, 5-9, 12-13, and 15-18 are adopted, and paragraphs 19-25, and 31-33 are rejected;

e. *Accounting Principles Board Opinion No. 28, Interim Financial Reporting,* paragraphs 19 and 20 are adopted and all other paragraphs rejected.

34. The following lists FASB Technical Bulletins that are adopted or rejected by this statement:

a. *FASB Technical Bulletin No. 79-9, Accounting in Interim Periods for Changes in Income Tax Rates* is rejected in its entirety;

b. *FASB Technical Bulletin No. 82-1, Disclosure of the Sale or Purchase of Tax Benefits through Tax Leases* is adopted in its entirety.

35. The following lists FASB Emerging Issues Task Force Issues that are adopted or rejected by this statement:

a. *FASB Emerging Issues Task Force No. 91-8, Application of FASB Statement No. 96 to a State Tax Based on the Greater of a Franchise Tax or an Income Tax,* is rejected in its entirety;

b. *FASB Emerging Issues Task Force No. 92-8, Accounting for the Income Tax Effects under FASB Statement No. 109 of a Change in Functional Currency When an Economy Ceases to Be Considered Highly Inflationary*, is adopted in its entirety;

c. *FASB Emerging Issues Task Force No. 93-13, Effect of a Retroactive Change in Enacted Tax Rates That Is Included in Income from Continuing Operations*, is rejected in its entirety;

d. *FASB Emerging Issues Task Force No. 93-16, Application of FASB Statement No. 109 to Basis Differences within Foreign Subsidiaries That Meet the Indefinite Reversal Criterion of APB Opinion No. 23*, is rejected in its entirety;

e. *FASB Emerging Issues Task Force No. 93-17, Recognition of Deferred Tax Assets for a Parent Company's Excess Tax Basis in the Stock of a Subsidiary That Is Accounted for as a Discontinued Operation*, is adopted in its entirety;

f. *FASB Emerging Issues Task Force No. 94-10, Accounting by a Company for the Income Tax Effects of Transactions among or with Its Shareholders under FASB Statement No. 109*, is rejected in its entirety;

g. *FASB Emerging Issues Task Force No. 95-9, Accounting for Tax Effects of Dividends in France in Accordance with FASB Statement No. 109*, is rejected in its entirety;

h. *FASB Emerging Issues Task Force No. 95-10, Accounting for Tax Credits Related to Dividend Payments in Accordance with FASB Statement No. 109*, is rejected in its entirety;

i. *FASB Emerging Issues Task Force No. 95-20, Measurement in the Consolidated Financial Statements of a Parent of the Tax Effects Related to the Operations of a Foreign Subsidiary That Receives Tax Credits Related to Dividend Payments*, is rejected in its entirety.

36. This statement rejects AICPA Accounting Interpretations, Accounting for the Investment Credit: Accounting Interpretations of APB Opinion No. 4 in its entirety.

Effective Date and Transition

37. This statement shall be effective for years beginning January 1, 2012. 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*. Revisions adopted in August 2019 to the Implementation Questions and Answers in Exhibit A which update the exhibit in response to changes from the federal Tax Cuts and Jobs Act and to clarify deferred tax asset and deferred tax liability offsetting under paragraph 11.c., are effective for financial accounting years ending December 31, 2019. Any change in income tax balances resulting from the August 2019 revisions are 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. 83—Accounting for Income Taxes*

EXHIBIT A – IMPLEMENTATION QUESTIONS AND ANSWERS

The National Association of Insurance Commissioners issued *SSAP No. 101—Income Taxes* (SSAP No. 101), with a corresponding implementation question and answer exhibit, with an effective date of January 1, 2012. Further nonsubstantive revisions ~~are necessary~~were developed to update the Q&A for the revised corporate federal income tax rate and certain other federal tax law changes primarily under the Tax Cuts and Jobs Act enacted in December 2017 and to clarify deferred tax asset and deferred tax liability offsetting under SSAP No. 101, paragraph 11.c. These revisions to the implementation guidance are effective for financial accounting years ending December 31, 2019. Any change in income tax balances resulting from the August 2019 revisions are accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors.* ~~will be completed as a separate project of the Statutory Accounting Principles (E) Working Group.for reporting periods ending on or after January 1, 2012. Note: Minor revisions were adopted in May 2018 in response to the federal income tax law changes enacted December 22, 2017. These revisions have been limited to updating the post-2017 ordinary loss carryback provisions for entities taxed as life insurance companies. Further nonsubstantive revisions are necessary to update the Q&A for the revised corporate federal income tax rate and certain other federal tax law changes enacted in December 2017. These revisions will be completed as a separate project of the Statutory Accounting Principles (E) Working Group~~.

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1. Q – What are the primary differences between the accounting for income taxes pursuant to FAS 109 and SSAP No. 101? [No specific paragraph reference]

1.1 A – SSAP No. 101 establishes statutory accounting principles for current and deferred federal and foreign income taxes and current state income taxes. In general, SSAP No. 101 adopts the concepts of FAS 109, with modifications. The primary differences and modifications are summarized below:

1.2 State Income Tax

- FAS 109 – State income taxes should be included as "income taxes incurred." Deferred state income taxes are recognized.

- SSAP No. 101 – State income taxes should be included as "Taxes, Licenses, and Fees" by property and casualty insurers and as "Insurance taxes, licenses, and fees, excluding federal income taxes" by life and accident and health insurers. No deferred state income taxes are recognized.

1.3 Valuation Allowance

- FAS 109 – Gross deferred tax assets (DTAs) are reduced by a valuation allowance if it is more likely than not that some portion or all of the DTAs will not be realized. The valuation allowance should be sufficient to reduce the DTA to the amount that is more likely than not to be realized.

- SSAP No. 101 – Gross DTAs are reduced by a statutory valuation allowance adjustment that is determined on a separate company, reporting entity basis. Pursuant to paragraphs 2 and 7.e. of SSAP No. 101, gross DTAs are adjusted to an amount that is more likely than not to be realized (a likelihood of more than 50 percent). Only adjusted gross DTAs shall be considered in determining admitted adjusted gross DTAs. See Question 2 for further discussion of the statutory valuation allowance adjustment. See Question 4 for a further discussion of the admissibility test. See Question 12 for further discussion of presentation and disclosure of the statutory valuation allowance adjustment.

1.4 Unique Statutory Accounting Items

- FAS 109 – In general, the effects of all temporary differences must be reflected with limited exceptions provided in FAS 109 paragraphs 31-34 (relating to items specified in Accounting Principles Board Opinion No. 23) and for temporary differences related to goodwill for which amortization is not deductible for tax purposes.

- SSAP No. 101 – In addition to the exceptions provided in FAS 109, temporary differences do not include asset valuation reserve (AVR), interest maintenance reserve (IMR), Schedule F penalties and, in the case of a mortgage guaranty insurer, amounts attributable to its statutory contingency reserve to the extent that "tax and loss" bonds have been purchased.

1.5 Changes in Deferred Tax Assets and Liabilities

- FAS 109 – Changes in DTAs and deferred tax liabilities (DTLs) are included in income tax expense or benefit and are allocated to continuing operations, discontinued operations, extraordinary items and items charged directly to shareholders' equity.

- SSAP No. 101 – Changes in DTAs and DTLs are recognized as a separate component of gains and losses in surplus, except to the extent allocated to changes in unrealized gains and losses.

1.6 Regulated Enterprises

- FAS 109 – Regulated enterprises that meet the criteria for application of FAS 71, *Accounting for* the *Effects of Certain Types of Regulation*, are not exempt from the requirements of FAS 109. However, assets are reported on a net-of-tax basis (see paragraphs 29, 57, 58 and 59 of FAS 109).

- SSAP No. 101 – These special paragraphs do not apply pursuant to paragraph 30 of SSAP No. 101.

1.7 Business Combinations

- FAS 109 – Paragraphs 30 and 53-56 of FAS 109 provide certain guidance regarding the treatment of business combinations. In general, a deferred tax asset or liability is recognized for the differences between the assigned values and the tax bases of the assets and liabilities recognized in a purchased business combination. If financial statements for prior years are restated, all purchase business combinations that were consummated in those prior years shall be remeasured in accordance with FAS 109.

- SSAP No. 101 – These special paragraphs do not apply pursuant to paragraph 30 of SSAP No. 101.

1.8 Intraperiod Tax Allocation

- FAS 109 – Income tax expense or benefit is allocated among continuing operations, discontinued operations, extraordinary items, and items charged or credited directly to shareholders' equity pursuant to paragraphs 36 and 37 of FAS 109.

- SSAP No. 101 – These paragraphs of FAS 109 do not apply pursuant to paragraph 30 of SSAP No. 101. Instead, paragraphs 18 and 19 of SSAP No. 101 provide special rules for statutory accounting. See Question 10 for a further discussion of these rules.

1.9 Certain Quasi-Reorganizations

- FAS 109 – Paragraph 39 provides special rules relating to the treatment of deductible temporary differences and carryforwards as of the date of a quasi-reorganization.

- SSAP No. 101 – Paragraph 39 of FAS 109 does not apply pursuant to paragraph 30 of SSAP No. 101.

1.10 Financial Statement Classification of DTAs and DTLs

- FAS 109 – Pursuant to paragraphs 41 and 42 of FAS 109, DTAs and DTLs are to be classified separately as either current or noncurrent, depending on the classification of the related asset or liability. Furthermore, current DTAs and DTLs and noncurrent DTAs and DTLs are netted within the classification and with the net amount reported.

- SSAP No. 101 – These paragraphs do not apply to statutory accounting pursuant to paragraph 30 of SSAP No. 101. The net admitted DTA, or the net DTL, should be reported in the statutory financial statements.

1.11 Accounting for Uncertainty in Income Taxes

- FAS 109 – Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48) provides accounting and reporting guidance for uncertain tax positions under GAAP.

- SSAP No. 101 – FIN 48 is rejected for statutory accounting pursuant to paragraph 31 of SSAP No. 101. *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5R) provides guidance in determining the amount of federal and foreign income tax loss contingencies with the following modifications. The term "probable" as used in SSAP No. 5R is replaced by the term "more likely than not (a likelihood of more than 50 percent)". In determining the amount of a federal or foreign income tax loss contingency, it shall be assumed that the reporting entity will be examined by the tax authority that has full knowledge of all relevant information. If the estimated tax loss contingency is greater than 50% of the tax benefit originally recognized, the tax loss contingency recorded shall be equal to 100% of the original tax benefit recognized. See Question 9 for further discussion of income tax loss contingencies.

1.12 Classification of Interest and Penalties

- FAS 109 – FIN 48 allows interest on tax assessments to be reported as either income taxes or interest expense and penalties to be reported as either income taxes or another expense classification, based on the accounting policy election of the enterprise.

- SSAP No. 101 – Interest and penalties related to foreign or federal income tax are included in income taxes pursuant to paragraph 3.a. of SSAP No. 101.

1.13 Financial Statement Disclosures

- FAS 109 – Paragraphs 43-45 and 47-48 of FAS 109 provide various requirements for providing information in the financial statements regarding the income taxes of the reporting entity. In general, the reporting entity is to provide certain information regarding the components of its DTAs and DTLs, the amount of and changes in its valuation allowance, significant components of income tax expense, differences between the expected amount of income tax expense using current tax rates and the amount of reported income tax expense, and tax attributes being carried over. In addition, FIN 48 includes specific disclosures related to uncertain tax positions.

- SSAP No. 101 – In general, paragraphs 21-29 of SSAP No. 101 follow the disclosure requirements provided by FAS 109, but with the following modifications and additions:

  - The disclosures regarding valuation allowance are replaced with disclosures relating to the statutory valuation allowance adjustment and the nonadmitted portion of the DTA.

  - The amount of the gross DTA, adjusted gross DTA, DTL, admitted and nonadmitted DTA is required to be separately disclosed, by tax character (ordinary or capital).

  - Disclose the amount of each result or component of the admission calculation, by tax character, for paragraphs 11.a, 11.b.i, 11.b.ii, and 11.c. In addition, disclose the ExDTA Authorized Control Level (ACL) RBC Ratio, the ExDTA Surplus plus Contingency Reserves/Required Aggregate Risk Capital Ratio (see paragraph 11.b.), or the Adjusted Gross DTA/Adjusted Capital and Surplus Ratio used in the applicable Realization Threshold Limitation Table (the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table, or the Other Non-RBC Reporting Entity Table) in paragraph 11.b., as applicable.

  - The impact of tax-planning strategies on the determination of adjusted gross DTAs and the determination of net admitted adjusted gross DTAs, by percentage and by tax character, must be disclosed. In addition, disclose whether tax-planning strategies include the use of reinsurance-related tax planning strategies.

  - FIN 48 and the associated disclosure requirements are rejected for statutory accounting purposes and replaced with the following disclosure. For any federal or foreign income tax loss contingencies for which it is reasonably possible that the total liability will significantly increase within 12 months of the reporting date, a disclosure of an estimate of the range of the reasonably possible increase is required. If determination of a reasonable range of the significant increase is not possible, the reporting entity is to provide a statement that an estimate cannot be made.

  - The disclosures relating to deferred income tax expense or benefit are replaced with certain disclosures relating to the reporting entity's "change in DTAs and DTLs."

  - Only the nature of significant reconciling items between the reported amount and "expected" amount of income tax expense and change in DTAs and DTLs are to be disclosed. This generally follows the disclosure requirements of FAS 109 for nonpublic entities.

  - See Question 12 for a more detailed discussion of the disclosure requirements of SSAP No. 101.

2. Q – How should an entity measure its adjusted gross deferred tax assets and its gross deferred tax liabilities? [Paragraph 7]

2.1 A – An enterprise shall record a gross deferred tax liability or asset for all temporary differences and operating loss, capital loss and tax credit carryforwards. Temporary differences include unrealized gains and losses and nonadmitted assets but do not include AVR, IMR, Schedule F penalties and, in the case of a mortgage guaranty insurer, amounts attributable to its statutory contingency reserve to the extent that "tax and loss" bonds have been purchased. In general, temporary differences produce taxable income or result in tax deductions when the related asset is recovered or the related liability is settled. A deferred tax asset or liability represents the increase or decrease in taxes payable or refundable in future years as a result of temporary differences and carryforwards at the end of the current year. Additionally, gross DTAs are reduced by a statutory valuation allowance adjustment if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of the gross DTAs will not be realized. The statutory valuation allowance adjustment, determined in a manner consistent with paragraphs 20-25 of FAS 109, shall reduce gross DTAs to the amount that is more likely than not to be realized (the adjusted gross deferred tax assets).[9] This answer only addresses the recognition of adjusted gross DTAs and gross DTLs and does not address the admissibility of such amounts. See Question 4 for a discussion of the admissibility criteria of SSAP No. 101.

2.2 Paragraph 7 of SSAP No. 101 states that temporary differences are identified and measured using a "balance sheet" approach whereby the statutory balance sheet and the tax basis balance sheet are compared. Operating loss, capital loss and tax credit carryforwards are computed in accordance with the applicable Internal Revenue Code.

2.3 The following illustrates the recognition and measurement of a typical book to tax difference for an insurance company:

Illustration

Assumptions:

1/1/X2 Purchase 100 shares of Darby/Allyn Corp. stock for $25 a share
3/31/X2 Fair Value of Darby/Allyn Corp. stock has increased to $35 a share
3/31/X2 Tax basis reserves are computed and determined to be 80% of the statutory basis reserves

Balance Sheet at 3/31/X2:

	Statutory Basis	**Tax Basis**	**Basis Difference**	**Tax Effect DTA (DTL) (21~~35~~%)[10]**
Common Stock	$3,500	$2,500	($1,000) [11]	($210~~350~~)
Reserves	$100,000	$80,000	$20,000 [12]	$4,200~~7,000~~

Journal Entries:

[9] SSAP No. 101 requires the statutory valuation allowance adjustment to be presented in the annual statement as a direct reduction in the gross DTA. It is not included in non-admitted DTA.

[10] See Question 3 for a discussion of "enacted rates."

[11] The carrying value of the stock on the statutory balance sheet reflects the fair value of the common stock per *SSAP No. 30R—Unaffiliated Common Stock* whereas the carrying value of the stock for tax purposes is its original cost. This difference is defined as temporary in that the $1,000 appreciation in value will be recognized in the tax return when the stock is disposed of. The difference is a deferred tax liability in that the reversal of this temporary difference will increase future taxable income.

[12] The reserve difference ~~is due to the fact that statutory reserves are computed on a more conservative set of assumptions than for tax (life and health entities) or the tax reserves are discounted (property and casualty and other health entities)~~arises because, even though tax reserves are based on statutory reserves, they generally are reduced below statutory reserves pursuant to various provisions of the Internal Revenue Code. This amount is a temporary difference in that the entity will recognize the difference between statutory and tax carrying values over the life of the reserve or upon settlement of the claim or payment of the reserve. The difference is a deferred tax asset in that the reversal of this temporary difference will decrease future taxable income.

1/1/X2	DR	Common stock	$2,500
	CR	Cash	($2,500)
		Acquisition of common stock at $25 per share	

3/31/X2	DR	Common stock	$1,000
	CR	Change in unrealized capital gains and losses	($1,000)
		Adjust carrying value to FV of $35 per share at end of quarter	

3/31/X2	DR	Change in reserves or unpaid losses	$100,000
	CR	Reserves or Unpaid losses	($100,000)
		Recognition of reserves computed on a statutory basis	
3/31/X2	DR	Deferred tax asset	$4,200~~7,000~~
	CR	Change in deferred income taxes	($3,990~~6,650~~)
	CR	Deferred tax liability	($210~~350~~)
		Recognition of deferred taxes	

NOTE: Presentation of deferred tax amounts and unrealized gain or losses net of tax is addressed in Question 12.

2.4 As depicted in the Illustration, the deferred tax assets and liabilities are tracked gross in the entity's ledger and not netted until after consideration of the statutory valuation allowance adjustment, if any (see below), and the admissibility of deferred tax assets.

Statutory Valuation Allowance Adjustment

2.5 SSAP No. 101 paragraph 7.e. provides that gross DTAs are reduced by a statutory valuation allowance *adjustment* if, based on the weight of available evidence, it is more likely than not that some portion or all of the gross DTAs will not be realized. The statutory valuation allowance adjustment is determined on a separate company, reporting entity basis. The determination of whether gross DTAs will be realized is based on the existence of sufficient taxable income of the appropriate character (ordinary income or capital gain) within the carryback, carryover period available under the tax law. Paragraph 13.a. through 13.d. of SSAP No. 101 identifies four sources of taxable income to be considered in evaluating the existence of sufficient taxable income. These sources are identical to those to be considered under FAS 109 paragraph 21. FAS 109 paragraph 20 provides that "all available evidence, both positive and negative, should be considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. Information about an enterprise's current financial position and its results of operations for the current and preceding years ordinarily is readily available. That historical information is supplemented by all currently available information about future years. Sometimes, however, historical information may not be available (for example, start-up operations) or it may not be as relevant (for example, if there has been a significant, recent change in circumstances) and special attention is required." A reporting entity is not required to consider all four sources of taxable income in determining the need for a statutory valuation allowance adjustment if one or more sources are alone sufficient to support the conclusion that the entity will realize the tax benefits of its gross deferred tax assets (i.e., a conclusion that no valuation allowance is necessary). However, the reporting entity is required to consider all of the potential sources of taxable income to determine the amount of the adjustment if a conclusion is reached that a statutory valuation allowance adjustment is necessary. SSAP No. 101 modifies FAS 109 related to admission of DTAs. Admission of DTAs is calculated irrespective of the conclusion reached in establishing or not establishing a statutory valuation allowance adjustment. See Question 4.13 for discussion regarding consideration of reversal patterns specific to paragraph 11.c. of the admissibility test.~~Historical and/or currently available information may exist that is also significant and relevant in determining the amount of the DTAs admitted under paragraph 11 of SSAP No. 101. This historical and/or currently available information must also be considered when determining the amount of DTAs admitted under paragraph 11 of SSAP No. 101, irrespective of the conclusion reached in establishing or not establishing a statutory valuation allowance adjustment. See Question 4.13 for specific guidance on the admissibility of DTAs under paragraph 11.c. of SSAP No. 101.~~

2.6 Footnote 1 to paragraph 7.e. of SSAP No. 101 indicates that a reporting entity shall consider reversal patterns of temporary differences, and might be required to schedule such differences:

> …to the extent necessary to support establishing or not establishing a valuation allowance adjustment, determined in accordance with paragraphs 228 and 229 of FAS 109. For purposes of this accounting statement, consideration of reversal patterns does not require scheduling beyond that necessary to support establishing or not establishing a valuation allowance adjustment.

Paragraph 228 of FAS 109 generally holds that a company may need to schedule its temporary differences to determine the particular years in which the reversal of temporary differences is expected to occur. As discussed in Question 5b, paragraph 229 of FAS 109 indicates that future originating temporary differences and their subsequent reversal should be considered in determining the existence of future taxable income.

2.7 Although a reporting entity may need to consider the reversal pattern of temporary differences in evaluating the need for a statutory valuation allowance adjustment, scheduling the reversal pattern of such differences is not required in every instance. Under SSAP No. 101 and consistent with FAS 109, a general understanding of reversal patterns is, in many cases, relevant in assessing the need for a valuation allowance. Judgment is crucial in making this assessment. The amount of scheduling, if any, that will be required will depend on the facts and circumstances of each situation. For example, a reporting entity which relies upon future taxable income exclusive of reversing temporary differences and carryforwards[13] for realization of DTAs is not required to schedule the reversal pattern of its existing temporary differences. This is consistent with guidance provided by the Financial Accounting Standards Board (FASB) in its answer to question 2 of *A Guide to Implementation of Statement 109 on Accounting for Income Taxes: Question and Answers* (Special Report on Statement 109) which states that scheduling of existing temporary differences is unnecessary for purposes of determining the need for a valuation allowance "where it can be easily demonstrated that future taxable income will more likely than not be adequate to realize future tax benefits of existing deferred tax assets." In contrast, a reporting entity which relies upon the future reversal of existing taxable temporary differences to realize the tax benefits of its deductible temporary differences and carryforwards may be required to consider the reversal patterns of its taxable temporary differences.[14] The degree of scheduling required, however, depends on the facts and circumstances of each situation and the relative magnitude of the taxable and deductible temporary differences. In certain situations, the ability to reasonably conclude that reversing taxable temporary differences will more likely than not create sufficient taxable income to realize reversing deductible temporary differences can be done without detailed scheduling.[15]

2.8 If scheduling is considered necessary, the amount of scheduling required will depend on the particular facts and circumstances and be subject to judgment. There may be more than one acceptable approach. The FASB's answer to question 1 of the Special Report on Statement 109 indicates that the following concepts underlie the determination of reversal patterns under Statement 109:

a. The particular years in which temporary differences result in taxable or deductible amounts generally are determined by the timing of the recovery of the related asset or settlement of the related liability' (paragraph 228).

b. The tax law determines whether future reversals of temporary differences will result in taxable and deductible amounts that offset each other in future years' (paragraph 227).

In addition, the FASB noted that "minimizing complexity is an appropriate consideration in selecting a method for determining reversal patterns"[16], but that the methods used must be systematic and logical and should be consistently applied for all similarly categorized temporary differences and from year to year. Furthermore, the same method should be utilized in determining the reversal patterns in every taxing jurisdiction for which the temporary difference exists.

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[13] One of the four possible sources of taxable income that can be used to realize a tax benefit. See paragraph 13.b. of SSAP No. 101.

[14] For example, due to the relatively short loss carryback periods (or, in the case of entities taxed as life insurance companies, no carryback of operating losses) under ~~existing~~ current tax law, such consideration may be appropriate when taxable temporary differences are expected to reverse in a short number of future years while the deductible temporary differences are expected to reverse over a long number of future years. In addition, for "indefinite-lived" intangible assets (i.e., intangible assets like those discussed in paragraph 11 of FAS 142 for which no legal, regulatory, contractual, competitive, economic, or other factors limit their useful lives), predicting reversal of temporary differences related to such assets would be inconsistent with financial reporting assertions that the assets are indefinite-lived. In such a case, the reversal of taxable temporary differences with respect to such indefinite-lived intangible assets should not be considered a source of future taxable income when determining the statutory valuation allowance adjustment for entities taxed as non-life insurance companies. On the other hand, entities taxed as life insurance companies may, under current tax law, carry forward operating losses with no expiration period, subject to a utilization limit of 80% of taxable income (before the loss carry forward) in the carry forward year. In such case, the reversal of taxable temporary differences with respect to indefinite-lived intangible assets may be considered a source of taxable income, subject to the applicable tax law limitations.

[15] Q&A 2 from the Special Report on Statement 109 published by the FASB.

[16] Q&A 1 from the Special Report on Statement 109 published by the FASB.

Grouping of Assets and Liabilities for Measurement

2.9 The manner in which an entity groups its assets and liabilities for measurement shall be conducted in a reasonable and consistent manner. For instance, an entity may group its invested assets into Annual Statement classifications (stocks, bonds, preferred stocks, etc.) or other reasonable groupings (lines of business for grouping its reserves). Entities have the option of recognizing the DTA and DTL within each grouping on a net or gross basis. For instance, a portfolio of common stocks will have both unrealized gain and unrealized losses associated with them. The reporting entity may elect to combine the unrealized gains and losses and compute a single DTA or DTL or it may elect to segregate the unrealized gains from the unrealized losses and compute separate DTAs and DTLs. This option might also arise with respect to depreciable assets. Regardless of which method an entity elects, it is crucial that consistency is maintained to and within each grouping from period to period. An entity shall retain internal documentation to support its grouping in addition to the methodologies employed to arrive at such. An entity is permitted to modify its groupings should events or circumstances change from a previous period. Examples include a change in materiality of underlying assets and liabilities, administrative costs associated with detailing groupings increases or changes in the computer systems that allow more specificity. Entities that modify their groupings should be prepared to rationalize these changes. These entities should also disclose that a modification was made and general reason for such in the notes to the financial statements.

Measurement of Nonadmitted Assets

2.10 As noted in paragraph 7.b. of SSAP No. 101, temporary differences include nonadmitted assets. The measurement of these types of assets is not addressed in FAS 109 in that the concept of nonadmission is unique to statutory accounting. For assets that are nonadmitted for statutory accounting purposes, DTAs and DTLs should be measured after nonadmission.

Illustration:

	Statutory Before Nonadmit (Info Purpose)	**Statutory After Nonadmit**	**Tax**	**Basis Difference**[17]	**Tax Effect DTA (DTL)** (21~~35~~%)
Furniture Fixtures and Equipment	$1,000	0	$1,000		
Accumulated Depreciation	200	0	400		
Basis	$800	0	$600	$600	$126~~210~~

2.11 The effect of this illustration is a reduction of surplus by $674~~590~~ ($800 decrease for nonadmitted asset and $126~~210~~ increase for DTA), provided the resulting DTA meets the admissibility test in paragraph 11 of SSAP No. 101.

3. Q – A reporting entity's deferred tax assets and liabilities are computed using "enacted tax rates." What is **the meaning of the term "enacted tax rates"? [Paragraph 7.c.]**

3.1 A – Paragraph 7.c. of SSAP No.101 provides that total DTAs and DTLs are computed using enacted tax rates.

3.2 Consistent with FAS 109, SSAP No. 101 further requires that deferred tax assets and liabilities be

[17] Difference is computed from the "Statutory After Nonadmit" balance.

measured using the enacted tax rate that is expected to apply to taxable income in the periods in which the deferred tax asset or liability is expected to be settled or realized. The effects of future changes in tax rates are not anticipated in the measurement of deferred tax assets and liabilities. Deferred tax assets and liabilities are adjusted for changes in tax rates and other changes in the tax law, and the effects of those changes are recognized at the time the change is enacted.

3.3 Tax laws may apply different tax rates to ordinary income and capital gains. In instances where the enacted tax law provides for different rates on income of different character, deferred tax assets and liabilities should be measured by applying the appropriate enacted tax rate based on the type of taxable or deductible amounts expected to be realized from the reversal of existing temporary differences.

~~3.4 As a reference, FAS 109 paragraphs 18 and 236 provide the following:~~

> ~~18. The objective is to measure a deferred tax liability or asset using the enacted tax rate(s) expected to apply to taxable income in the periods in which the deferred tax liability or asset is expected to be settled or realized. Under current U.S. federal tax law, if taxable income exceeds a specified amount, all taxable income is taxed, in substance, at a single flat tax rate. That tax rate shall be used for measurement of a deferred tax liability or asset by enterprises for which graduated tax rates are not a significant factor. Enterprises for which graduated tax rates are a significant factor shall measure a deferred tax liability or asset using the average graduated tax rate applicable to the amount of estimated annual taxable income in the periods in which the deferred tax liability or asset is estimated to be settled or realized (paragraph 236). Other provisions of enacted tax laws should be considered when determining the tax rate to apply to certain types of temporary differences and carryforwards (for example, the tax law may provide for different tax rates on ordinary income and capital gains). If there is a phased-in change in tax rates, determination of the applicable tax rate requires knowledge about when deferred tax liabilities and assets will be settled and realized.~~
>
> ~~236. The following example illustrates determination of the average graduated tax rate for measurement of deferred tax liabilities and assets by an enterprise for which graduated tax rates ordinarily are a significant factor. At the end of year 3 (the current year), an enterprise has $1,500 of taxable temporary differences and $900 of deductible temporary differences, which are expected to result in net taxable amounts of approximately $200 on the future tax returns for each of years 4-6. Enacted tax rates are 15 percent for the first $500 of taxable income, 25 percent for the next $500, and 40 percent for taxable income over $1,000. This example assumes that there is no income (for example, capital gains) subject to special tax rates.~~
>
> ~~The deferred tax liability and asset for those reversing taxable and deductible temporary differences in years 4-6 are measured using the average graduated tax rate for the estimated amount of annual taxable income in future years. Thus, the average graduated tax rate will differ depending on the expected level of annual taxable income (including reversing temporary differences) in years 4-6. The average tax rate will be:~~
>
> ~~a. 15 percent if the estimated annual level of taxable income in years 4-6 is $500 or less~~
>
> ~~b. 20 percent if the estimated annual level of taxable income in years 4-6 is $1,000~~
>
> ~~c. 30 percent if the estimated annual level of taxable income in years 4-6 is $2,000.~~
>
> ~~Temporary differences usually do not reverse in equal annual amounts as in the example above, and a different average graduated tax rate might apply to reversals in different future years. However, a detailed analysis to determine the net reversals of temporary differences in each future year usually is not warranted. It is not warranted because the other variable (that is, taxable income or losses exclusive of reversing temporary differences in each of those future years) for determination of the average graduated tax rate in each future year is no more than an estimate. For that reason, an aggregate calculation using a single estimated average graduated tax rate~~

~~based on estimated average annual taxable income in future years is sufficient. Judgment is permitted, however, to deal with unusual situations, for example, an abnormally large temporary difference that will reverse in a single future year, or an abnormal level of taxable income that is expected for a single future year. The lowest graduated tax rate should be used whenever the estimated average graduated tax rate otherwise would be zero.~~

4a. Q – How should a reporting entity calculate the amount of its admitted adjusted gross DTAs? [Paragraph 11]

4.1 A – After a reporting entity has calculated the amount of its adjusted gross DTAs and gross DTLs pursuant to paragraph 7, it must determine the amount of its adjusted gross DTAs that can be admitted under paragraph 11, not to exceed the amount of total adjusted gross DTAs. The amount of adjusted gross DTAs is not recalculated under paragraph 11; rather, some or all of the adjusted gross DTA may not be currently admitted. As noted in paragraph 11, the net admitted DTA shall not exceed the excess of the adjusted gross DTAs over gross DTLs.

4.2 Paragraphs 11.a., 11.b. and 11.c. require three interdependent calculations or components that when added together equals the amount of the reporting entity's admitted adjusted gross DTAs. Each of the calculations starts with the total of the reporting entity's adjusted gross DTAs, and determines the amount of such adjusted gross DTAs that can be admitted under that part. For example, the consideration of existing temporary differences in the calculation of admitted adjusted gross DTAs under paragraph 11.a., does not prevent the reconsideration of the same temporary differences in the paragraph 11.b.i. calculation. However, to avoid duplication of admitted adjusted gross DTAs when adding the three parts together, the amount of admitted adjusted gross DTAs under paragraph 11.a. must be subtracted from the amount of adjusted gross DTAs in the paragraph 11.b.i. calculation. Similarly, the amount of admitted adjusted gross DTAs under paragraphs 11.a. and 11.b. must be subtracted from the total adjusted gross DTAs in the paragraph 11.c. calculation. For illustrations of the paragraph 11 DTA admission calculations, see Question 4.16 through Question 4.25.

First Component – Admission Based on Previously Paid Taxes [Paragraph 11.a.]

4.3 Under paragraphs 11.a. and 12.b., a reporting entity can admit adjusted gross DTAs to the extent that it would be able to recover federal income taxes paid in the carryback period, by treating existing temporary differences that reverse during a timeframe corresponding with Internal Revenue Code tax loss carryback provisions[18], not to exceed three years as ordinary or capital losses that originated in each such subsequent year. The reversing temporary differences are specific to each year in which they reverse, and in turn, to the specific year(s) to which they can be carried back corresponding with tax loss carryback provisions. Reversing temporary differences for unrealized losses and nonadmitted assets are treated as capital or ordinary losses depending on their character for tax purposes. The entity is not required to project an actual net operating loss in future periods. This first component of admission is available to all entities, regardless of whether they meet any of the threshold limitations in paragraph 11.b. for reversals expected to be realized against future taxable income.

4.4 Paragraph 12.b. limits the amount of federal income taxes recoverable under paragraph 11.a. to the amount that would be refunded to the reporting entity if a carryback claim was filed with the Internal Revenue Service (IRS). If some amount of taxes paid in the carryback period is not recovered because of limitations imposed by the Alternative Minimum Tax system in effect in taxable years prior to 2018, the

[18] For example, under the Federal Internal Revenue Code ~~tax loss carryback provisions in effect as of January 1, 2012~~, ordinary losses can be carried back two years for entities taxed as nonlife insurance companies ~~and three years for life insurance companies~~, while capital losses for entities taxed both as nonlife and life insurance companies can be carried back three years. For losses arising in tax years after 2017, entities taxed as life insurance companies are not permitted to carryback ordinary losses.

resulting AMT credit is not treated as a newly created DTA. Paragraph 12.c. further limits the amount of federal income taxes recoverable under paragraph 11.a. for a reporting entity that files a consolidated income tax return with one or more affiliates, to the amount that the reporting entity could reasonably expect to have refunded by its parent. See Question 8 for a further discussion of the impact of filing a consolidated federal income tax return.

Second Component – Admission Based On Projected Future Tax Savings [Paragraph 11.b.]

4.5 The amount of a reporting entity's adjusted gross DTAs that can be admitted pursuant to paragraph 11.b. is in part, dependent on the amount of the reporting entity's adjusted capital and surplus. Accordingly, a reporting entity must determine which Realization Threshold Limitation Table set forth in paragraph 11.b. is applicable to the reporting entity and then, based on its respective facts, determine what applicable period to apply under paragraph 11.b.i. and applicable percentage to use under paragraph 11.b.ii.

4.6 If the reporting entity is subject to risk-based capital requirements or is required to file a Risk-Based Capital Report with the domiciliary state, it should use the RBC Reporting Entity Table set forth in paragraph 11.b. Threshold limitations for this table are contingent upon the ExDTA ACL RBC ratio. See Question 4b for a discussion on the ExDTA ACL RBC ratio.

4.7 If the reporting entity is (1) either a mortgage guaranty insurer or financial guaranty insurer that is not subject to risk-based capital requirements, (2) is not required to file a Risk-Based Capital Report with the domiciliary state, and (3) the reporting entity meets the minimum capital and reserve requirements[19] for the state of domicile, then it should use the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table set forth in paragraph 11.b. Threshold limitations for this table are contingent upon the ratio of ExDTA Surplus plus contingency reserves divided by the minimum aggregate capital required (see further detail in paragraph 11.b.).

4.8 If the reporting entity (1) is not subject to risk-based capital requirements, (2) is not required to file a Risk-Based Capital Report with the domiciliary state, (3) is not a mortgage guaranty or financial guaranty insurer, and (4) meets the minimum capital and reserve requirements[20], it should use the Other Non-RBC Reporting Entity Table set forth in paragraph 11.b. Threshold limitations for this table are contingent upon the ratio of adjusted gross DTA less the amount of adjusted gross DTA admitted in paragraph 11.a. to adjusted capital and surplus.

4.9 The amount of admitted adjusted gross DTAs under paragraph 11.b.i., is limited to the amount that the reporting entity expects to realize within the applicable period as determined using the applicable Realization Threshold Limitation Table following the balance sheet date. See Question 6 for a further discussion of the meaning of "expected to be realized." See Question 4.2 regarding the amount of adjusted gross DTAs considered in the paragraph 11.b.i. calculation. The amount of admitted adjusted gross DTAs under the paragraph 11.a. calculation is subtracted from the amount of adjusted gross DTAs under paragraph 11.b.i., to prevent the counting of the same admitted adjusted gross DTAs more than once. If the reporting entity expects to realize an amount of adjusted gross DTAs under paragraph 11.b.i. that is equal to or less than the admitted adjusted gross DTAs calculated under paragraph 11.a., then the resulting admitted adjusted gross DTAs under paragraph 11.b.i. will be zero.

4.10 The reference to applicable period following the balance sheet date in 4.9 refers to the paragraph 11.b.i. column of the applicable Realization Threshold Limitation Table, the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table or the Other Non-RBC

[19] If a reporting entity is not at the minimum capital and reserve requirements, the admitted adjusted gross DTA for this component is zero.

[20] See Footnote 19

Reporting Entity Table.

4.11 The amount of admitted adjusted gross DTAs under paragraph 11.b.i. is also limited to an amount that is no greater than the applicable percentage of adjusted statutory capital and surplus specified in paragraph 11.b.ii. See Question 4c for a discussion of the meaning of "an amount that is no greater than".

4.12 The reference to an amount no greater than the applicable percentage of statutory capital and surplus in 4.11 refers to the 11.b.ii. column of the applicable Realization Threshold Limitation Table; the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table or the Other Non-RBC Reporting Entity Table.

Third Component – Admission Based On Offset Against DTL [Paragraph 11.c.]

4.13 Under paragraph 11.c., a reporting entity can admit adjusted gross DTAs as an offset against gross DTLs in an amount equal to the lesser of: (1) its adjusted gross DTAs, after subtracting the amount of admitted adjusted gross DTAs under paragraphs 11.a. and 11.b., or (2) its gross DTLs. See Question 4.2 regarding the amount of adjusted gross DTAs considered in the paragraph 11.c. calculation. In determining the amount of adjusted gross DTAs that can be offset against existing gross DTLs in the paragraph 11.c. calculation, the character (i.e., ordinary versus capital) of the DTAs and DTLs must be taken into consideration such that offsetting would be permitted in the tax return under existing enacted federal income tax laws and regulations. For example, an adjusted gross DTA related to unrealized capital losses could not be offset against an ordinary income DTL. Ordinary DTAs can be admitted by offset with ordinary DTLs and/or capital DTLs. However, capital DTAs can only be admitted by offset with capital DTLs. In addition~~ to consideration of the character of the DTAs and DTLs~~, for reporting entities that consider reversal of existing temporary differences in determining the need for a statutory valuation allowance adjustment, significant and relevant historical and/or currently available information may exist specific to the remaining amount of total adjusted gross DTAs and gross DTLs~~. This information~~ must also be taken into consideration ~~when determining admission by offset with gross DTLs~~in the determination of the admission of adjusted gross DTAs under paragraph 11.c. However, for those reporting entities, no scheduling is required beyond that necessary in determining the need for a statutory valuation allowance adjustment. As stated in paragraph 11.c., "for purposes of this component, the reporting entity shall consider the reversal patterns of temporary differences; however, this consideration does not require scheduling beyond that required in paragraph 7.e." See Question 2.5 through Question 2.8 for further discussion of scheduling for purposes of determining the reporting entity's statutory valuation allowance adjustment.) This consideration requires a scheduling exercise if scheduling is needed for determination of the statutory valuation allowance adjustment and, as a result, should be consistent with the determination of any statutory valuation allowance adjustment, which occurs prior to performing the admissibility calculations.[21] However, ~~A~~as noted in Question 2.7, scheduling reversal patterns of temporary differences in evaluating the need for a statutory valuation allowance adjustment where a reporting entity relies on sources of future taxable income, exclusive of reversals of temporary differences, is not required. In such case, that reporting entity is not required to schedule reversal patterns of temporary differences for purposes of paragraph 11.c. of SSAP No. 101. This is the case even if the reversal pattern of the temporary difference is readily determinable, such as straight-line amortization of a fixed amount. It also is the case if, for example, the reporting entity in determining its statutory valuation allowance adjustment has considered a source of future income reversal of existing temporary differences that are capital in character, but not those that are ordinary in character. In such case, the reporting entity is not required to schedule reversal patterns of ordinary temporary differences for purposes of paragraph 11.c.~~However, the significant and relevant historical and/or currently available information noted above must be considered and be consistent with the conclusion to admit or nonadmit adjusted gross DTAs~~

[21] Footnote 1 of SSAP No. 101 provides that a reporting entity "shall consider reversal patterns of temporary differences *to the extent necessary* to support establishing or not establishing a valuation allowance adjustment." (Emphasis added).

~~under paragraph 11.c. without additional detailed scheduling. See Question 2.5 through 2.8 for further discussion of scheduling for purposes of determining the reporting entity's statutory valuation allowance adjustment.~~

Other Considerations

4.14 In certain situations, a reporting entity's expected federal income tax rate on its reversing temporary differences ~~will~~ are expected to be less than the enacted tax rate used in the determination of its gross DTAs and DTLs. Examples of such entities include: ~~property/casualty insurance companies with large municipal bond portfolios that are AMT taxpayers,~~ Blue Cross-Blue Shield Organizations with section 833(b) deductions, ~~small life insurance companies,~~ reporting entities projecting a tax loss, and entities that file in a consolidated federal income tax return that cannot realize the full amount of their adjusted gross DTAs under the existing intercompany tax sharing or tax allocation agreement. Pursuant to paragraphs 231, 232 and 238 of FAS 109, such entities are required to report their gross DTLs at the enacted tax rate, and cannot take into consideration the impact of other adjustments such as the ~~AMT,~~ section 833(b) deduction~~, or the small life insurance company deduction~~ to reduce their gross DTLs.

4.15 For those entities, the amount of admitted adjusted gross DTAs calculated under paragraph~~s~~ 11.a. ~~and 11.b.~~ will reflect the actual tax rate in the carryback period under paragraph 11.a. ~~and the expected tax rate in the applicable period as discussed in 4.10 above under paragraph 11.b.,~~ which takes into consideration the impact in the carryback years of the AMT~~,~~ and special deductions, ~~and~~ as well as the provisions of the intercompany tax sharing or allocation agreement. Likewise, the amount of admitted adjusted gross DTAs calculated under paragraph 11.b. will reflect the expected tax rate in the applicable period as discussed in paragraph 4.14 ~~above~~, which takes into consideration the impact of special deductions and the provisions of the intercompany tax sharing or allocation agreement. See Question 6 for further discussion of this issue. As such, the entity's admitted adjusted gross DTAs under paragraphs 11.a. and 11.b. may be less than its adjusted gross DTAs on temporary differences at the enacted rate. Any unused amount of DTAs resulting from ~~a rate~~this differential under paragraphs 11.a. and 11.b. can be used under paragraph 11.c. to offset existing DTLs.

4.16 The above principles can be illustrated by the following examples:

4.17 Facts:

RBC Reporting Entity Example

1. Life Insurance Company ABC[22] has $9~~12~~,500,000 of deductible temporary differences ($6,000,000 ordinary and $3,500,000 capital) at 12-31-20X2 that generate $1,995,~~4,375~~,000 of gross DTAs ($1,260~~2,100~~,000 ~~O~~ordinary, $735~~2,275~~,000 ~~C~~capital), at the enacted federal income tax rate of 21%~~35~~%. ABC has sufficient evidence of projected future taxable income exclusive of reversing temporary differences and carryforwards to support a conclusion that it will realize the full amount of its ordinary gross DTAs, and it was unnecessary in reaching that conclusion (i.e., that no valuation allowance adjustment need be established for ordinary DTAs) to consider reversal patterns of temporary differences. However, management has concluded, after considering all four sources of taxable income described in paragraph 13 of SSAP No. 101, that a statutory valuation allowance adjustment should be recognized for $168,000 of capital DTAs, reducing capital DTAs from $735,000 to $567,000. Thus, in total, m~~M~~anagement has concluded that ABC will more likely than not realize gross DTAs of $1,827~~4,100~~,000 ($1,260~~2,100~~,000 ~~O~~ordinary, $567~~2,000~~,000 ~~C~~capital) related to its $9,500,000~~12.5 million~~ of deductible temporary

[22] ~~ABC does not qualify for the small life insurance company deduction.~~ Please note the results in this example may be different due to differences in the applicable carryback periods if ABC was ~~a P&C~~taxed as a non-life insurance company.

differences. ~~Based on management's conclusion, a statutory valuation allowance adjustment was recognized for $275,000 reducing capital DTAs from $2,275,000 to $2,000,000.~~ ABC also has $4,000,000 of taxable temporary differences ($2,800,000 ordinary and $1,200,000 capital) resulting in $840~~1,400~~,000 ($588~~1,000~~,000 ~~O~~ordinary, $252~~400~~,000 ~~C~~capital) of gross DTLs.

2. ABC has determined that $2,000,000 of its $6,000,000 existing deductible ordinary temporary differences will reverse in ~~12-31-~~20X3, another $1,500,000 will reverse in ~~12-31-~~20X4, and another $2,000,000 will reverse in ~~12-31-~~20X5. The remaining $500,000 of ABC's existing deductible ordinary temporary differences will reverse in years 20X6 or later. ~~None of~~ ABC~~'s~~ has determined that $200,000, $300,000, and $400,000 of its $3,500,000 deductible capital temporary differences are expected to reverse ~~within the applicable period~~in 20X3, 20X4, and 20X5, respectively, and the remaining $2,600,000 will reverse in years 20X6 or later.

3. ABC reported $400,000 ($300,000 ordinary, $100,000 capital) and $1,000~~600~~,000 ($800,000 ordinary, $200,000 capital) of taxable income in 20X0 and 20X1, respectively. ABC reported $84~~140~~,000 ($63,000 ordinary, $21,000 capital) and $210,000 ($168,000 ordinary, $42,000 capital) of tax expense on its 20X0 and 20X1 federal income tax returns, respectively. It has also projected taxable income of $1,500~~1,200~~,000 ($1,200,000 ordinary, $300,000 capital) and $315~~420~~,000 ($252,000 ordinary, $63,000 capital) of federal income taxes for 20X2 that have been reflected in its current statutory income tax provision calculation. ~~There are no differences between its regular and alternative minimum taxable income during 20X0 through 20X2.~~

4. ~~ABC is projecting an income tax rate of 35% in 20X3, as well as in years 20X4 and 20X5 based on its estimated taxable income and federal income tax liability.~~ ABC expects to realize[23] a federal income tax benefit of 21~~35~~% from 20X3 through 20X5 related to reversing ordinary temporary differences. ABC does not anticipate any capital gain income in 20X3 through 20X5.

5. ABC has an ExDTA ACL RBC Ratio at 12-31-20X2 of 600%. Adjusted statutory capital and surplus under paragraph 11.b.ii. is $7,000,000 at 12-31-20X2, and was computed by subtracting the admitted balances of net DTA's, goodwill and EDP from the current period statutory surplus. Statutory surplus is defined in paragraph 2 of SSAP No. 72.

6. The above facts are summarized in the following table:

	Ordinary	Capital	Total
20X2 – Current Year Taxable Income & Tax:			
Taxable Income in CY	$ 1,200,000	$ 300,000	$ 1,500,000
Tax Provision @ 21%	$ 252,000	$ 63,000	$ 315,000
Deductible Temporary Differences	$ 6,000,000	$ 3,500,000	$ 9,500,000
DTA @21%	$ 1,260,000	$ 735,000	$ 1,995,000
Taxable Temporary Differences	$ 2,800,000	$ 1,200,000	$ 4,000,000
DTL @21%	$ 588,000	$ 252,000	$ 840,000
Valuation Allowance		$ 168,000	$ 168,000
Carryback Taxable Income & Tax:			
20X0 Taxable Income	$ 300,000	$ 100,000	$ 400,000

[23] See Question 6 for discussion on the admittance calculation under paragraph 11.b.i. and what is meant by the phrase: "expected to be realized."

Tax	$ 63,000	$ 21,000	$ 84,000
20X1 Taxable Income	$ 800,000	$ 200,000	$ 1,000,000
Tax	$ 168,000	$ 42,000	$ 210,000
Reversal of Deductible Temp Differences:			
20X3	$ 2,000,000	$ 200,000	$ 2,200,000
20X4	$ 1,500,000	$ 300,000	$ 1,800,000
20X5	$ 2,000,000	$ 400,000	$ 2,400,000
20X6 and later	$ 500,000	$ 2,600,000	$ 3,100,000
Total (before valuation allowance)	$ 6,000,000	$ 3,500,000	$ 9,500,000

4.18 Calculation of ABC's Admitted Adjusted Gross DTAs:

1. Paragraph 11.a. calculation. ABC cannot admit ~~$726,000 ($132,000 + $198,000 + $396,000) of~~ any ordinary adjusted gross DTAs under paragraph 11.a.,~~–~~because entities taxed as life insurance companies are not permitted to carry back ordinary tax losses under existing Federal income tax law. ~~all of which are ordinary in tax character.~~ However, ABC can admit capital adjusted gross DTAs of $126,000 under paragraph 11.a. because all capital losses are permitted a 3-year carryback under existing Federal income tax law and ABC paid taxes on capital gains in each year 20X0-20X2.~~ABC can admit $726,000 ($132,000 + $198,000 + $396,000) of adjusted gross DTAs under paragraph 11.a., all of which are ordinary in tax character.~~

   a. ABC first carries $~~400~~100,000 of the hypothetical ~~net operating~~capital loss[24] of $~~2,000~~200,000 from 20X3 back to 20X0 recovering $~~132~~21,000 in taxes paid. ~~The difference between the total 20X0 taxes paid at 35% ($140,000) and the amount recoverable ($132,000) through carryback of the $400,000 represents an $8,000 AMT credit generated as a result of the 90% AMT net operating loss[25] limitation. This AMT credit is not treated as a new DTA as of 12-31-20X2.~~ The remaining $~~1,600~~100,000 of the 20X3 hypothetical ~~net operating~~capital loss ($~~2,000~~200,000 – $~~400~~100,000) is available for utilization in years 20X1 and 20X2.

   b. ABC would carry ~~an additional~~the remaining $~~600~~100,000 of the ~~remaining~~ hypothetical ~~net operating~~capital loss ~~of $1,600,000~~ from 20X3 back to 20X1 recovering $~~198~~21,000 in taxes paid. In addition, ABC would carry back $100,000 of hypothetical capital loss from 20X4 to 20X1 to recover another $21,000 of taxes paid.[26] ~~The difference between the total taxes paid at 35% ($210,000) and the amount recoverable ($198,000) through carryback of the $600,000 represents a $12,000 AMT credit generated as a result of the 90% AMT NOL limitation. Again, this AMT credit is not treated as a new DTA as~~

[24] It should be noted that if ABC's hypothetical 20X3 carryback was insufficient to fully offset all ~~positive taxable~~capital gain income in 20X0, the company would not be allowed to carryback any of the hypothetical loss from 20X4 or 20X5 to 20X0 per paragraph 11.a., as 20X0 is outside of the timeframe corresponding with ~~tax~~ capital loss carryback provisions for an ~~life~~ insurance company.

~~[25] A life insurance company incurs an "operating loss deduction" rather than a "net operating loss". The term "net operating loss" or "NOL" will be used generically throughout this document to refer to any operating loss incurred or expected to be incurred by the reporting entity.~~

[26] If ABC would not have had sufficient hypothetical ~~NOL~~ capital loss from ~~20X3~~ 20X4 to carryback to 20X1, the company would not have been able to carryback its hypothetical ~~NOL~~ capital loss of $~~1,500~~400,000 from ~~20X4~~ 20X5 back to 20X1 pursuant to the applicable tax loss carryback provisions.

~~of 12-31-20X2. The remaining $1,000,000 of hypothetical net operating loss ($1,600,000 – $600,000) is available for utilization in 20X2.~~

c. ABC would carry the remaining $~~1,000~~200,000 of the hypothetical ~~net operating~~capital loss from 20X4~~3~~ plus an additional $~~200~~100,000 of the hypothetical ~~net operating~~capital loss from 20X5~~4~~ back to 20X2, recovering $~~396~~63,000 in taxes projected to be paid.~~[27]~~ ~~The difference between the total taxes projected to be paid at 35% ($420,000) and the amount recoverable ($396,000) through carryback of the $1,200,000 represents a $24,000 AMT credit generated as a result of the 90% AMT NOL limitation. As noted previously, this AMT credit is not treated as a new DTA as of 12-31-20X2.~~

~~The fact that the full $5,500,000 of reversing deductible ordinary temporary differences available for carryback were not used in the paragraph 11.a. calculation does not prevent their inclusion in the paragraph 11.b. and 11.c. calculations.~~

2. Paragraph 11.b. calculation. ABC can admit $1,050,000 of adjusted gross DTAs under paragraph 11.b. Since ABC has an ExDTA ACL RBC ratio of 600%, the Realization Threshold Limitation Table provides that the company can use the thresholds of 3 years for projected realization and 15% of adjusted capital and surplus. The company expects to realize a federal income tax benefit of $1,155~~1,925~~,000 ($5,500,000 X 21~~35~~%) in 20X3 through 20X5 related to its reversing ordinary deductible temporary differences and $126,000 ($600,000 X 21%) in 20X3 through 20X5 related to its reversing capital deductible temporary differences (through carryback to 20X0-20X2).[28] The $1,281~~1,925~~,000 amount ($1,155,000 + $126,000) must be reduced by the $~~726~~126,000 of admitted adjusted gross DTAs under paragraph 11.a. to prevent double counting of the same income tax benefit. As a result, ABC has projected adjusted gross DTAs available for admission under this component of $1,155~~,199~~,000 ($~~1,925~~1,281,000 – $~~726~~126,000), all of which ~~is~~ are ordinary in tax character. However, 15% of adjusted capital and surplus is a limiting factor in this example. As such, even though ABC has sufficient sources of future taxable income exclusive of reversing taxable temporary differences to realize a federal income tax benefit of $1,155,000 in 20X3 through 20X5 related to its reversing ordinary deductible temporary differences, admission of ~~reversing deductible~~those temporary differences ~~that are projected to be realized during 20X3 through 20X5~~ is limited to $1,050,000 ($7,000,000 X 15%).

3. Paragraph 11.c. calculation. ABC can admit $462~~724~~,000 ($210~~324~~,000 ~~O~~ordinary, $252~~400~~,000 ~~C~~capital) of adjusted gross DTAs under paragraph 11.c. ~~Even though~~ ABC has $1,827~~2,324~~,000 of total adjusted gross DTAs available for admission under ~~this component~~paragraph 11 ~~($4,100,000 – $726,000 – $1,050,000) and only $1,400,000 DTLs~~.~~,~~ ~~T~~These DTAs are made up of $1,260~~324~~,000 ~~O~~ordinary DTAs ~~($2,100,000 – $726,000 – $1,050,000)~~ and $567~~2,000~~,000 of ~~C~~capital DTAs. ~~Thus, the tax character of the DTAs and DTLs becomes the limiting factor for this component.~~ To prevent double counting of admitted adjusted gross DTAs, the $1,260,000 of ordinary DTAs must be reduced by the $1,050,000 admitted under paragraph 11.b., leaving $210,000 for admission under paragraph 11.c. Likewise, the $567,000 of capital DTAs must be reduced by the $126,000 admitted under paragraph 11.a., leaving $441,000 for admission under paragraph 11.c. There are~~is~~ $588~~1,000~~,000 of ~~O~~ordinary DTLs

~~[27] If ABC would not have had sufficient hypothetical NOL from 20X4 to carryback to 20X2, the company would have been able to carryback is hypothetical NOL of $2,000,000 from 20X5 back to 20X2 pursuant to the applicable tax loss carryback provisions.~~

[28] Because ABC projects no capital gain income in 20X3 through 20X5, it is not able to realize a federal income tax benefit on the remaining $300,000 of capital temporary differences reversing in that 3-year period.

available to offset against the $210~~324~~,000 of ~~O~~ordinary DTAs. There are~~is~~ $252~~400~~,000 of ~~C~~capital DTLs available to offset against the $441~~2,000~~,000 c~~C~~apital DTAs. However, the tax character of the DTAs and DTLs becomes a limiting factor for this component. While ordinary DTAs can be offset against both ordinary and capital DTLs, the reverse is not allowed in the tax return (see Question 4.13). Because ABC did not consider reversal of existing temporary differences in determining that no valuation allowance was necessary for gross ordinary DTAs, it need not consider reversal patterns of temporary differences for admission of ordinary DTAs in its paragraph 11.c. calculation. On the other hand, because ABC was required to consider all four sources of taxable income specified in paragraph 13 of SSAP No. 101(including future reversals of existing taxable capital temporary differences) in establishing a valuation allowance for gross capital DTAs, it is required to consider reversal patterns of temporary differences for admission of capital DTAs in its paragraph 11.c. calculation, but this consideration does not require scheduling beyond that required by paragraph 7.e. of SSAP No. 101 (again see Question 4.13). In this situation, after the required consideration, ABC can admit $210~~324~~,000 and $252~~400~~,000 of its o~~O~~rdinary and c~~C~~apital DTAs, respectively.

4.19 Summary of ABC's Admitted Gross DTA Calculation:

~~Gross DTAs at Enacted Tax Rate~~		~~$4,375,000~~
~~Less: Statutory Valuation Allowance Adjustment~~		~~275,000~~
~~Adjusted Gross DTAs at Enacted Tax Rate~~		~~4,100,000~~
~~Admitted Gross DTAs (paragraph 11.a.)~~	~~$ 726,000~~	
~~Admitted Gross DTAs (paragraph 11.b.)~~	~~1,050,000~~	
~~Admitted Gross DTAs (paragraph 11.c.)~~	~~724,000~~	
~~Total Admitted Adjusted Gross DTAs(sum of 11.a., 11.b., and 11.c.)~~	~~2,500,000~~	~~(2,500,000)~~
~~Nonadmitted Adjusted Gross DTAs~~		~~1,600,000~~
~~Admitted DTA~~		~~2,500,000~~
~~Gross DTL~~		~~(1,400,000)~~
~~Net Admitted DTA/DTL~~		~~$1,100,000~~

	Ordinary	**Capital**	**Total**
Gross DTAs at Enacted Tax Rate	$1,260,000	$735,000	$1,995,000
Less: Statutory Valuation Allowance		$168,000	$168,000
Adjusted Gross DTAs at Enacted Tax Rate	$1,260,000	$567,000	$1,827,000
Admitted Gross DTAs (paragraph 11.a.)	0	$126,000	$126,000
Admitted Gross DTAs (paragraph 11.b.)	$1,050,000	0	$1,050,000
Admitted Gross DTAs (paragraph 11.c.)	$210,000	$252,000	$462,000
Total Admitted Adjusted Gross DTAs (sum of 11.a, 11.b., and 11.c)	$1,260,000	$378,000	$1,638,000
Nonadmitted Adjusted Gross DTAs	0	$239,000	$239,000
Admitted DTA	$1,260,000	$378,000	$1,638,000
Gross DTL	$(588,000)	$(252,000)	$(840,000)
Net Admitted DTA/DTL	$672,000	$126,000	$798,000

4.20 Facts:

Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Example

1. Financial Guaranty Insurance Company DEF has the same facts as Life Insurance Company ABC except:

a. DEF is not an RBC reporting entity and therefore does not calculate an RBC percentage. DEF is a financial guaranty insurer and has an ExDTA Surplus plus Contingency Reserve/Required Aggregate Risk Capital ratio of 105%. This ratio represents the sum of surplus to policyholders (excluding any admitted DTA from 11.a.) plus contingency reserves divided by the minimum aggregate capital required.

b. DEF reported $1,000,000 of taxable income and $210~~350~~,000 of tax expense on its 20X1 federal income tax return. It has also projected taxable income of $1,500~~1,200~~,000 and $315~~420~~,000 of federal income taxes for 20X2 that has~~ve~~ been reflected in its current statutory income tax provision calculation. DEF recognized no capital gain income in 20X1 or 20X2, so all of its taxable income in those years was ordinary in character. But DEF has $1,000,000 less deductible capital temporary differences than ABC and so, after considering all four sources of taxable income specified in paragraph 13 of SSAP No. 101, DEF establishes the same valuation allowance against gross capital DTAs as ABC. After the valuation allowance, DEF has $357,000 ($2,500,000 gross capital DTAs x 21% = $525,000 less $168,000 valuation allowance = $357,000) of adjusted gross capital DTAs.~~There are no differences between its regular and alternative minimum taxable income in 20X1 or 20X2.~~

4.21 Calculation of DEF's Admitted Adjusted Gross DTAs:

1. Paragraph 11.a. calculation. DEF can admit $525~~726~~,000 ($210~~330~~,000 + $315~~396~~,000) of adjusted gross DTAs under paragraph 11.a, all of which are ordinary in tax character.

a. As an entity taxed as a nonlife insurance company, DEF, unlike ABC, is permitted to carry back ordinary tax losses. DEF first carries $1,000,000 of the hypothetical net operating loss[29] of $2,000,000 from 20X3 back to 20X1 recovering $210~~330~~,000 in taxes paid. ~~The difference between the total 20X1 taxes paid at 35% ($350,000) and the amount recoverable ($330,000) through carryback of the $1,000,000 represents a $20,000 AMT credit generated as a result of the 90% AMT net operating loss limitation. This AMT credit is not treated as a new DTA as of 12-31-20X2.~~ The remaining $1,000,000 of the hypothetical net operating loss ($2,000,000 – $1,000,000) is available for utilization in 20X2.

b. DEF would carry the remaining $1,000,000 of the hypothetical net operating loss from 20X3 plus an additional $500~~200~~,000 of the hypothetical net operating loss from 20X4 back to 20X2 recovering $315~~396~~,000 in taxes projected to be paid.[30] ~~The difference between the total taxes projected to be paid at 35% ($420,000) and the amount recoverable ($396,000) through carryback of the $1,200,000 represents a $24,000 AMT credit generated as a result of the 90% AMT net~~

[29] It should be noted that if DEF's hypothetical 20X3 carryback was insufficient to fully offset all positive taxable income in 20X1, the company would not be allowed to carryback any of the hypothetical loss from 20X4 or 20X5 to 20X1 per paragraph 11.a., as 20X1 is outside of the timeframe corresponding with the tax loss carryback provisions for a non-life insurance company.

[30] If DEF would not have had sufficient hypothetical NOL from 20X4~~3~~ to carryback to 20X2, the company would not have been able to carryback its hypothetical NOL of $2,000~~1,500~~,000 from 20X5~~4~~ back to 20X2 ~~pursuant to the applicable tax loss carryback provisions~~as 20X2 is outside of the timeframe corresponding with the tax loss carryback provisions for a nonlife insurance company.

~~operating loss limitation. As noted previously, this AMT credit is not treated as a new DTA as of 12-31-20X2.~~

~~The fact that the full $3,500,000 of reversing deductible ordinary temporary differences available for carryback were not used in the paragraph 11.a. calculation does not prevent their inclusion in the paragraph 11.b. and 11.c. calculations.~~

2. Paragraph 11.b. calculation. DEF cannot admit any additional adjusted gross DTAs under paragraph 11.b. Since DEF has an ExDTA Surplus/Policyholders and Contingency Reserves ratio of 105%, the Realization Threshold Limitation Table provides that the company can use the thresholds of 1 year for projected realization and 10% of adjusted capital and surplus. The company expects to realize a federal income tax benefit of $420~~700~~,000 ($2,000,000 X 21~~35~~%) in 20X3 related to its reversing deductible temporary differences. The $420~~700~~,000 amount must be reduced by the $525~~726~~,000 of admitted adjusted gross DTAs under paragraph 11.a. to prevent double counting of the same income tax benefit. DEF admitted $105~~26~~,000 ($525,000 - $420,000) more adjusted gross DTAs based on carryback of ~~the~~ hypothetical net operating losses under paragraph 11.a. than is projected to be realized within the 1- year applicable threshold limitation. As a result, there is $0 of expected additional reversing deductible differences available for admission under paragraph 11.b.

3. Paragraph 11.c. calculation. DEF can admit $840~~1,400~~,000 ($588~~1,000~~,000 ~~O~~ordinary, $252~~400~~,000 ~~C~~capital) of adjusted gross DTAs under paragraph 11.c. ~~Even though~~ DEF has $1,617~~3,374~~,000 of total adjusted gross DTAs available for admission under paragraph 11.~~this component ($4,100,000 – $726,000),~~ T~~t~~hese DTAs are made up of $1,260~~1,374~~,000 ~~O~~ordinary DTAs ~~($2,000,000 – $726,000)~~ and $357~~2,000~~,000 of ~~C~~capital DTAs. ~~Thus, the tax character of the DTAs and DTLs must be considered as a potential limiting factor for this component.~~ To prevent double counting of admitted adjusted gross DTAs, the $1,260,000 of ordinary adjusted gross DTAs must be reduced by the $525,000 admitted under paragraph 11.a., leaving $735,000 for admission under paragraph 11.c. There are~~is~~ $588~~1,000~~,000 of ~~O~~ordinary DTLs to offset against the $735~~1,374~~,000 of ~~O~~ordinary DTAs. There are~~is~~ $252~~400~~,000 of ~~C~~capital DTLs to offset against the $357~~2,000~~,000 ~~C~~capital DTAs. However, the tax character of the DTAs and DTLs must be considered as a pot4ential limiting factor for this component because ~~W~~while ~~O~~ordinary DTAs can be offset against both ~~O~~ordinary and ~~C~~capital DTLs, the reverse is not allowed in the tax return (see Question 4.13). In this situation, DEF can admit $588~~1,000~~,000 and $252~~400~~,000 of its ~~O~~ordinary and ~~C~~capital DTAs, respectively.[31] If DEF's adjusted gross DTAs, after reduction for the amount of adjusted gross DTAs admitted under paragraphs 11.a. and 11.b., were less than $840~~1,400~~,000 in this example, DEF would be limited to the balance of its adjusted gross DTAs in the paragraph 11.c. calculation, subject to the rules of offset under existing enacted federal income tax laws and regulations.

4.22 Summary of DEF's Admitted Gross DTA Calculation:

~~Gross DTAs at Enacted Tax Rate~~		~~$4,375,000~~
~~Less: Statutory Valuation Allowance Adjustment~~		~~275,000~~
~~Adjusted Gross DTAs at Enacted Tax Rate~~		~~4,100,000~~
~~Admitted Gross DTAs (paragraph 11.a.)~~	~~$ 726,000~~	
~~Admitted Gross DTAs (paragraph 11.b.)~~	~~0~~	
~~Admitted Gross DTAs (paragraph 11.c.)~~	~~1,400,000~~	
~~Total Admitted Adjusted Gross DTAs (sum of 11.a., 11.b. and 11.c.)~~	~~2,126,000~~	~~(2,126,000)~~

[31] DEF's required consideration of reversal patterns of temporary differences is the same as ABC's. See Question 4.18.3.

~~Nonadmitted Adjusted Gross DTAs~~		~~1,974,000~~
~~Admitted DTA~~		~~2,126,000~~
~~Gross DTL~~		~~(1,400,000)~~
~~Net Admitted DTA/DTL~~		~~$726,000~~

	Ordinary	**Capital**	**Total**
Gross DTAs at Enacted Tax Rate	$1,260,000	$525,000	$1,785,000
Less: Statutory Valuation Allowance		$168,000	$168,000
Adjusted Gross DTAs at Enacted Tax Rate	$1,260,000	$357,000	$1,617,000
Admitted Gross DTAs (paragraph 11.a.)	$525,000	$0	$525,000
Admitted Gross DTAs (paragraph 11.b.)	$0	0	$0
Admitted Gross DTAs (paragraph 11.c.)	$588,000	$252,000	$840,000
Total Admitted Adjusted Gross DTAs (sum of 11.a, 11.b., and 11.c)	$1,113,000	$252,000	$1,365,000
Nonadmitted Adjusted Gross DTAs	$147,000	$105,000	$352,000
Admitted DTA	$1,113,000	$252,000	$1,365,000
Gross DTL	$(588,000)	$(252,000)	$(840,000)
Net Admitted DTA/DTL	$525,000	$0	$525,000

4.23 Facts:

Other Non-RBC Reporting Entity Example

1. Title Insurance Company GHI has the same facts as Life Insurance Company ABC ~~E~~except:

a. GHI is not a RBC reporting entity and therefore does not calculate a RBC percentage. GHI is also not a financial guaranty or mortgage guaranty insurer. As such, GHI must use the Other Non-RBC Reporting Entity Threshold Limitation Table under paragraph 11.b.

b. GHI reported $1,000,000 of taxable income and $210~~350~~,000 of tax expense on its 20X1 federal income tax return. It has also projected taxable income of $1,500~~1,200~~,000 and $315~~420~~,000 of federal income taxes for 20X2 that has~~ve~~ been reflected in its current statutory income tax provision calculation. GHI recognized no capital gain income in 20X1 or 20X2, so all of its taxable income in those years was ordinary in character. But GHI has $1,000,000 less deductible capital temporary differences than ABC and so, after considering all four sources of taxable income specified in paragraph 13 of SSAP No. 101, GHI establishes the same valuation allowance against gross capital DTAs as ABC. After the valuation allowance, DEF has $357,000 ($2,500,000 gross capital DTAs x 21% = $525,000 less $168,000 valuation allowance = $357,000) of adjusted gross capital DTAs.~~There are no differences between its regular and alternative minimum taxable income in 20X1 or 20X2.~~

4.24 Calculation of GHI's Admitted Adjusted Gross DTAs:

1. Paragraph 11.a. calculation. GHI can admit $525~~726~~,000 ($210~~330~~,000 + $315~~396~~,000) of adjusted gross DTAs under paragraph 11.a, all of which are ordinary in tax character.

a. As an entity taxed as a nonlife insurance company, GHI, unlike ABC, is permitted to carry back ordinary tax losses. GHI first carries $1,000,000 of the hypothetical net operating loss[32] of $2,000,000 from 20X3 back to 20X1 recovering $210~~330~~,000 in taxes paid.~~ The difference between the total 20X1 taxes paid at 35% ($350,000) and the amount recoverable ($330,000) through carryback of the $1,000,000 represents a $20,000 AMT credit generated as a result of the 90% AMT net operating loss limitation. This AMT credit is not treated as a new DTA as of 12-31-20X2.~~ The remaining $1,000,000 of the hypothetical net operating loss ($2,000,000 – $1,000,000) is available for utilization in 20X2.

b. GHI would carry the remaining $1,000,000 of the hypothetical net operating loss from 20X3 plus an additional $500~~200~~,000 of the hypothetical net operating loss from 20X4 back to 20X2 recovering $315~~396~~,000 in taxes projected to be paid.[33] ~~The difference between the total taxes projected to be paid at 35% ($420,000) and the amount recoverable ($396,000) through carryback of the $1,200,000 represents a $24,000 AMT credit generated as a result of the 90% AMT net operating loss limitation. As noted previously, this AMT credit is not treated as a new DTA as of 12-31-20X2.~~

~~The fact that the full $3,500,000 of reversing deductible ordinary temporary differences available for carryback were not used in the paragraph 11.a. calculation does not prevent their inclusion in the paragraph 11.b. and 11.c. calculations.~~

2. Paragraph 11.b. calculation. GHI can admit $630~~1,050~~,000 of adjusted gross DTAs under paragraph 11.b. Since GHI has an Adjusted Gross DTA to Adjusted Capital and Surplus ratio of 15.6~~48~~% ($1,092~~3,374~~,000/$7,000,000), the Realization Threshold Limitation Table provides that the company can use the thresholds of 3 years for projected realization and 15% of adjusted capital and surplus. The company expects to realize a federal income tax benefit of $1,155~~1,925~~,000 ($5,500,000 X 21~~35~~%) in 20X3 through 20X5 related to its reversing deductible temporary differences. The $1,155~~1,925~~,000 amount must be reduced by the $525~~726~~,000 of admitted adjusted gross DTAs under paragraph 11.a. to prevent double counting of the same income tax benefit. As a result, GHI has projected adjusted gross DTAs available for admission under this component of $630~~1,199~~,000 ($1,155~~1,925~~,000 – $525~~726~~,000), all of which is ordinary in tax character. ~~However,~~ 15% of adjusted capital and surplus ($7,000,000 X 15% = $1,050,000) is not a limiting factor in this example. As such, admission of reversing deductible temporary differences that are projected to be realized during 20X3 through 20X5 is $630,000 ~~limited to $1,050,000 ($7,000,000 X 15%)~~.

3. Paragraph 11.c. calculation. GHI can admit $357~~724~~,000 ($105~~324~~,000 ~~O~~ordinary, $252~~400~~,000 ~~C~~capital) of adjusted gross DTAs under paragraph 11.c. ~~Even though~~ GHI has $1,617~~2,324~~,000 of total adjusted gross DTAs available for admission under paragraph 11.~~this component ($4,100,000 – $726,000 – $1,050,000),~~ T~~t~~hese DTAs are made up of 1,260$~~324~~,000 ~~O~~ordinary DTAs ~~($2,000,000 – $726,000 – $1,050,000)~~ and $357~~2,000~~,000 of ~~C~~capital DTAs. ~~Thus, the tax character of the DTAs and DTLs becomes the limiting factor for~~

[32] It should be noted that if GHI's hypothetical 20X3 carryback was insufficient to fully offset all positive taxable income in 20X1, the company would not be allowed to carryback any of the hypothetical loss from 20X4 or 20X5 to 20X1 per paragraph 11.a., as 20X1 is outside of the timeframe corresponding with the tax loss carryback provisions for a non-life insurance company.

[33] If GHI would not have had sufficient hypothetical NOL from 20X4~~3~~ to carryback to 20X2, the company would not have been able to carryback is hypothetical NOL of $2,000~~1,500~~,000 from 20X5~~4~~ back to 20X2 ~~pursuant to the applicable tax loss carryback provisions~~as 20X2 is outside of the timeframe corresponding with the tax loss carryback provisions for a nonlife insurance company.

~~this component.~~ To prevent double counting of admitted adjusted gross DTAs, the $1,260,000 of ordinary adjusted gross DTAs must be reduced by the $525,000 admitted under paragraph 11.a. and the $630,00 admitted under paragraph 11.b., leaving $105,000 for admission under paragraph 11.c. There is $588~~1,000~~,000 of ~~O~~ordinary DTLs available to offset against the $105~~324~~,000 of ~~O~~ordinary DTAs. There is $252~~400~~,000 of ~~C~~capital DTLs to offset against the $357~~2,000~~,000 ~~C~~capital DTAs. Accordingly, the tax character of the DTAs and DTLs becomes a limiting factor for this component. While ordinary DTAs can be offset against both ordinary and capital DTLs, the reverse is not allowed in the tax return (see Question 4.13). In this situation, GHI can admit $105~~324~~,000 and $252~~400~~,000 of its ~~O~~ordinary and ~~C~~capital DTAs, respectively[34].

4.25 Summary of GHI's Admitted Gross DTA Calculation:

~~Gross DTAs at Enacted Tax Rate~~		~~$4,375,000~~
~~Less: Statutory Valuation Allowance Adjustment~~		~~275,000~~
~~Adjusted Gross DTAs at Enacted Tax Rate~~		~~4,100,000~~
~~Admitted Gross DTAs (paragraph 11.a.)~~	~~$ 726,000~~	
~~Admitted Gross DTAs (paragraph 11.b.)~~	~~1,050,000~~	
~~Admitted Gross DTAs (paragraph 11.c.)~~	~~724,000~~	
~~Total Admitted Adjusted Gross DTAs (sum of 11.a., 11.b. and 11.c.)~~	~~2,500,000~~	~~(2,500,000)~~
~~Nonadmitted Adjusted Gross DTAs~~		~~1,600,000~~
~~Admitted DTA~~		~~2,500,000~~
~~Gross DTL~~		~~(1,400,000)~~
~~Net Admitted DTA/DTL~~		~~$1,100,000~~

	Ordinary	**Capital**	**Total**
Gross DTAs at Enacted Tax Rate	$1,260,000	$525,000	$1,785,000
Less: Statutory Valuation Allowance		$168,000	$168,000
Adjusted Gross DTAs at Enacted Tax Rate	$1,260,000	$357,000	$1,617,000
Admitted Gross DTAs (paragraph 11.a.)	$525,000	$0	$525,000
Admitted Gross DTAs (paragraph 11.b.)	$630,000	0	$630,000
Admitted Gross DTAs (paragraph 11.c.)	$105,000	$252,000	$357,000
Total Admitted Adjusted Gross DTAs (sum of 11.a, 11.b., and 11.c)	$1,260,000	$252,000	$1,512,000
Nonadmitted Adjusted Gross DTAs	$0	$105,000	$352,000
Admitted DTA	$1,260,000	$252,000	$1,512,000
Gross DTL	$(588,000)	$(252,000)	$(840,000)
Net Admitted DTA/DTL	$ 672,000	$0	$672,000

4b. Q – How is the ExDTA ACL RBC ratio calculated? [Paragraph 11.b.i.]

4.26 A – The December 31 ExDTA ACL RBC ratio is calculated in the same manner as in the ACL RBC Ratio computed in the Annual RBC Report, where Total Adjusted Capital (TAC) is divided by ACL RBC. However, for purposes of paragraph 11.b.i., TAC does not include any DTAs of the reporting entity. The ACL RBC would be the amount calculated in the Annual RBC Report.

4.27 The interim period (March 31, June 30, and September 30) ExDTA ACL RBC ratio calculation is discussed in 4.29-4.33.

[34] GHI's required consideration of reversal patterns of temporary differences is the same as ABC's. See Question 4.18.3.

4.28 For all companies, the TAC will include current period capital and surplus, excluding any DTAs of the reporting entity. Other TAC adjustments are dependent on whether the company is a Life, P&C or Health insurer.

4.29 For life companies, the AVR adjustment is calculated as a required part of the development of capital and surplus each quarter, and is one of the major adjustments to TAC (added back to surplus). As noted on the illustrative interim TAC calculation in 4.33 for life companies, there are other TAC adjustments such as subsidiaries' dividend liabilities, etc., that are drawn from the Quarterly Statement.

4.30 For P&C and Health companies, except for the AVR and life subsidiaries' dividend liability amounts (both of which are only applicable to P&C companies with life subsidiaries), which are readily available on the quarter, the prior year's annual TAC adjustments should be used in the current quarter's TAC calculation. The P&C and Health interim TAC illustrations in 4.33 provide example details of various interim RBC TAC adjustments.

4.31 The ACL RBC used for the interim RBC calculation is the ACL RBC from the most recently filed Annual Statement for the most recent calendar year. For example, for June 30, 20X3, the ACL for the interim RBC calculation is taken from the 20X2 RBC Report based on the 20X2 Annual Statement.

4.32 In most instances, the prior year's annual ACL RBC will suffice. A company should only revise its interim ACL RBC for a material change in its risk profile when requested to do so by its domiciliary state or subject to domiciliary state approval.

4.33 The above principles are illustrated below:

Interim Life RBC Example			
Based on the 2018~~1~~ Life RBC Report page LR033			
		Reported	Interim Period
	SOURCE OF THE DATA	12/31/20X2	3/31/20X3
Capital and Surplus	P3, L38	$1,800,000,000	$1,700,000,000
Adjustments:			
AVR	P3, L24.01	60,000,000	65,000,000
Dividend Liability	P3, L6.1, L6.2 in part	0	0
Sub AVR	P3, L24.01 of subs	5,000,000	4,500,000
Sub Dividend Liability	P3, L6.1, L6.2 in part of subs	0	0
P&C Non-Tabular Discounts and/or Alien Insurance Subsidiary: Other	P&C Subs P3, L1 & L3 in part	0	0
Hedging Fair Value Adjustment	Company Records	0	0
Credit for Capital Notes	P3, L24.11	0	0
Total Adjusted Capital (TAC)	5-Year Historical Data, P22, C1, L30	1,865,000,000	1,769,500,000
Less: Deferred Tax Asset	P2, C3, L18.2	190,000,000	200,000,000
TAC ExDTA		$1,675,000,000	$1,569,500,000
Authorized Control Level RBC	5-Year Historical Data	$175,000,000	$175,000,000*

Total Adjusted Capital ExDTA/Authorized Control Level ~~Risk-Based Capital~~RBC		957%	897%
*ACL RBC amount for interim period is the 12/31/20X2 amount			

Interim P&C RBC Example			
(Based on the 2018~~1~~ P&C RBC Report page PR026			
		Reported	Interim Period
	SOURCE OF THE DATA	12/31/20X2	3/31/20X3
Capital and Surplus	P3, C1, L37 (Ann. & Qtrly. Stmt.)	$850,000,000	$765,000,000
Adjustments:			
Non-Tabular Discount-Losses	SCHEDULE P P1-SUM C32, L12 (Ann. Stmt. Only)	(800,000)	(800,000)
Non-Tabular Discount-Expense	SCHEDULE P P1-SUM C33. L12 (Ann. Stmt. Only)	(60,000)	(60,000)
Discount on Medical Loss Reserves Reported as Tabular in Schedule P	Company Records	0	0
Discount on Medical Expense Reserves Reported as Tabular In Schedule P	Company Records	0	0
P&C Subs Non-Tabular Discount-Losses	SCHEDULE P P1-SUM C32, L12 (Ann. Stmt. Only)	0	0
P&C Subs Non-Tabular Discount-Expenses	SCHEDULE P P1-SUM C33, L12 (Ann. Stmt. Only)	0	0
P&C Subs Discount on Medical Loss Reserves Reported as Tabular in Schedule P	Subs' Company Records	0	0
P&C Subs Discount on Medical Expense Reserves Reported as Tabular In Schedule P	Subs' Company Records	0	0
AVR - Life Subs	Subs P3, C1, L24.01 (Ann. & Qtrly. Stmt.)	5,000,000	6,000,000
Dividend Liability - Life Subs	Subs P3 C1 L6.1 + L6.2 (Ann. & Qtrly. Stmt.)	0	0
Total Adjusted Capital	5-Year Historical Data P17, C1, L28	854,140,000	770,140,000
	(Annual/Current calc. on Qtr.)		
Less: Deferred Tax Asset	P2, C3, L18.2 (Ann. & Qtrly. Stmt.)	82,000,000	72,000,000
Total Adjusted Capital ExDTA	PR026 (Annual RBC Report/Current	772,140,000	698,140,000

	Calc. on Qtr.)		
Authorized Control Level Risk-Based Capital	5-Year Historical Data P17, C1, L29 (Annual)	171,000,000	171,000,000*
Total Adjusted Capital ExDTA/ Authorized Control Level Risk-Based Capital		452%	408%
*ACL RBC amount for interim period is the 12/31/20X2 amount			

Interim Health RBC Example			
(Based on the 201~~1~~8 Health RBC Report page XR024			
		Reported	Interim Period
	SOURCE OF THE DATA	12/31/20X2	3/31/20X3
Capital and Surplus	P3, C3, L33 (Ann. & Qtrly. Stmt.)	$850,000,000	$765,000,000
Adjustments:			
AVR – Life Subs	Subs' Company Records	0	0
Dividend Liability – Life Subs	Subs' Company Records	0	0
Tabular Discounts – P&C subs	Subs' Company Records	0	0
Non-Tabular Discounts – P&C Subs	Subs' Company Records	0	0
Total Adjusted Capital	5-Year Historical Data P28, C1, L14 (Annual/ Current calc. on Qtr.)	850,000,000	765,000,000
Less: Deferred Tax Asset	P2, C3, L18.2 (Ann. & Qtrly. Stmt.)	82,000,000	72,000,000
Total Adjusted Capital ExDTA	XR 24 (Annual RBC Report/Current Calc. on Qtr.)	768,000,000	693,000,000
Authorized Control Level Risk-Based Capital	5-Year Historical Data P28, C1, L15 (Annual)	171,000,000	171,000,000*
Total Adjusted Capital ExDTA/ Authorized Control Level Risk-Based Capital		449%	405%
*ACL RBC amount for interim period is the 12/31/20X2 amount			

4c. Q – What is meant by the phrase "an amount that is no greater than"? [Paragraph 11.b.ii.]

4.34 A – As discussed in ~~paragraph~~question 4.11 the amount of admitted adjusted gross DTAs under paragraph 11.b.i. is also limited to an amount that is no greater than the applicable percentage of statutory capital and surplus test specified in paragraph 11.b.ii. For purposes of this test, statutory capital and surplus as shown on the statutory balance sheet of the reporting entity for the current period's statement filed with the domiciliary state commissioner is adjusted to exclude any net DTAs, EDP equipment and operating system software and any net positive goodwill.

4.35 The phrase "an amount that is no greater than" in paragraph 11.b.ii. allows an entity to utilize an amount lower (e.g., from the reporting entity's most recently filed statement) than what would be allowed if it utilized the amount of statutory capital and surplus adjusted to exclude any net DTAs, EDP equipment and operating system software and any net positive goodwill as required to be shown on the statutory balance sheet of the reporting entity for the current period's statement filed with the domiciliary state commissioner. This ability to utilize a lower amount is for administrative ease if a reporting entity's surplus is increasing.

4.36 For example, at 12/31/20X2 if adjusted capital and surplus is $100M and at 9/30/20X2 it was $80M, the entity may utilize the $80M amount from the prior quarter.

4.37 If instead 12/31/20X2 adjusted capital and surplus were $60M, the entity may not utilize the $80M amount from the prior quarter as that would overstate the limitation under paragraph 11.b.ii.

4.38 If at 12/31/20X2 an entity's adjusted capital and surplus was initially determined to be $150M, the entity can still utilize that amount under paragraph 11.b.ii., if there is a late accounting adjustment that increases that amount to $160M.

5a. Q – How is the timing of reversals of temporary differences and carryforwards determined for SSAP No. 101 purposes? [Paragraphs 7, 11.a., 11.b.i. and 12.a.]

5.1 A – The timing of temporary difference reversals is critical in determining the amount of admitted adjusted gross DTAs. Determining the reversal of temporary differences impacts the adjusted gross DTA admitted pursuant to paragraphs 11.a., 11.b.i. and potentially 11.c. of SSAP No. 101. For purposes of paragraph 11.c., determining the reversal of temporary differences is necessary only to the extent required by paragraph 7.e. as discussed in Question 4.13.

5.2 Paragraph 12.a. of SSAP No. 101 states that "For purposes of paragraph 11.a., existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years, shall be determined in accordance with paragraphs 228 and 229 of FAS 109." The timing of reversals of temporary differences and carryforwards for purposes of paragraph 11.b. of SSAP No. 101 shall be determined under similar principles.

5.3 Paragraph 228 of FAS 109 states, in pertinent part, that "[t]he particular years in which temporary differences result in taxable or deductible amounts generally are determined by the timing of the recovery of the related asset or settlement of the related liability." Question 1 of the FASB's Special Report on Statement 109 provides additional guidance on scheduling. It defines "scheduling" as the analysis performed to determine the pattern and timing of the reversal of temporary differences. ~~It~~The FASB's Special Report also provides certain scheduling guidelines to be followed, including the need for the method employed to be systematic and logical, that a consistent method be used for each category of temporary differences, and that a change in the method used be considered a change in accounting principle.

5.4 Assume Company A purchases its only asset for $1,000, an asset that is admissible for statutory accounting purposes and depreciated over five years on a straight-line basis. Assume also that the asset is depreciated over seven years for tax purposes using the Modified Accelerated Cost Recovery System (MACRS). The following table summarizes the statutory and tax basis of the asset at the end of each year.

Year	Cost	Statutory Depreciation	Statutory Basis	Tax Depreciation	Tax Basis	Deductible/ (Taxable) Temporary Difference
1	$1,000	$200	$800	$143	$857	$57
2	-	200	600	245	612	12
3	-	200	400	175	437	37
4	-	200	200	125	312	112
5	-	200	-	89	223	223
6	-	-	-	89	134	134
7	-	-	-	89	45	45
8	-	-	-	45[35]	-	-

5.5 At the end of year one, the Company would conclude that $45 ($57 - $12) of the $57 outstanding deductible temporary difference would reverse within one year, leaving a temporary difference of $12 at the end of year two. However, for computing a two or three-year reversal, the Company would not project a reversal of the temporary difference by the end of year three or four as the deductible temporary difference is scheduled to increase (from $12 to $37 and from $37 to $112, respectively). If the Company had decided to sell the asset in year two, it may be appropriate to conclude that the outstanding deductible temporary difference of $57 would reverse in year two.

5.6 A similar rationale would apply in the instance of a nonadmitted asset. Assume the same facts as aforementioned, except that the asset is nonadmitted for statutory accounting purposes. The results are summarized in tabular form below.

Year	Cost	Statutory Charge to Surplus	Statutory Basis	Tax Depreciation	Tax Basis	Deductible/ (Taxable) Temporary Difference
1	$1,000	$1,000	-	$143	$857	$857
2	-	-	-	245	612	612
3	-	-	-	175	437	437
4	-	-	-	125	312	312
5	-	-	-	89	223	223
6	-	-	-	89	134	134
7	-	-	-	89	45	45
8	-	-	-	45	-	-

[35] Due to the mid-year convention applicable to most asset acquisitions for tax purposes, the asset is treated as acquired in mid-year, meaning that a seven (7) year asset is depreciated over eight (8) tax years.

5.7 In this example, the Company has a steady decline in the deductible temporary difference that is not complicated by competing depreciation regimes. This is due to the fact that the Company took the large surplus charge when the asset was nonadmitted, thereby creating a significant deductible temporary difference. The Company would project a $245 temporary difference reversal in year two (from $857 to $612), a $175 temporary difference reversal in year three (from $612 to $437), and a $125 temporary difference reversal in year four (from $437 to $312). Although the Company will take income statement charges for depreciation on the nonadmitted asset, the statutory basis is nonetheless zero from the moment the asset was nonadmitted. Future statutory depreciation deductions will not impact the statutory basis and have no impact on the analysis.

5.8 The above examples assume a single asset. However, the analysis becomes more complicated when the Company has hundreds or thousands of assets within its fixed asset pool. In this instance, it is expected that management will make its best estimate of the expected reversal pattern determined in a manner consistent with the grouping for measurement (see question 2 for more discussion about grouping).

5.9 As indicated above, the timing of the reversal of a particular balance sheet item will depend on the expected recovery of the related asset and liability. For example, the temporary difference associated with property & casualty loss reserves would be expected to reverse in a manner consistent with the payout pattern ("development") of the underlying loss reserves. Historical loss development triangles may be useful in substantiating a reversal pattern. For instance, assume Company A writes two types of property and casualty policies: auto liability and workers' compensation. The following table details the components of the statutory and tax reserves for Company A as of December 31, 20X2.[36]

Private Passenger Auto Liability	Statutory Reserves	Tax Reserves	Temporary Difference
AY + 0	$1,000	$900	$100
AY + 1	850	690	160
AY + 2	700	580	120
AY + 3	550	490	60
AY + 4	400	385	15
AY + 5	300	275	25
AY + 6	200	175	25
AY + 7	100	90	10
AY + 8	80	75	5
AY + 9	70	65	5
Prior	50	45	5
Total	$4,300	$3,770	$530

Workers' Compensation	Statutory Reserves	Tax Reserves	Temporary Difference
AY + 0	$1,000	$825	$175
AY + 1	900	800	100
AY + 2	850	770	80
AY + 3	790	695	95
AY + 4	725	610	115
AY + 5	695	600	95

[36] Under current tax law, the loss payment period extends for more years, but the concepts illustrated herein are unchanged.

AY + 6	655	575	80
AY + 7	605	545	60
AY + 8	575	505	70
AY + 9	550	495	55
Prior	505	450	55
Total	$7,850	$6,870	$980

5.10 One option in analyzing the reversal of the temporary difference would be to calculate the historical loss development patterns for the two lines of business by accident year for each year in the applicable reversal period. By applying these development patterns to the individual temporary differences, the Company could estimate the expected reversal of the temporary difference as a whole for each year in the applicable reversal period.

5.11 Another option would be to apply the average development factor by line of business to each reserve for each year in the applicable reversal period. If the average one-year development factor for all accident years for auto liability and workers' compensation were 70% and 35%, respectively, the one-year temporary difference reversal would be $371 ($530 x 70%) for auto liability and $343 ($980 x 35%) for workers' compensation. The same approach could be used in determining the reversal for any other year in the applicable reversal period.

5.12 The temporary difference related to property and casualty unearned premiums is typically twenty percent (20%) of the outstanding statutory unearned premium reserve. If a company issues only one-year policies, it is reasonable to assume that the entire temporary difference will reverse in one year. If a company writes multi-year contracts, management will be required to estimate the percentage of the unearned premium that will be earned within each year of the applicable reversal period and apply these percentages to the outstanding temporary difference.

5.13 The reversal of the temporary difference related to life insurance reserves may require actuarial assistance, normally involving anticipated development of the statutory and tax reserves for policies issued prior to the end of the current reporting year. In computing the anticipated development, it would be expected that reasonable assumptions be used, which may include cash-flow modeling of the entity's reserves. Deferred acquisition costs on life insurance policies are amortized over prescribed periods pursuant to federal tax law. The amortization schedules should provide management with the ability to estimate the reversal for each year in the applicable reversal period with reasonable accuracy.

5.14 For those temporary differences that do not have a defined reversal period, such as unrealized losses on common stock or deferred compensation liabilities, management will need to determine when the temporary difference is "expected" to reverse. For instance, assume a company has an unrealized loss of $200 in its equity portfolio and that, on average, the portfolio turns over twenty percent (20%) per year. It would be appropriate for the company to conclude that $40 of the temporary difference will reverse in each year in the applicable reversal period. When determining when the temporary difference would be "expected" to reverse, management should normally take into account events that are likely to occur using information, facts and circumstances in existence as of the reporting date. The estimates used in this circumstance should not be extended to other tests of impairment. For instance, when the entity assumed a 20% turnover in its equity portfolio, it is not involuntarily required to record an impairment in accordance with paragraph 10~~9~~ of *SSAP No. 30R—Unaffiliated Common Stock*~~—Investments in Common Stock (excluding investments in common stock of subsidiary, controlled, or affiliated entities)~~.

5.15 In summary, the methodology used to develop the reversal pattern should be consistent, systematic, and rational. Although consistency is encouraged, business conditions may dictate that certain factors be given more or less weight than in previous periods. Factors to be considered include historical patterns, recent trends, and the likely impact of future initiatives (without regard to future originating temporary differences). For instance, if a company has migrated to a more efficient claims management system, outstanding reserves may be settled more quickly than historical payment patterns may indicate. A company that expects to enter into a loss portfolio transfer reinsurance transaction should consider the implications of that treaty in determining the reversal of the loss reserve temporary difference.

5b. Q – How should future originating differences impact the scheduling of temporary difference reversals during the applicable period? [Paragraphs 11.a., 11.b.i., 11.c. and 12.a]

5.16 A – Future originating differences, and their subsequent reversals, are considered in assessing the existence of future taxable income. However, they should not impact the scheduling of existing temporary difference reversals during the applicable period. Paragraph 229 of FAS 109 provides the following:

> 229. For some assets or liabilities, temporary differences may accumulate over several years and then reverse over several years. That pattern is common for depreciable assets. Future originating differences for existing depreciable assets and their subsequent reversals are a factor to be considered when assessing the likelihood of future taxable income (paragraph 21(b)) for realization of a tax benefit for existing deductible temporary differences and carryforwards.

6. Q – What is meant by the phrase "expected to be realized"? [Paragraph 11.b.i.]

6.1 A – A reporting entity calculates the amount of its adjusted gross DTAs and gross DTLs under paragraph 7 using the enacted tax rate. The amount of adjusted gross DTAs and gross DTLs is not recalculated under paragraph 11. The purpose of paragraph 11 is to determine the amount of adjusted gross DTAs that can be admitted in the reporting period.

6.2 An excerpt of SSAP No. 4 – *Assets and Nonadmitted Assets* indicates:

> 2. For purposes of statutory accounting, an asset shall be defined as: probable[37] future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.

6.3 The phrase "expected to be realized" encompasses a reasonable expectation as to the value of the DTAs consistent with SSAP No. 4. This means that if a reporting entity's management expects that deductible temporary differences that reverse in the applicable period will produce a federal income tax benefit at a rate that is lower than the enacted rate, the expected rate should be taken into consideration in the determination of the amount of admitted adjusted gross DTAs under paragraph 11.b.i. In other words, available evidence causes the reporting entity to expect the asset to be realized at less than the enacted rate. In such cases, it would not be appropriate to calculate the amount of admitted adjusted gross DTAs under paragraph 11.b.i. on the basis of reversing deductible temporary differences at the enacted tax rate.

6.4 The following examples illustrate situations where the amount of admitted adjusted gross DTAs under paragraph 11.b.i. would be less than the adjusted gross DTAs calculated using deductible temporary differences reversing in the applicable period at the enacted income tax rate. The approach in these examples is to determine the tax savings that the company would expect to realize from its reversing deductible temporary differences. This is accomplished through a calculation of the company's income tax liability "with and without" these temporary differences. It is assumed that in these examples there are no prudent and feasible tax-planning strategies that would cause the entity to expect the asset to be

[37] *FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements* (CON 6) states, "Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, Accounting for Contingencies, par. 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved."

realized at a rate different than that presented in the examples.

~~*Example 1:*~~

~~6.5 P&C has a significant portion of its investment portfolio in municipal bonds. It is estimating regular taxable income to be $6,000,000 in 20X3, $4,000,000 in 20X4, and $5,000,000 in 20X5. Included in these amounts are $10,000,000 ($8,500,000 net of 15% "proration") of excluded tax-exempt interest per year and $2,000,000 of reversing deductible temporary differences per year that were included in P&C's deferred inventory at 12/31/X2. The Company's ExDTA ACL RBC percentage is 700% and therefore required to use the three-year applicable period under paragraph 11.b.i.~~

~~20X3~~	**~~Without Reversing Temporary Differences~~**		**~~With Reversing Temporary Differences~~**	
	~~Regular Tax~~	~~AMT~~	~~Regular Tax~~	~~AMT~~
~~Regular Taxable Income~~	~~$8,000,000~~	~~$8,000,000~~	~~$8,000,000~~	~~$8,000,000~~
~~AMT/ACE Adjustment~~		~~6,375,000~~[38]		~~6,375,000~~
~~Reversing Temporary Differences~~			~~(2,000,000)~~	~~(2,000,000)~~
~~Taxable Income~~	~~8,000,000~~	~~14,375,000~~	~~6,000,000~~	~~12,375,000~~
~~Tax (35% regular/20% AMT)~~	~~2,800,000~~	~~2,875,000~~	~~2,100,000~~	~~2,475,000~~
~~Tax Liability~~	~~$2,800,000~~	~~75,000~~	~~$2,100,000~~	~~375,000~~
~~Total Tax~~		~~$2,875,000~~		~~$2,475,000~~

~~20X4~~	**~~Without Reversing Temporary Differences~~**		**~~With Reversing Temporary Differences~~**	
	~~Regular Tax~~	~~AMT~~	~~Regular Tax~~	~~AMT~~
~~Regular Taxable Income~~	~~$6,000,000~~	~~$6,000,000~~	~~$6,000,000~~	~~$6,000,000~~
~~AMT/ACE Adjustment~~		~~6,375,000~~		~~6,375,000~~
~~Reversing Temporary Differences~~			~~(2,000,000)~~	~~(2,000,000)~~
~~Taxable Income~~	~~6,000,000~~	~~12,375,000~~	~~4,000,000~~	~~10,375,000~~
~~Tax (35% regular/20% AMT)~~	~~2,100,000~~	~~2,475,000~~	~~1,400,000~~	~~2,075,000~~
~~Tax Liability~~	~~$2,100,000~~	~~375,000~~	~~$1,400,000~~	~~675,000~~
~~Total Tax~~		~~$2,475,000~~		~~$2,075,000~~

~~20X5~~	**~~Without Reversing Temporary Differences~~**		**~~With Reversing Temporary Differences~~**	
	~~Regular Tax~~	~~AMT~~	~~Regular Tax~~	~~AMT~~
~~Regular Taxable Income~~	~~$7,000,000~~	~~$7,000,000~~	~~$7,000,000~~	~~$7,000,000~~
~~AMT/ACE Adjustment~~		~~6,375,000~~		~~6,375,000~~
~~Reversing Temporary Differences~~			~~(2,000,000)~~	~~(2,000,000)~~
~~Taxable Income~~	~~7,000,000~~	~~13,375,000~~	~~5,000,000~~	~~11,375,000~~
~~Tax (35% regular/20% AMT)~~	~~2,450,000~~	~~2,675,000~~	~~1,750,000~~	~~2,275,000~~
~~Tax Liability~~	~~$2,450,000~~	~~225,000~~	~~$1,750,000~~	~~525,000~~
~~Total Tax~~		~~$2,675,000~~		~~$2,275,000~~

[38] ~~$10,000,000 x 85% x 75%~~

~~Total~~[39]	**~~Without Reversing Temporary Differences~~**		**~~With Reversing Temporary Differences~~**	
	~~Regular Tax~~	~~AMT~~	~~Regular Tax~~	~~AMT~~
~~Regular Taxable Income~~	~~$21,000,000~~	~~$21,000,000~~	~~$21,000,000~~	~~$21,000,000~~
~~AMT/ACE Adjustment~~		~~19,125,000~~		~~19,125,000~~
~~Reversing Temporary Differences~~			~~(6,000,000)~~	~~(6,000,000)~~
~~Taxable Income~~	~~21,000,000~~	~~40,125,000~~	~~15,000,000~~	~~34,125,000~~
~~Tax (35% regular/20% AMT)~~	~~7,350,000~~	~~8,025,000~~	~~5,250,000~~	~~6,825,000~~
~~Tax Liability~~	~~$7,350,000~~	~~675,000~~	~~$5,250,000~~	~~1,575,000~~
~~Total Tax~~		~~$8,025,000~~		~~$6,825,000~~

~~6.6 Over the three-year applicable period, the reversing deductible temporary differences of $6,000,000 are expected to save P&C income taxes at a rate of 20% or $1,200,000 ($8,025,000 - $6,825,000). The remaining 15% tax benefit represents an additional AMT credit carryover of $900,000 ($1,575,000 - $675,000). Therefore, P&C's admitted adjusted gross DTAs under paragraph 11.b.i., before reduction for any admitted adjusted gross DTAs under paragraph 11.a. would be $1,200,000, which is less than the amount of its adjusted gross DTAs of $2,100,000 ($6,000,000 x 35%) on reversing deductible temporary differences at the enacted rate. However, the $900,000 difference generated by the 15% (35% - 20%) rate differential under paragraph 11.b.i. would be taken into account in the paragraph 11.c. calculation as part of the amount of adjusted gross DTAs, after application of paragraphs 11.a. and 11.b., that can be offset against existing gross DTLs.~~

~~6.7 In the above example, if P&C were to be in a regular tax liability during 20X5 (i.e. a year in the applicable period subsequent to the creation of the 20X3 and 20X4 AMT credit carryovers), these credit carryovers may be utilized in determining the 20X5 with and without calculation. This utilization must be within the applicable period and would be limited to the amount allowed under tax law. In Example 1, assuming full utilization of the 20X3 and 20X4 carryovers, in 20X5 the admitted adjusted gross DTAs under paragraph 11.b.i. (before reduction for any admitted adjusted gross DTAs under paragraph 11.a.) would then be equal to the $2,100,000 adjusted gross DTAs on the $6,000,000 of reversing deductible temporary differences because the AMT credit is both generated and fully utilized in the applicable period.~~

~~Example 2:~~

~~6.8 SL is a small life insurance company with projected assets of less than $500 million at the end of 20X3. SL also estimates that its 20X3 taxable income before the small life insurance company deduction (SLICD) will be $1,300,000. Included in this amount is $400,000 of reversing deductible temporary items that were part of SL's deferred inventory at 12/31/X2. The Company's ExDTA ACL RBC percentage is 250% and therefore it is required to use the one-year applicable period under paragraph 11.b.i.~~

~~20X3~~	**~~Without Reversing Temporary Differences~~**		**~~With Reversing Temporary Differences~~**	
	~~Regular Tax~~	~~AMT~~	~~Regular Tax~~	~~AMT~~
~~Regular Taxable Income before SLICD~~	~~$1,700,000~~	~~$1,700,000~~	~~$1,700,000~~	~~$1,700,000~~
~~Reversing Temporary Differences~~			~~(400,000)~~	~~(400,000)~~
~~Net~~	~~1,700,000~~	~~1,700,000~~	~~1,300,000~~	~~1,300,000~~

[39] ~~The totals are provided for illustration purposes only. The calculations are required to be performed individually each year.~~

~~Small Life Insurance Company Deduction (60%)~~	~~(1,020,000)~~	~~(1,020,000)~~	~~(780,000)~~	~~(780,000)~~
~~AMT/ACE Adjustment (75% of SLICD)~~		~~765,000~~		~~585,000~~
~~Taxable Income~~	~~680,000~~	~~1,445,000~~	~~520,000~~	~~1,105,000~~
~~Tax (35% regular/20% AMT)~~	~~238,000~~	~~289,000~~	~~182,000~~	~~221,000~~
~~Tax Liability~~	~~$238,000~~	~~51,000~~	~~$182,000~~	~~39,000~~
~~Total Tax~~		~~$289,000~~		~~$221,000~~

~~6.9 Since SL is a small life insurance company with less than $3 million of taxable income before the small life insurance company deduction, it is taxed at an effective federal income tax rate of 17%. The $400,000 of reversing deductible temporary differences in 20X3 is expected to save SL $68,000 ($289,000 - $221,000) in federal income taxes at the 17% rate. The tax savings represents a reduction in regular taxes of $56,000 and AMT taxes of $12,000. Under paragraph 11.b.i., SL would admit adjusted gross DTAs of $68,000, before reduction for any adjusted gross DTAs admitted under paragraph 11.a. Any unused amount of adjusted gross DTAs related to the 18% (35% - 17%) rate differential under paragraph 11.b.i. would be taken into account under paragraph 11.c. as part of the amount of adjusted gross DTAs, after reduction for adjusted gross DTAs admitted under paragraphs 11.a. and 11.b., that can be offset against existing gross DTLs. This same approach would be used in 20X4 and 20X5, if the Company instead qualified for the three-year applicable period under paragraph 11.b.i.~~

Example 1~~3~~:

6.5~~10~~ BCBS is a Blue Cross/Blue Shield Organization that expects to fully offset its regular taxable income with available section 833 (b) deductions in 20X2. Prior to considering the section 833 (b) deduction, BCBS projects $8,000,000 of taxable income in 20X3, which includes $3,000,000 of reversing deductible temporary differences that were part of its deferred inventory at 12/31/X2. The Company's ExDTA ACL RBC percentage is 250% and therefore it is required to use the one-year applicable period under paragraph 11.b.i.

20X3	**Without Reversing Temporary Differences**	**With Reversing Temporary Differences**
Taxable Income Before 833(b)	$11,000,000	$11,000,000
Reversing Temporary Differences		(3,000,000)
Net	11,000,000	8,000,000
Section 833 (b) Deduction	(11,000,000)	(8,000,000)
Taxable Income	0	0
Tax	0	0

6.6~~11~~ BCBS has a 0% effective tax rate on ~~regular~~ taxable income in 20X3~~ and is taxed at 20% for AMT.~~ Its regular taxable income is $0, both "with and without" the $3,000,000 reversing deductible temporary differences since the section 833 (b) deduction changes by an equal amount. ~~The $600,000 reduction in AMT tax liability related to the $3,000,000 reversing deduction temporary differences is expected to generate a 20% tax savings in 20X3.~~ Therefore, BCBS would admit ~~$600,000 of~~ zero adjusted gross DTAs under paragraph 11.b.i., before reduction for any adjusted gross DTAs admitted under paragraph 11.a. ~~Any~~ The unused amount of adjusted gross DTAs related to the 21~~15~~% ~~(35% - 20%)~~ rate differential under paragraph 11.b.i. would be taken into account under paragraph 11.c. as part of the amount of adjusted gross DTAs, after reduction for adjusted gross DTAs admitted under paragraphs 11.a. and 11.b., that can be offset against existing gross DTLs. The same approach would be used in 20X4 and 20X5 if the Company instead qualified for the three-year applicable period under paragraph

11.b.i.

Example 24:

6.7~~12~~ ABC, a ~~insurance~~ company taxed as a nonlife insurance company, is projecting an income tax loss in 20X3 of $20,000,000, which includes $5,000,000 of reversing deductible temporary differences that were part of its deferred inventory at 12/31/X2. ABC expects to pay $0 federal income taxes in 20X3 ~~for both regular and AMT tax purposes~~ as a result of its tax loss. The Company's ExDTA ACL RBC percentage is 250% and therefore, it is required to use the one-year applicable period under paragraph 11.b.i.

20X3	Without Reversing Temporary Differences		With Reversing Temporary Differences	
	~~Regular Tax~~	~~AMT~~	~~Regular Tax~~	~~AMT~~
~~Regular~~ Taxable Income (Loss)	($15,000,000)	~~($15,000,000)~~	($15,000,000)	~~($15,000,000)~~
Reversing Temporary Differences			(5,000,000)	~~(5,000,000)~~
Taxable Income (Loss)	(15,000,000)	~~(15,000,000)~~	(20,000,000)	~~(20,000,000)~~
Tax ~~(35% regular/20% AMT)~~	$0	~~$0~~	$0	~~$0~~

6.8~~13~~ In 20X3, ABC expects to realize no tax benefit related to the $5,000,000 of reversing deductible temporary differences since they simply increase the amount of an NOL. Its expected income tax rate for 20X3 would be 0% and ABC would have $0 admitted adjusted gross DTAs under paragraph 11.b.i. However, if some or all of the reversing temporary differences could be absorbed in the carryback period, ABC would have an admitted adjusted gross DTA under paragraph 11.a.[40] The adjusted gross DTAs of $1,050~~1,750~~,000 ($5,000,000 x 21~~35~~%), related to ABC's reversing temporary differences, would also be available as part of its total adjusted gross DTAs, after reduction for adjusted gross DTAs admitted under paragraphs 11.a. and 11.b., that can be offset against gross DTLs in the paragraph 11.c. calculation.

6.9~~14~~ If a company qualified to utilize the three-year applicable period under paragraph 11.b.i. and within that applicable period forecasted a taxable loss in one or more of the years and taxable income in the other years, the loss may be utilized in determining the with and without calculation. This loss utilization must be within the applicable period and would be limited to the amount allowed to be carried back or carried forward under applicable tax law.

7. Q – SSAP No. 101 provides that a reporting entity may admit deferred tax assets in an amount equal to federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years, including any amounts established in accordance with the provisions of SSAP No. 5R as described in paragraph 3.a. of this statement related to those periods. What is the meaning of the term "taxes paid"? [Paragraph 11.a.]

7.1 A – Under paragraph 11.a. of SSAP No. 101, the term "taxes paid" means the total tax (~~both regular and AMT, but~~ not including interest and penalties), that was or will be reported on the reporting entity's federal income tax returns for the ~~periods included in the~~applicable carryback period including any amounts established in accordance with the provision of SSAP No. 5R as described in paragraph 3.a. of SSAP No. 101 related to those periods. If a federal income tax return in the applicable carryback period has been amended, or adjusted by the IRS, "taxes paid" would reflect the impact of the amended

[40] For purposes of determining the amount of admitted adjusted gross DTAs under paragraph 11.a., ABC would look to the amount of existing temporary differences that reverse during a timeframe corresponding with the tax loss carryback provisions allowed by the applicable tax law, ~~not to exceed three years~~in this case 2 years, notwithstanding that it is limited to a one-year applicable period for purposes of paragraph 11.b.i.

tax return, or settlement with the IRS.

7.2 In applying the term "taxes paid" to a reporting entity that is party to a consolidated federal income tax return, the term "taxes paid" means the total federal income tax ~~(both regular and AMT)~~ that was paid, or is expected to be paid to the common parent of the reporting entity's affiliated group, in accordance with the intercompany tax sharing agreement, with respect to the income tax years included in the applicable carryback period. "Taxes paid" includes amounts established in accordance with the provision of SSAP No. 5R as described in paragraph 3.a. of SSAP No. 101 related to those periods, including current federal income taxes payable (i.e., accrued in the entity's financial statements) related to the applicable carryback period. The ability of the reporting entity to recover (through loss or credit carrybacks) taxes that were paid to its common parent is generally governed by the terms and provisions of the affiliated group's intercompany tax sharing or tax allocation agreement.

7.3 For purposes of paragraphs 7.1 and 7.2, "taxes paid" includes both regular tax and alternative minimum tax for taxable years beginning before January 1, 2018. For taxable years beginning after December 31, 2017, the applicable carryback periods are two years for ordinary losses for entities taxed as nonlife insurance companies, and three years for capital losses for entities taxed both as nonlife and life insurance companies. Entities taxed as life insurance companies are not permitted to carryback ordinary losses arising in tax years after 2017.

8. Q – How is a company's computation of adjusted gross and admitted adjusted gross deferred tax assets impacted if it joins in the filing of a consolidated federal income tax return? [paragraphs 7, 11, 12 and 16]

8.1 A – For purposes of determining the amount of DTAs and the amount admitted under paragraph 11, the calculation should be made on a separate company, reporting entity basis. Under paragraph 7, a reporting entity's gross deferred tax assets and liabilities are determined by identifying its temporary differences. These temporary differences are measured using a "balance sheet" approach by comparing statutory and tax basis balance sheets for that entity. Once a reporting entity determines its gross DTAs, they are reduced for any statutory valuation allowance adjustment that may be necessary to determine the adjusted gross DTAs. The amount of adjusted gross DTAs that are admitted is determined in accordance with paragraph 11.

8.2 Under paragraph 11.a., an entity shall determine the amount of "federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years." Such amount shall include any amounts established for tax loss contingencies in accordance with paragraph 3.a. Consistent with guidance promulgated in other EAIWG interpretations, a reporting entity that files a consolidated federal income tax return with its parent should look to the amount of taxes it paid (or were allocable to it) as a separate legal entity in determining the admitted adjusted gross DTAs under paragraph 11.a. Furthermore, the admitted adjusted gross DTAs under paragraph 11.a. may not exceed the amount that the entity could reasonably expect to have refunded by its parent (paragraph 12.c.). The taxes paid by the reporting entity represent the maximum DTAs that may be admitted under paragraph 11.a., although the amount could be reduced pursuant to the group's tax allocation agreement.

8.3 The amount of admitted adjusted gross DTAs under paragraph 11.b.i. is limited to the amount that the reporting entity expects to realize within the applicable period (refer to the 11.b.i. column of the applicable Realization Threshold Limitation Table in paragraph 11.b.) following the balance sheet date on a separate company basis. The entity must estimate its separate company taxable income and the tax benefit that it expects to receive from reversing deductible temporary differences in the form of lower tax payments to its parent. If the reporting entity has reversing adjusted gross DTAs during the applicable period for which it does not expect to realize a benefit under paragraph 11.b. on a separate company basis, the reporting entity cannot admit an amount related to such DTAs under paragraph 11,b., even though the reporting entity may be paid a tax benefit for such items pursuant to its tax allocation agreement.

8.4 The following examples reflect this analysis and assume that the surplus limitation of paragraph 11.b.ii. is not applicable:

Example 1:

8.5 Assume Company A, an entity taxed as a nonlife insurance company, joins in the filing of a consolidated federal income tax return. Consolidated taxes paid in prior carryback years total $150, of which Company A paid $100. Company A has existing temporary differences that reverse by the end of the ~~third~~ second calendar year following the balance sheet date[41] that, on a separate company reporting entity basis and following the applicable carryback provisions of the Internal Revenue Code for each year in which temporary differences reverse, would give rise to a tax recovery of $125.

8.6 Under paragraph 11.a., Company A could record an admitted DTA of $100, equal to the taxes it paid. ~~Additionally, under paragraph 11.b.i., Company A could admit an additional $25, assuming it expects to realize such tax benefit based on its separate company analysis.~~ Due to the consolidated return filing, the $100 admitted under paragraph 11.a. could only be admitted provided this amount could reasonably be expected to be refunded by the parent [paragraph 12.c.] and would be available pursuant to a written income tax allocation agreement [paragraph 16.b.]. Additionally, assume Company A's ExDTA ACL RBC exceeds 300%, and that it expects to realize $175 from 3 years of DTA reversals, based on its separate company analysis. A 3-year period is applicable for paragraph 11.b.i., notwithstanding that only 2 years of DTA reversals may be taken int account under paragraph 11.a. due to tax limitations on operating loss carrybacks. In such case, Company A could admit an additional $75 under paragraph 11.b.i. ($175 less the $100 admitted under paragraph 11.a.).

Example 2:

8.7 Assume the same facts as in Example 1, except consolidated taxes paid in prior carryback years that could be recovered are $70 and, pursuant to a written income tax allocation agreement, taxes recoverable through loss carrybacks may not exceed consolidated taxes paid in prior carryback years.

8.8 In this situation, Company A would admit a DTA of $70 under paragraph 11.a. (recoverable taxes limited to consolidated taxes paid which could be refunded by the parent). In addition, $105~~55~~ ($175~~125~~-$70) of DTA may be admitted under paragraph 11.b.i., ~~if Company A expected to realize this tax benefit~~ on the basis of ~~its~~ Company A's separate company estimated taxable income and temporary differences that are expected to be realized within the applicable 3 year period following the balance sheet date.

Example 3:

8.9 Parent Company P files a consolidated federal income tax return with its nonlife 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

[41] Corresponds to the timeframe permitted by the Internal Revenue Code for carrybacks of tax losses for a nonlife insurance company. ~~Please note that the applicable carryback period for a non-life insurance company may be different~~. For tax years beginning after 2017, entities taxed as life insurance companies are not permitted to carry back ordinary tax losses. However, entities taxed both as life insurance and nonlife insurance companies are permitted to carry back capital losses three taxable years. Accordingly, if this example involved a capital loss, it could apply either to an entity taxed as a life insurance company or as a nonlife insurance company.

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.

9a. Q – Current income taxes are defined by paragraph 3.a. to include tax loss contingencies for current and all prior years, computed in accordance with SSAP No. 5R, including the modifications in paragraphs 3.a.i, 3.a.ii. and 3.a.iii. How does the modification provided in paragraph 3.a.iii. impact the calculation of the tax contingencies recorded?

9.1 A – Paragraph 3.a.iii. provides the following rule: If the estimated tax loss contingency is greater than 50% of the tax benefit originally recognized, the tax loss contingency recorded shall be equal to 100% of the original tax benefit recognized.

9.2 For example, assume that a company claimed a deduction in its current year federal income tax return that resulted in a $100 permanent tax benefit[42]. Management must assume that the tax position will be examined by a taxing authority that has full knowledge of all relevant information (paragraph 3.a.ii.). In addition, management has determined that the probability of a liability is more likely than not (a likelihood of more than 50% pursuant to paragraph 3.a.i.) and that the liability can be reasonably estimated. Management's best estimate of the loss of the tax benefit is $40 (an amount not greater than 50% of the tax benefit originally recognized). Under these facts, the company would establish a current tax liability in the amount of $40, increasing its current income tax expense by $40.

DR	Current income tax expense	$40	
CR	Liability for current income tax		$40

9.3 Assume the same facts as 9.2, except that management determines the best estimate of the liability to be $60 (an amount greater than 50% of the tax benefit originally recorded). Under paragraph 3.a.iii., the company would be required to record a tax contingency of $100 offsetting the entire original tax benefit recorded. Under these facts, the company would establish a current tax liability in the amount of $100, increasing its current income tax expense by $100.

DR	Current income tax expense	$100	
CR	Liability for current income tax		$100

9b. Q – What impact, if any, does the inclusion of tax contingencies as a component of current income taxes have on the determination of deferred income taxes? [Paragraph 3.c.]

[42] The treatment of tax contingencies related to temporary differences is discussed in Question 9b.

9.4 A – The purpose of this interpretation is to address when such contingencies should be "grossed-up" and reflected in the calculation of both statutory current and deferred federal income taxes.

9.5 Gross deferred tax assets and liabilities are determined in accordance with paragraph 7 of SSAP No. 101, and reflect the changes in temporary differences taken into account in estimating taxes currently payable and are manifested in the enterprise's tax basis balance sheet. If gross tax loss contingencies associated with temporary differences have been included in taxes currently payable, a corresponding adjustment must be made to the tax basis balance sheet used in the determination of gross deferred tax assets and liabilities. Deferred tax assets and liabilities are not adjusted for tax contingencies not associated with temporary differences (i.e. permanent differences).

9.6 For example, assume that a company determines, in accordance with SSAP No. 5R, including the modifications in paragraph 3.a. of SSAP No. 101, a tax loss contingency is required to be established for a $100 deduction claimed in a prior year federal income tax return. Assuming a ~~35~~21% tax rate, the company would establish a current tax liability in the amount of $21~~35~~, increasing its current income tax expense by $21~~35~~.

DR	Current income tax expense	$21~~35~~	
CR	Liability for current income tax		$21~~35~~

9.7 If the $100 deduction was associated with a temporary difference such as reserves, the company would make a corresponding adjustment to deferred taxes. The company would increase its gross deferred tax asset for reserves by $21~~35~~ to reflect the future tax benefit associated with that reserve deduction. Any gross deferred tax asset recorded would still be subject to the admissibility requirements of paragraph 11.

DR	Gross deferred tax asset	$21~~35~~	
CR	Change in net deferred tax (surplus)		$21~~35~~

9.8 If the $100 deduction was associated with a permanent item such as meals and entertainment expenses, the company would make no corresponding adjustment to the deferred tax assets.

9.9 In determining the timing of when a tax loss contingency for a temporary item should be grossed up, paragraph 3.c. of SSAP No. 101 provides the following guidance:

> 3.c. In determining when tax loss contingencies associated with temporary differences should be included in current income taxes under Paragraph 3.a., and therefore included in deferred taxes under paragraph 7, a reporting entity is not required to "gross-up" its current and deferred taxes until such time as an event has occurred that would cause a re-evaluation of the contingency and its probability of assessment, e.g., the IRS has identified the item as one which may be adjusted upon audit. Such an event could be the reporting entity's (or its affiliate or parent in a consolidated income tax return) receipt of a Form 5701, Proposed Audit Adjustment, or could occur earlier upon receipt of an Information Document Request. At such time, the company must reassess the probability of an adjustment, reasonably re-estimate the amount of tax contingency as determined in accordance with paragraph 3.a., make any necessary adjustment to deferred taxes, and re-determine the admissibility of any adjusted gross deferred tax asset as provided in paragraph 11.

10a. Q – If the reporting entity adjusts the amount of regular taxable income and capital gains reported on a prior year income tax return from the amount originally determined for financial reporting purposes, how is the effect of the change reported in the current year? [Paragraph 19]

10.1 A – Paragraph 19 of SSAP No. 101 indicates that "income taxes incurred or received during the current year attributable to prior years shall be allocated, to the extent not previously provided, to net income in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors* (SSAP No. 3) unless attributable, in whole or in part, to realized capital gains or losses, in which case, such amounts shall be apportioned between net income and realized capital gains and losses, as appropriate". Paragraph 19 also indicates that income taxes incurred are to be allocated to ordinary income and realized capital gains consistent with paragraph 38 of FAS 109. Paragraph 38 of FAS 109 provides, in general, that the portion of the total income tax expense remaining after allocation to ordinary income would be allocated to realized capital gains or losses.

10.2 In accordance with paragraph 19, the amount of additional federal income taxes incurred in the current year with respect to the prior year would be allocated between ordinary income and realized capital gain items. The amount of additional federal income tax expense allocated to ordinary income should be determined by comparing the amount of additional tax expense actually incurred to the amount of tax expense that would have been incurred had the adjustment to ordinary income been zero (a "with and without" computation). The remaining amount of additional federal income tax expense would then be allocated to realized capital gains. The amounts of additional federal income tax expense allocated to ordinary income and realized capital gains would be included in the current period's federal income tax expense and not as a direct adjustment to surplus.

10.3 As an example, assume Company X files its 20X1 federal income tax return and reports $1,000,000 of taxable income comprised of $800,000 of ordinary income and $200,000 of capital gain income. Since the company is subject to taxation at a 21~~34~~ percent tax rate on all its income, it incurred federal income tax expense of $210~~340~~,000. In preparing its 20X1 statutory income tax provision, the company estimated that its liability for 20X1 federal income tax would be $147~~238~~,000 based on $600,000 of ordinary income and $100,000 realized capital gains.

10.4 In determining the amount of "income taxes incurred" for its 20X2 financial statement, Company X must include the additional $63~~102~~,000 of income tax expense incurred on its 20X1 federal income tax return ($210~~340~~,000 actual tax incurred less $147~~238~~,000 originally reported) in net income for 20X2 pursuant to paragraph 19 of SSAP No. 101 and not as a surplus adjustment. The $63~~102~~,000 additional expense would be allocated to federal income taxes on net income and realized capital gains and losses as follows:

Total additional income tax expense	$63~~102~~,000
Tax expense allocated to operations ($200,000 additional income x 34%)	42~~68~~,000
Tax expense allocated to realized gains	$ 21~~34~~,000

The tax expense allocated to operations was determined as follows:

Total recomputed tax expense	$210~~340~~,000
Tax expense with only capital gain changes	168~~272~~,000~~[43]~~
Tax expense allocated to operations	$ 42~~68~~,000

10.5 For all purposes of computing and allocating federal income taxes between operations and capital gains and losses, the character of the income or loss item as determined for statutory accounting purposes should be followed. Thus, if an income item is treated as a capital gain for statutory accounting purposes but as ordinary income for tax purposes, the federal income tax allocable to such income would be

~~[43] This is a company with less than $10 million of taxable income therefore $600,000 of original ordinary income plus $200,000 recomputed capital gains equals $800,000 taxable income times 34 percent applicable tax rate equals $272,000.~~

considered tax expense attributable to capital gains.

10b. Q – What is meant by the phrase in paragraph 18 "a reporting entity's unrealized gains and losses shall be recorded net of any allocated DTA or DTL"? [Paragraph 18]

10.6 A – Pursuant to Paragraph 18 of SSAP No. 101, a reporting entity's unrealized gains and losses shall be recorded net of any allocated DTA or DTL in accordance with paragraph 35 of FAS 109. Paragraph 35 of FAS 109 indicates that income taxes incurred are to be allocated between various items, including gains from operations and items charged or credited directly to shareholders' equity, such as the change in unrealized gains and losses.

10.7 To the extent a reporting entity's admitted DTA or its DTL changes during the year, the portion of such change allocable to changes in unrealized gains and losses during the year should be determined. The portion so allocable would be reported with, and netted against, the related change in unrealized gains and losses reported as a component of changes in surplus. The remaining portion of the change in DTA or DTL allocable to other temporary differences should be reported as a separate component of changes in surplus and/or change in nonadmitted assets.

10.8 For example, assume the reporting entity has DTAs of $1,000 relating to temporary differences other than unrealized losses, and a $100 DTL relating to unrealized gains as of the beginning of the year. Since the entity is subject to tax at 21~~35~~ percent and all of its DTAs are expected to reverse within one year, the entity recorded a $900 net admitted DTA as of the beginning of the year.

10.9 During the current year, the DTAs relating to temporary differences other than unrealized losses did not change, but the DTL relating to the entity's unrealized gains increased by $100 (unrealized gains increased by $476~~285~~ during the year). As a result, the amount of the entity's net admitted DTAs decreased by $100.

10.10 Pursuant to paragraph 18 of SSAP No. 101, the $100 decrease in the DTA during the year is to be allocated between changes attributable to temporary differences other than unrealized gains and losses and those attributable to unrealized gains and losses. Since the DTA relating to temporary differences other than unrealized gains and losses did not change during the year, the entire decrease is allocable to the change in unrealized gains. Therefore, the $100 decrease is to be allocated and netted against the $476~~285~~ change in unrealized gains reported in change in surplus, resulting in a $376~~185~~ net increase in surplus relating to its unrealized gains. If a portion of the unrealized loss DTA is determined to be nonadmitted, that amount is not recorded separately from the operating differences DTA. The change in the total nonadmitted DTA from period to period is recorded in surplus as a Change in Nonadmitted Assets.

11. Q – How are current and deferred income taxes to be accounted for in interim periods? [Paragraphs 12.d. and 20]

11.1 A – In setting forth the methodology for the computation of current income taxes (income taxes incurred) in interim periods, paragraph 20 states:

> 20. Income taxes incurred in interim periods shall be computed using an estimated annual effective current tax rate for the annual period in accordance with the methodology described in paragraphs 19 and 20 of *Accounting Principles Board Opinion No. 28, Interim Financial Reporting*. Estimates of the annual effective tax rate at the end of interim periods are, of necessity, based on estimates and are subject to subsequent refinement or revision. If a reliable estimate cannot be made, the actual effective tax rate for the year-to-date may be the best estimate of the annual effective tax rate. If an insurer is unable to estimate a part of its "ordinary" income (or loss) or the related tax (or benefit) but is otherwise able to make a reliable estimate,

the tax (or benefit) applicable to the item that cannot be estimated shall be reported in the interim period in which the item is reported.

11.2 As a result, to the extent a reliable estimate can be made of an expected annual effective tax rate, reporting entities should apply this rate to net income before federal and foreign income taxes, in the case of property and casualty insurers and health insurers, and net income and realized capital gains before federal and foreign income taxes in the case of life insurers. If a reliable estimate of the expected annual effective tax rate cannot be made, reporting entities should compute current and deferred taxes at interim reporting dates using the most reliable information that is available.

11.3 The following examples illustrate the estimation process for income taxes incurred using the estimated annual effective rate:

Projected statutory net income[44] for current year		$10,000,000
Estimated annual permanent differences		(2,800,000)
Estimated annual temporary differences:		2,000,000
Projected taxable income for current year		$9,200,000
Projected federal tax for current year (at 35%)		$1,932~~3,220~~,000
Estimated annual effective tax rate		19.32~~32.2~~%

11.4 As a result, assuming that during the calendar year the reporting entity's expectations as to its statutory and taxable income do not change, income tax incurred will be recorded on a quarterly basis as follows:

Quarter	Statutory Income (Loss)	Income Taxes Incurred
1	$(2,000,000)	$(386,400~~644,000~~)
2	4,000,000	772,800~~1,288,000~~
3	6,000,000	1,159,200~~1,932,000~~
4	2,000,000	386,400~~644,000~~
Total	$10,000,000	$1,932~~3,220~~,000

11.5 If the reporting entity's expectations as to its statutory and taxable income change in the second quarter so that it expects that its annual effective rate will increase from ~~32.2~~19.32% to 20~~34~~%, it will record income taxes incurred in the second quarter of $786,400~~1,324,000~~ (cumulative statutory income at end of the second quarter of $2,000,000 at 20~~34~~% or $400~~680~~,000 less $386,400~~644,000~~ tax benefit recorded in first quarter).

11.6 As noted above, life insurers must estimate their annual effective tax rate and record income taxes incurred based on net income and realized capital gains before federal and foreign income taxes. With regard to intraperiod tax allocation, paragraph 19 states in relevant part:

19. Income taxes incurred shall be allocated to net income and realized capital gains or losses in a manner consistent with paragraph 38 of FAS 109.

11.7 As a result of the above and where the reporting entity expects realized capital gains or losses for the annual period, income taxes incurred must be allocated using a "with and without" methodology to net income before taxes and realized capital gains (see Question 10.4 for further discussion).

[44] For all examples in Question 11, statutory net income represents operating and capital gain income before federal and foreign income taxes.

11.8 An example of this "with and without" methodology is as follows:

Projected statutory net income for current year		$10,000,000
Realized gains included above		(1,000,000)
		9,000,000
Estimated annual permanent differences:		(2,800,000)
Estimated annual temporary differences:		2,000,000
Projected ordinary taxable income for current year		$8,200,000
Projected ordinary federal tax for current year (at 21~~35~~%)		$1,722~~2,870~~,000
Projected capital gain federal tax for current year (at 21~~35~~%)		210~~350~~,000
Projected total federal tax for current year		$1,932~~3,220~~,000
Estimated ordinary annual effective tax rate ($1,722~~2,870~~,000 / $9,000,000)		19.13~~31.9~~%
Estimated capital gain annual effective tax rate ($210~~350~~,000 / $1,000,000)		21~~35~~.0%
Estimated total annual effective tax rate ($1,932~~3,220~~,000 / $10,000,000)		19.32~~32.2~~%

11.9 As a result, assuming that during the calendar year the reporting entity's expectations as to its statutory and taxable income (including the amounts of ordinary and capital income) do not change, income tax incurred will be recorded on a quarterly basis as follows:

Quarter	Ordinary Income (Loss)	Capital Income (Loss)	Ordinary Taxes Incurred	Capital Taxes Incurred
1	$(1,000,000)	$(1,000,000)	$(191,333~~319,000~~)	$(210~~350~~,000)
2	3,000,000	1,000,000	573,999~~956,000~~	210~~350~~,000
3	5,000,000	1,000,000	956,667~~1,595,000~~	210~~350~~,000
4	2,000,000	0	383,667~~638,000~~	0
Total	$9,000,000	$1,000,000	$1,722~~2,870~~,000	$210~~350~~,000

11.10 With respect to the recording of deferred taxes on an interim basis paragraph 12.d. states:

> 12.d. The phrases "reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years," "realized within one year of the balance sheet date" and "realized within three years of the balance sheet date" are intended to accommodate interim reporting dates and reporting entities that file on an other than calendar year basis for federal income tax purposes.

11.11 When considered in the context of paragraph 20, this paragraph requires the use of the annual effective rate when determining deferred taxes at an interim reporting date. As such, a reporting entity's admitted adjusted gross DTAs are determined in accordance with paragraph 11 by reference to the adjusted gross DTAs that will reverse each year in the applicable period. Note however, that due to the inherent unpredictability, and general inability to project changes in capital gains and losses on a quarter by quarter basis, the deferred tax implications of the changes in unrealized gains and losses should be recorded on a discrete period basis (i.e., based on the change in the amounts on a quarter by quarter basis). For example in determining its admitted adjusted gross DTAs at March 31, 20X2, the reversal period referred to above is calendar years 20X3, 20X4 and 20X5 (i.e., expected adjusted gross DTAs at December 31, 20X2 that are expected to reverse in 20X3, 20X4 and 20X5).

11.12 This methodology is illustrated by the following example:

In this example, XYZ Co. is a nonlife insurance company[45] that has a ~~three~~two-year carryback potential and also has an ExDTA ACL RBC percentage of 700%.

Projected statutory net income for 20X3			$10,000,000
Estimated annual permanent differences:			(2,800,000)
Estimated annual temporary differences:			2,000,000
Projected ordinary taxable income for current year			$9,200,000
Temporary differences at December 31, 20X2:			$5,000,000
Estimated temporary differences at December 31, 20X3:			$7,000,000
Taxable income in carryback period (taxes paid at 35%):			
	~~Year ended December 31, 20X0~~	~~$800,000~~	~~($280,000)~~
	Year ended December 31, 20X1	2,000,000	(420~~700~~,000)
	Year ended December 31, 20X2	3,000,000	(630~~1,050~~,000)
	Year ended December 31, 20X3	$9,200,000	($1,932~~3,220~~,000)

Note: Year ended December 31, 20X3 taxable income and taxes paid considered in the calculation of its interim tax accruals are based on the reporting entity's estimate of its annual taxable income and taxes to be paid. This amount may differ from the quarterly federal income tax estimates it expects to make during the year.

	Reversing Period		
	20X3	20X4	20X5
December 31, 20X2 Temporary difference reversals:	$2,000,000	$1,500,000	$1,500,000
	20X4	20X5	20X6
December 31, 20X3 Temporary difference reversals:	$3,000,000	$2,000,000	$2,000,000

Admitted deferred tax assets at December 31, 20X2:				
	Paragraph 11.a.			
		~~20X0~~	~~$800,000~~	
		20X1	$2,000,000	
		20X2	1,500~~2,200~~,000	
			3,500~~5,000~~,000	
		Taxes paid at 21~~35~~%		$735~~1,750~~,000
	Paragraph 11.b.			315,000~~0~~
	Paragraph 11.c.			0
	Total admitted			$1,050~~1,750~~,000

45 ~~XYZ Co. does not qualify for the small life insurance company deduction.~~ Please note the results in this example ~~may~~ could be different ~~due to differences in the applicable carryback periods~~ if XYZ Co. was a ~~P&C~~life insurance company because, under current Federal income tax law, life insurance companies are not permitted to carry back net operating losses. In such case, XYZ would not admit any deferred tax assets under paragraph 11.a. However, if XYZ were able to admit deferred tax assets for all of its 20X3-20X5 temporary difference reversals at December 31, 20X2 and for all of its 20X4-20X6 temporary difference reversals at December 31, 20X3 under paragraph 11.b. (based on adequate sources of projected taxable income in those reversal periods), then the results in this example would be unchanged.

Note: The recovery of federal income taxes paid in prior years under paragraph 11.a. is calculated in this example by carrying back 20X3's temporary difference reversals of $2,000,000 to offset ~~20X0's taxable income of $800,000 and $1,200,000 of~~ 20X1's taxable income of $2,000,000; then carrying back 20X4's temporary difference reversals of $1,500,000 to offset ~~20X1's remaining taxable income of $800,000 and~~ $1,500~~700~~,000 of 20X2's taxable income of $3,000,000~~; finally, carrying back 20X5's temporary difference reversals to offset $1,500,000 of 20X2's taxable income. Since all gross DTAs were admitted under paragraph 11.a., paragraphs 11.b.and 11.c. need not be considered.~~ XYZ's projected taxable income for 20X3 ($9,200,000) is more than adequate to allow the remaining $315,000 of the $1,050,000 expected to be realized from temporary difference reversals in 20X3-20X5 ($5,000,000 x 21% = $1,050,000) to be recognized under paragraph 11.b.				
Admitted deferred tax assets at December 31, 20X3:				
	Paragraph 11.a.			
		~~20X1~~	~~$2,000,000~~	
		20X2	$3,000,000	
		20X3	2,000,000	
			5~~7~~,000,000	
		Taxes paid at 21~~35~~%		$1,050~~2,450~~,000
	Paragraph 11.b.			420,0000
	Paragraph 11.c.			0
	Total admitted			$1,470~~2,450~~,000
Note: The recovery of federal income taxes paid in prior years under paragraph 11.a. is calculated in this example by carrying back 20X4's temporary difference reversals of $3,000,000 to offset ~~20X1's taxable income of $2,000,000 and $1,000,000 of~~ 20X2's taxable income of $3,000,000; then carrying back 20X5's temporary difference reversals of $2,000,000 to offset $2,000,000 of 20X3~~2~~'s ~~remaining~~ taxable income ~~of $2,000,000~~. ~~; finally, carrying back 20X6's temporary difference reversals to offset $2,000,000 of 20X3's taxable income. Since all gross DTAs were admitted under paragraph 11.a., paragraphs 11.b. and 11.c. need not be considered.~~ It is assumed for this example that XYZ has more than adequate amounts of projected income for 20X4-20X6 to allow the remaining $420,000 of the $1,470,000 expected to be realized from temporary difference reversals in 20X4-20X6 ($7,000,000 x 21% = $1,470,000) to be recognized under paragraph 11.b.				
Total estimated federal taxes for 20X3:				
	Income taxes incurred (current tax) ($9,200,000 X 35%)			$1,932~~3,220~~,000
	Change in deferred tax ($1,750,000 – $2,450,000)			(420~~700~~,000)
				$1,512~~2,520~~,000

11.13 As a result of the above, the annual effective tax rate for current and deferred income taxes is as follows:

Current ($3,220,000/$10,000,000)	19.32~~32.2~~%
Deferred (($700,000)/$10,000,000)	(4.2~~7.0~~)%
Total annual effective rate	15.12~~25.2~~%

Quarter	Statutory Income (Loss)	Income Taxes Incurred	Deferred Taxes
1	$(2,000,000)	$(386,400~~644,000~~)	$84~~140~~,000
2	4,000,000	772,800~~1,288,000~~	(168~~280~~,000)
3	6,000,000	1,159,200~~1,932,000~~	(252~~420~~,000)
4	2,000,000	386,400~~644,000~~	(84~~140~~,000)
Total	$10,000,000	$1,932~~3,220~~,000	$(420~~700~~,000)

11.14 To the extent that a reporting entity's estimated year end[46] admitted adjusted gross deferred tax assets are limited by its surplus pursuant to paragraph 11.b.ii., the annual effective deferred tax rate must be adjusted to consider the impact of this limitation on a quarterly basis.

12. Q – How do you present deferred taxes in the Annual Statement? [Paragraphs 8, 18, 21-28 and 36]

12.1 A – This answer is divided into ~~four~~ three different parts.

~~Change in Accounting Principle~~

~~12.2 As required by paragraph 37 of SSAP No. 101, balances of current and deferred federal and foreign income taxes resulting from the adoption of SSAP No. 101 effective January 1, 2012 shall be presented in the Annual Statement as a Cumulative Effect of Changes in Accounting Principles. SSAP No. 3 provides the following:~~

> ~~3. A change in accounting principle results from the adoption of an accepted accounting principle, or method of applying the principle, which differs from the principles or methods previously used for reporting purposes. A change in the method of applying an accounting principle shall be considered a change in accounting principle.~~
>
> ~~4. A characteristic of a change in accounting principle is that it concerns a choice from among two or more statutory accounting principles. However, a change in accounting principle is neither (a) the initial adoption of an accounting principle in recognition of events or transactions occurring for the first time or previously immaterial in their effect, nor (b) the adoption or modification of an accounting principle necessitated by transactions or events that are clearly different in substance from those previously occurring.~~
>
> ~~5. The cumulative effect of changes in accounting principles shall be reported as adjustments to unassigned funds (surplus) in the period of the change in accounting principle. The cumulative effect is the difference between the amount of capital and surplus at the beginning of the year and the amount of capital and surplus that would have been reported at that date if the new accounting principle had been applied retroactively for all prior periods.~~

~~12.3 In accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors* (SSAP No. 3), adjustments to amounts recorded as of January 1, 2012, would be recorded as a modification to the changes in accounting principle account rather than corrections of an error through the period of 2012.~~

~~*Illustration A Assumptions:*~~

~~12.4 On January 1, 2012, as a result of applying paragraph 11.b. requirements to use current period statutory capital and surplus rather than prior quarter statutory capital and surplus as required by previous guidance, the AlphaBeta P/C Company computed the following balances related to deferred taxes:~~

[46] In the previous example, year-end is December 31, 20X3.

	~~**1/1/12**~~	~~**12/31/11**~~
~~Gross DTA~~	~~$200,000~~	~~$200,000~~
~~Statutory Valuation Allowance Adjustment~~	~~0~~	~~0~~
~~Adjusted Gross DTA~~	~~200,000~~	~~200,000~~
~~Deferred Tax Assets Nonadmitted~~	~~25,000~~	~~10,000~~
~~Admitted Adjusted Gross DTA~~	~~175,000~~	~~190,000~~
~~Gross DTL~~	~~100,000~~	~~100,000~~
~~Net Admitted Adjusted Gross DTA~~	~~$75,000~~	~~$90,000~~

~~There was no change in the amount of the current tax liability recorded by AlphaBeta as a result of the adoption of SSAP No. 101.~~

~~12.5 The Cumulative Effect of Changes in Accounting Principles line shown in the surplus section of the Annual Statement would show a decrease of $15,000 ($90,000 – $75,000) on 1/1/2012. In addition, during the second quarter of 2012, the Company determined that it incorrectly computed its Net Admitted Adjusted Gross DTA as of 1/1/2012 under SSAP No. 101 and modified its opening balance as follows (note that modifications were not a result of changes in circumstances or events which occurred during 2012):~~

	~~**Revised 1/1/12**~~
~~Gross DTA~~	~~$200,000~~
~~Statutory Valuation Allowance Adjustment~~	~~0~~
~~Adjusted Gross DTA~~	~~200,000~~
~~DTA Nonadmitted~~	~~35,000~~
~~Admitted Adjusted Gross DTA~~	~~165,000~~
~~Gross DTL~~	~~100,000~~
~~Net Admitted Adjusted Gross DTA~~	~~$65,000~~

~~12.6 The Company would record the following balances in its 3/31/12 financial statements:~~

	~~**1/1/12**~~	~~**Revised 1/1/12**~~	~~**Increase (Decrease)**~~
~~Gross DTA~~	~~$200,000~~	~~$200,000~~	~~$0~~
~~Statutory Valuation Allowance Adjustment~~	~~0~~	~~0~~	~~0~~
~~Adjusted Gross DTA~~	~~200,000~~	~~200,000~~	~~0~~
~~DTA Nonadmitted~~	~~25,000~~	~~35,000~~	~~10,000~~

~~Admitted Adjusted Gross DTA~~	~~175,000~~	~~165,000~~	~~(10,000)~~
~~Gross DTL~~	~~100,000~~	~~100,000~~	~~0~~
~~Net Admitted Adjusted Gross DTA~~	~~$75,000~~	~~$65,000~~	~~($10,000)~~

~~12.7 The additional $10,000 decrease in net admitted adjusted gross DTA would also be recorded through the Cumulative Effect of Changes in Accounting Principles line shown in the surplus section of the Annual Statement.~~

Unrealized Capital Gains and Losses

12.2~~8~~ SSAP No. 101 paragraph 18 states:

> 14. In accordance with paragraph 35 of FAS 109, a reporting entity's unrealized gains and losses shall be recorded net of any allocated DTA or DTL. The amount allocated shall be computed in a manner consistent with paragraph 38 of FAS 109.

12.3~~9~~ The following illustrates the presentation of such requirement in the Annual Statement:

Illustration A~~B~~ Assumptions:

12.4~~10~~ Entity grouped its investments in a reasonable and consistent manner and calculated the following gross amounts attributable to appreciation and depreciation in the fair value of its common stocks during 20X2 (see question 2 regarding grouping of assets and liabilities for measurement):

	Gross	**Carrying Value**	**Rate**	**Tax Effected DTA (DTL)**
Common stock carrying value 1/1/X2		$800,000		
Unrealized (loss)	($714,286~~428,571~~)		21~~35~~%	$150,000
Unrealized gain	571,429~~342,857~~		21~~35~~%	(120,000)
Net (loss) gain		(142,857~~85,714~~)		$30,000
Common stock carrying value 12/31/X2		$657,143~~714,286~~		

12.5~~11~~ The journal entries need to present unrealized losses and gains net of tax are:

12/31/X2	DR	Change in unrealized capital gains and losses	$142,857~~85,714~~
	CR	Common stock	($142,857~~85,714~~)
	Recognition of net depreciation in FV of common stock		

12/31/X2	DR	Deferred tax asset	$150,000
	CR	Deferred tax liability	($120,000)
	CR	Change in deferred income taxes	($30,000)
	Recognition of gross deferred tax amounts		

12/31/X2	DR	Change in deferred income taxes	$30,000
	CR	Change in unrealized capital gains and losses	($30,000)
	Reclass tax effect of net unrealized loss per paragraph 18 of SSAP No. 101		

12.6~~12~~ Condensed 12/31/X2 Balance Sheet:

ASSETS	**20X2**	**20X1**		**LIABILITIES, SURPLUS AND OTHER FUNDS**	**20X2**	**20X1**
Common Stock	$657,143 ~~714,286~~	$800,000		Surplus:		
Net deferred tax asset	30,000			Beginning of year	$800,000	
				Change in UNL	(~~55,714~~112,857)[47]	
Total Assets	$~~744,286~~ 687,143	$800,000		**Liabilities & Surplus**	$~~744,286~~ 687,143	$800,000

Annual Statement Presentation

12.7~~13~~ In accordance with SSAP No. 101, DTAs and DTLs shall be offset and presented as a single amount on the statement of financial position. The following illustrates this requirement:

Illustration B~~C~~ Assumptions:

12.8~~14~~ The entity had the following balances ~~(1/1/X2 balances carried forward from Illustration A)~~:

	1/1/X2	**12/31/X2**	**Change**
Gross DTA	$200,000	$510,000	$310,000
Statutory Valuation Allowance Adjustment	0	10,000	10,000
Adjusted Gross DTA	200,000	500,000	300,000[48]
DTA Nonadmitted	25,000	150,000	125,000
Admitted Adjusted Gross DTA	175,000	350,000	175,000
Gross DTL	100,000	200,000	100,000
Net Admitted Adjusted Gross DTA	$75,000	$150,000	$75,000
Current FIT Recoverable	**$18,000**	**$20,000**	**$2,000**

12.9~~15~~ Illustrative 12/31/X2 Balance Sheet for Illustration B~~C~~:

ASSETS	Current Year			Prior Year
	1 Assets	2 Nonadmitted Assets	3 Net Admitted Assets (Cols. 1 - 2)	4 Net Admitted Assets
Current Federal and foreign income tax recoverable and interest thereon	$20,000	$0	$20,000	$18,000
Net deferred tax asset	$300,000	$150,000	$150,000	$75,000

[47] Computed at $142,857~~85,714~~ (total change in UNG/UNL) - $30,000 tax effect.

[48] Includes $30,000 resulting from net unrealized losses as shown in Illustration A~~B~~. As such the change in net deferred income taxes at 12/31/X2 is $170,000 ($300,000 (gross change in DTA) – $100,000 (gross change in DTL) – $30,000 reclass to net unrealized capital gains (losses)).

12.10~~6~~ Illustrative 12/31/X2 Income Statement for Illustration B~~C~~:

STATEMENT OF INCOME (P/C) SUMMARY OF OPERATIONS (Life & Health) STATEMENT OF REVENUES AND EXPENSES (Health)	1 Current Year	2 Prior Year
Gains and (losses) in surplus		
Change in net unrealized capital gains (losses) less capital gains tax of $30,000	($112,857 ~~($55,714~~)	0
Change in net deferred income tax	$170,000	0
Change in nonadmitted assets	($125,000)	0

12.11~~7~~ Illustrative 12/31/X2 Exhibit of Nonadmitted Assets for Illustration B~~C~~:

	1 End of Current Year	2 End of Prior Year	3 Changes for Year (Increase) Decrease
Net deferred tax asset	$150,000	$25,000	($125,000)
Total	$150,000	$25,000	($125,000)

Illustration C~~D~~ Assumptions:

12.12~~8~~ The entity had the following balances (1/1/~~20~~X2 balances carried forward from Illustration B~~A~~):

	1/1/X2	**12/31/X2**	**Change**
Gross DTA	$200,000	$510,000	$310,000
Statutory Valuation Allowance Adjustment	0	10,000	10,000
Adjusted Gross DTA	200,000	500,000	300,000[49]
DTA Nonadmitted	25,000	150,000	125,000
Net Admitted Adjusted Gross DTA	175,000	350,000	175,000
Gross DTL	100,000	200,000	100,000
Net Admitted Adjusted Gross DTA	$75,000	$150,000	$75,000
Current FIT Liability	**$7,000**	**$12,000**	**$5,000**

12.13~~9~~ Illustrative 12/31/X2 Balance Sheet for Illustration C~~D~~:

ASSETS	Current Year			Prior Year
	1 Assets	2 Nonadmitted Assets	3 Net Admitted Assets (Cols. 1 - 2)	4 Net Admitted Assets
Net deferred tax asset	$300,000	$150,000	$150,000	75,000

[49] Includes $30,000 resulting from net unrealized losses as shown in Illustration A~~B~~. As such the change in net deferred income taxes at 12/31/X2 is $170,000 ($300,000 (gross change in DTA) – $100,000 (gross change in DTL) – $30,000 reclass to net unrealized capital gains (losses)).

LIABILITIES, SURPLUS AND OTHER FUNDS	1 Current Year	2 Prior Year
Current Federal and foreign income taxes (including $0 on realized capital gains (Losses))	$12,000	$7,000

12.14~~20~~Illustrative 12/31/X2 Income Statement for Illustration C~~D~~:

STATEMENT OF INCOME (P/C) **SUMMARY OF OPERATIONS (Life & Health)** **STATEMENT OF REVENUES AND EXPENSES (Health)**	1 Current Year	2 Prior Year
Gains and (losses) in surplus		
Change in net unrealized capital gains (losses) less capital gains tax of $30,000	($112,857) ~~($55,714)~~	0
Change in net deferred income tax	$170,000	0
Change in nonadmitted assets	($125,000)	0

12.15~~21~~Illustrative 12/31/X2 Exhibit of Nonadmitted Assets for Illustration C~~D~~:

	1 End of Current Year	2 End of Prior Year	3 Changes for Year (Increase) Decrease
Net deferred tax asset	$150,000	$25,000	($125,000)
Total	$150,000	$25,000	($125,000)

Notes to the Financial Statements Disclosures:

12.16~~22~~SSAP No. 101 paragraphs 21-28 include extensive disclosure requirements. Although some of these amounts are presented on the face of the financial statements or in schedules or exhibits to the Annual Statement, they will be included in the Notes to the Financial Statements both in the Annual Statement and in the Annual Audited Financial Statements.

12.17~~23~~This section provides specific examples that illustrate the disclosures required in SSAP No. 101. The formats in the illustrations are not requirements. Some of the disclosure paragraphs of SSAP No. 101 are not specific as to whether the entity should disclose the nature of certain items or whether the entity should disclose specific amounts. The illustrations included herein use a combination of each method. The NAIC encourages a format that provides the information in the most understandable manner in the specific circumstances. The following illustrations are for a single hypothetical insurance enterprise, referred to as AlphaBeta Property & Casualty Insurance Company.[50]

~~12.24~~All of the disclosures would be completed in the year-end Annual Statement and audited statutory financial statements. ~~The disclosures of paragraphs 22-24, and 25 (on a prospective basis) and 26-28 should be presented in accordance with paragraph 61 of the Preamble on the initial adoption of SSAP No.10, a predecessor of SSAP No. 101, therefore these notes would only be presented in the first, second and third Quarterly Statements if the underlying data changed significantly.~~

12.18~~25~~Selected AlphaBeta P/C Company Financial Data at December 31, 20X2 (Balance Sheet information carried forward from Illustration B~~C~~):

~~[50] In applying the illustrative examples to the 2012 calendar year, prior year balances would include any adjustments required from the cumulative change in accounting principle required as a result of the adoption of SSAP No. 101.~~

ASSETS	Current Year			Prior Year
	1 Assets	2 Nonadmitted Assets	3 Net Admitted Assets (Cols. 1 - 2)	4 Net Admitted Assets
Current federal and foreign income tax recoverable and interest thereon	$20,000	$0	$20,000	$18,000
Net deferred tax asset	$300,000	$150,000	$150,000	$75,000

CAPITAL AND SURPLUS ACCOUNT	1 Current Year	2 Prior Year
Change in net unrealized capital gains (losses) less capital gains tax of $30,000	($112,857~~55,714~~)	0
Change in net deferred income tax	$170,000	0
Change in nonadmitted assets	($125,000)	0

EXHIBIT OF NONADMITTED ASSETS	1 End of Current Year	2 End of Prior Year	3 Changes for Year (Increase) Decrease
Net deferred tax asset	$150,000	$25,000	($125,000)

STATEMENT OF INCOME	**20X2**
UNDERWRITING INCOME	
Premiums earned	$5,250,000
DEDUCTIONS:	
Losses incurred	3,550,000
Loss adjustment expenses incurred	1,750,000
Other underwriting expenses incurred	525,000
Net underwriting gain (loss)	(575,000)
INVESTMENT INCOME	
Net investment gain (loss)	1,350,000
OTHER INCOME	
Total other income	125,000
Net income before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	900,000
Dividends to policyholders	200,000
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	700,000
Federal and foreign income taxes incurred	220,000
Net income	$480,000

Paragraph 22 Illustration:

12.19~~26~~The components of the net DTA recognized in the Company's Assets, Liabilities, Surplus and Other Funds are as follows:

	12/31/20X2			12/31/20X1			Change		
	Ordinary	Capital	Total	Ordinary	Capital	Total	Ordinary	Capital	Total
Gross Deferred Tax Assets	$375,000	$135,000	$510,000	$93,000	$107,000	$200,000	$282,000	$28,000	$310,000
Statutory Valuation Allowance Adjustments	0	10,000	10,000	0	0	0	0	10,000	10,000
Adjusted Gross Deferred Tax Assets	375,000	125,000	500,000	93,000	107,000	200,000	282,000	18,000	300,000
Deferred Tax Assets Nonadmitted	150,000	0	150,000	20,000	5,000	25,000	130,000	(5,000)	125,000
Subtotal Net Admitted Deferred Tax Asset	225,000	125,000	350,000	73,000	102,000	175,000	152,000	23,000	175,000
Deferred Tax Liabilities	21,000	179,000	200,000	15,000	85,000	100,000	6,000	94,000	100,000
Net Admitted Deferred Tax Asset/(Net Deferred Tax Liability)	$204,000	($54,000)	$150,000	$58,000	$17,000	$75,000	$146,000	($71,000)	$75,000
Admission Calculation Components SSAP No. 101 (Paragraph 11)									
a. Federal Income Taxes Paid In Prior Years Recoverable Through Loss Carrybacks.	$85,000	$5,000	$90,000	$45,000	$5,000	$50,000	$40,000	0	$40,000
b. Adjusted Gross Deferred Tax Assets Expected To Be Realized (Excluding The Amount Of Deferred Tax Assets From a, above) After Application of the Threshold Limitation. (The Lesser of b.i. and b.ii. Below)	50,000	10,000	60,000	13,000	12,000	25,000	37,000	(2,000)	35,000
i. Adjusted Gross Deferred Tax Assets Expected to be Realized Following the Balance Sheet Date.	**NA**	**NA**	**60,000**	**NA**	**NA**	**25,000**	**NA**	**NA**	**35,000**
ii. Adjusted Gross Deferred Tax Assets Allowed per Limitation Threshold.	**NA**	**NA**	**900,000**	**NA**	**NA**	**750,000**	**NA**	**NA**	**150,000**
c. Adjusted Gross Deferred Tax Assets (Excluding the Amount Of Deferred Tax Assets From a. and b. above) Offset by Gross Deferred Tax Liabilities.	90,000	110,000	200,000	15,000	85,000	100,000	75,000	25,000	100,000
Deferred Tax Assets Admitted as the result of application of SSAP No. 101.Total (a. + b. + c.)	$225,000	$125,000	$350,000	$73,000	$102,000	$175,000	$152,000	$23,000	$175,000
	20X2 Percentage	20X1 Percentage							
Ratio Percentage Used to Determine Recovery Period and Threshold Limitation Amount[51]	600%	500%							
Amount of Adjusted Capital and Surplus Used to Determine Recovery Period And Threshold Limitation[52]	$6,000,000	$5,000,000							
The Company's tax-planning strategies include the use of reinsurance-related tax-planning strategies.									

[51] Disclose the ratio used by the reporting entity from the applicable Realization Threshold Limitation Table in paragraph 11.b. of SSAP No. 101 to determine the appropriate limitations of paragraph 11.b. In the event that late immaterial modifications to a reporting entity's statutory financial statements occur subsequent to initial completion of the statutory financial statements but prior to filing or similar deadline, these immaterial changes do not need to be reflected in this ratio if such modifications do not cause the reporting entity to change the threshold limitation from the applicable Realization Threshold Limitation Table.

[52] Provide the amount of adjusted capital and surplus used to calculate the limitation under paragraph 11.b.ii.

	12/31/20X2			12/31/20X1			Change		
	Ordinary	Capital	Total	Ordinary	Capital	Total	Ordinary	Capital	Total
Impact of Tax Planning Strategies	12/31/20X2			12/31/20X1			Change		
	Ordinary Percent	Capital Percent	Total Percent[53]	Ordinary Percent	Capital Percent	Total Percent	Ordinary Percent	Capital Percent	Total Percent
Adjusted Gross DTAs (% of Total Adjusted Gross DTAs)	6%	7%	13%	7%	7%	14%	-1%	0%	-1%
Net Admitted Adjusted Gross DTAs (% of Total Net Admitted Adjusted Gross DTAs)	14%	15%	29%	15%	15%	30%	-1%	0%	-1%

Paragraph 23 Illustration:

12.20~~7~~ The Company has not recognized a deferred tax liability of approximately $30,000 of foreign withholding taxes for the undistributed earnings of its 100 percent owned foreign subsidiaries that arose in 20X2 and prior years because the Company does not expect those unremitted earnings to reverse and become taxable to the Company in the foreseeable future. A deferred tax liability will be recognized when the Company expects that it will recover those undistributed earnings in a taxable manner, such as through receipt of dividends or sale of the investments. As of December 31, 20X2, the undistributed earnings of these subsidiaries were approximately $200~~88~~,000.

Paragraph 24 Illustration:

12.21~~8~~ The provisions for incurred taxes on earnings for the years ended December 31 are:

	20X2	20X1
Federal	$180,000	$135,000
Foreign	40,000	15,000
	220,000	150,000
Federal income tax on net capital gains	52,000	36,000
Utilization of capital loss carry-forwards	(52,000)	(36,000)
Federal and foreign income taxes incurred	$220,000	$150,000

12.22~~9~~ The tax effects of temporary differences that give rise to significant[54] portions of the deferred tax assets and deferred tax liabilities are as follows:

Deferred Tax Assets:	12/31/20X2	12/31/20X1	Change
Ordinary			
Discounting of unpaid losses	30,000	10,000	20,000
Unearned premium reserve	235,000	50,000	185,000
Investments	25,000	15,000	10,000
Pension accrual	65,000	15,000	50,000
Other (including items <5% of total ordinary tax assets)	20,000	3,000	17,000
Subtotal	375,000	93,000	282,000
Statutory valuation allowance adjustment	0	0	0
Nonadmitted	150,000	20,000	130,000
Admitted ordinary deferred tax assets	225,000	73,000	152,000
Capital			
Investments	125,000	45,000	80,000
Net capital loss carry-forward	10,000	62,000	(52,000)

[53] The total percentage should be separately calculated and is not intended to be a summation of the percentages by tax character.

[54] Significant is defined as any amount in excess of 5% of the total applicable DTAs or DTLs.

Other (including items <5% of total capital tax assets)	0	0	0
Subtotal	135,000	107,000	28,000
Statutory valuation allowance adjustment	10,000	0	10,000
Nonadmitted	0	5,000	(5,000)
Admitted capital deferred tax assets	125,000	102,000	23,000
Admitted deferred tax assets	350,000	175,000	175,000
Deferred Tax Liabilities:			
Ordinary			
Investments	10,000	5,000	5,000
Fixed assets	6,000	5,000	1,000
Other (including items <5% of total ordinary tax liabilities)	5,000	5,000	0
Subtotal	21,000	15,000	6,000
Capital:			
Investments	110,000	55,000	55,000
Real estate	64,000	25,000	39,000
Other (including items <5% of total capital tax liabilities)	5,000	5,000	
Subtotal	179,000	85,000	94,000
Deferred tax liabilities	200,000	100,000	100,000
Net deferred tax assets/liabilities	150,000	75,000	75,000

12.23~~30~~The change in net deferred income taxes is comprised of the following (this analysis is exclusive of nonadmitted assets as the Change in Nonadmitted Assets is reported separately from the Change in Net Deferred Income Taxes in the surplus section of the Annual Statement):

	Dec. 31, 20X2	Dec. 31, 20X1	Change
Adjusted gross deferred tax assets	$500,000	$200,000	$300,000
Total deferred tax liabilities	200,000	100,000	100,000
Net deferred tax assets (liabilities)	$300,000	$100,000	200,000
Tax effect of unrealized gains (losses)			(30,000)
Change in net deferred income tax			$170,000

Paragraph 25 Illustration[55]:

12.24~~31~~The provision for federal and foreign income taxes incurred is different from that which would be obtained by applying the statutory Federal income tax rate to income before income taxes. The significant items causing this difference are as follows:

	Dec. 31, 20X2	Effective Tax Rate
Provision computed at statutory rate	$147~~245~~,000	21~~35~~.0%
Tax exempt income deduction	(61,000~~102,000~~)	(8.7~~14.6~~)
Dividends received deduction	(50,000~~84,000~~)	(7.1~~12.0~~)
Tax differentials on foreign earnings	(21,000~~34,000~~)	(3.0~~4.8~~)
Change in statutory valuation allowance adjustment	10,000	1.4
Nondeductible goodwill	8,000	1.1
Other	7,000	2.4~~1.0~~

[55] This illustration includes both the rate reconciliation and the tax effected amounts although only one of these is required to be disclosed under SSAP No. 101.

Total	$50,000	7.1%
Federal and foreign income taxes incurred	$220,000	31.4%
Change in net deferred income taxes[56]	(170,000)	(24.3)
Total statutory income taxes	$50,000	7.1%

Paragraph 26 Illustration:

12.25~~32~~The Company has net capital loss carryforwards which expire as follows: 20X5, $9,000; 20X6; $1,000.

Paragraph 27 Illustration:

12.26~~33~~The Company believes it is reasonably possible that the liability related to any federal or foreign tax loss contingencies may significantly increase within the next 12 months. However, an estimate of the reasonably possible increase cannot be made at this time.

Paragraph 28 Illustration:

12.27~~34~~The Company is included in a consolidated federal income tax return with its parent company, Alpha Corporation. The Company has a written agreement, approved by the Company's Board of Directors, which sets forth the manner in which the total combined federal income tax is allocated to each entity which is a party to the consolidation. Pursuant to this agreement, the Company has the enforceable right to recoup federal income taxes paid in prior years in the event of future net losses, which it may incur, or to recoup its net losses carried forward as an offset to future net income subject to federal income taxes.

13. Q – How are tax-planning strategies to be considered in determining adjusted gross DTAs [Paragraph 7.e.] and admitted adjusted gross DTAs [Paragraphs 11.a., 11.b.i., 14 and 15]?

Overview:

13.1 A – Paragraph 14 of SSAP No. 101 states:

> In some circumstances, there are tax-planning strategies (including elections for tax purposes) that (a) are prudent and feasible, (b) a reporting entity ordinarily might not take, but would take to prevent an operating loss or tax credit carryforward from expiring unused, and (c) would result in realization of deferred tax assets. A reporting entity shall consider tax-planning strategies in (1) determining the amount of the statutory valuation allowance adjustment necessary under paragraph 7.e. and (2) the realization of deferred tax assets when determining admission under paragraph 11…

13.2 Paragraph 248 of FAS 109 additionally states that:

> Tax-planning strategies also may shift the estimated pattern and timing of future reversals of temporary differences…. A tax-planning strategy to accelerate the reversal of deductible temporary differences in time to offset taxable income that is expected in an early future year might be the only means to realize a tax benefit for those deductible temporary differences if they otherwise would reverse and provide no tax benefit in some later future year(s).

[56] As reported in the surplus section of the Annual Statement. The change in net deferred income taxes is before nonadmission of any DTA. The change in nonadmitted DTA is reported together with the total change in nonadmitted assets and presented as a separate component of surplus.

13.3 As also provided in paragraph 14 of SSAP No. 101, if a tax-planning strategy is used to accelerate the reversal or realization of an item, any significant net-of-tax potential costs or losses associated with the implementation of the strategy should reduce the adjusted gross or admitted DTA.

13.4 When considering a prudent and feasible tax-planning strategy that is more likely than not to enable realization of all or part of an adjusted gross DTA or admitted DTA, paragraph 15 of SSAP No. 101 states that "paragraph 3 of this statement related to tax loss contingencies shall be applied in determining admissibility of deferred tax assets under paragraph 11 of this statement." Accordingly, a reporting entity must evaluate the likelihood, if a tax-planning strategy were implemented, of whether a tax loss contingency would be required to be recorded under paragraph 3.a. If so, the admitted tax benefit of a tax-planning strategy must be reduced by the amount of tax loss contingency so required. For example, if a tax-planning strategy provided a $100 admitted DTA, but the reporting entity estimated that a tax loss contingency reserve of $40 would be required if the strategy was implemented, the admitted DTA resulting from the tax-planning strategy would be reduced by $40. Since the admitted DTA would be net of any applicable tax loss contingencies, no separate tax loss contingencies would actually be recorded for these items.

Statutory Valuation Allowance Adjustment:

13.5 As discussed in Question 2.5, future realization of gross DTAs ultimately depends on the existence of sufficient taxable income of the appropriate character within the carryback or carryforward period available under the tax law. In determining adjusted gross DTAs, a reporting entity shall consider the four sources of taxable income that may be available under the tax law, one of which is tax-planning strategies[57]. As noted in paragraph 13 of SSAP No. 101, a reporting entity is not required to consider all four sources of taxable income if one or more sources are alone sufficient to support the conclusion that the entity will realize the tax benefits of its adjusted gross DTAs (i.e., a conclusion that no statutory valuation allowance is necessary). Accordingly, tax-planning strategies need not be considered if the other sources of taxable income are sufficient to realize the benefits of reversing existing DTAs. However, the reporting entity is required to consider the impact of tax planning strategies to determine the amount of the adjustment if a conclusion is reached that a statutory valuation allowance adjustment is necessary.

Tax-Planning Strategies for Admission of DTAs:

13.6 In order for a tax-planning strategy to support admission of adjusted gross DTAs under paragraph 11, the reporting entity must demonstrate that (1) the admitted DTAs would be realized either within a period that would give rise to a carryback of tax losses under the Internal Revenue Code, not to exceed three years (for admission under paragraph 11.a.), or within the applicable period (refer to the 11.b.i. column of the applicable Realization Threshold Limitation Table in paragraph 11) and (2) it would have the ability to implement the strategy. In such circumstances an entity may recognize, as admitted assets, the related DTAs that are realizable as a result of the available tax-planning strategy in accordance with paragraphs 11.a., 11.b.i. and 11.c. of SSAP No. 101. Using tax-planning strategies in determining the admissible DTA is analogous to the use of tax-planning strategies in determining the amount of the statutory valuation allowance adjustment required under paragraph 7.e. of SSAP No. 101 and paragraph 22 of FAS 109. Although a reporting entity may use tax-planning strategies in determining the portion of its adjusted gross DTAs that are admissible, it is not required to do so.

13.7 The requirement in paragraph 11.a. and 11.b.i. of SSAP No. 101 to consider only those DTAs that reverse or are realized within a period that would give rise to a carryback of losses under the Internal

[57] See paragraph 13 of SSAP No. 101 and paragraph 21 of FAS 109. Examples of tax-planning strategies as provided in paragraph 13.d. are (1) accelerate taxable amounts to utilize expiring carryforward, (2) change the character of taxable or deductible amounts from ordinary income or loss to capital gain or loss, and (3) switch from tax-exempt to taxable investments.

Revenue Code not to exceed three years (paragraph 11.a.) or within the applicable period following the balance sheet date (paragraph 11.b.i.) causes those DTAs which would otherwise reverse beyond such period to potentially provide no tax benefit (unless admitted under paragraph 11.c.). The potential reversal beyond the appropriate period is comparable to an expiring ~~net~~ operating loss or tax credit carryforward, in that the deduction would not provide a tax benefit under SSAP No. 101. Thus, to the extent prudent and feasible tax-planning strategies exist to accelerate the reversal or realization of these DTAs, these strategies are comparable to those contemplated in paragraph 248 of FAS 109 above.

13.8 An example of a prudent and feasible tax-planning strategy is as follows:

13.9 Company A, a property/casualty insurance company for federal income tax purposes, has paid federal income taxes of $500,000 in each of calendar years 20X1 and 20X2. The company has an ExDTA ACL RBC percentage of 250% and therefore is required to use the one-year applicable period under paragraph 11.b.i. of SSAP No. 101. It has capital and surplus for purposes of paragraph 11.b.ii. of SSAP No. 101 of $20,000,000. Company A has an obligation to provide post-retirement health benefits to its employees. At December 31, 20X2, Company A has included a liability for $1,000,000 on its statutory-basis financial statements for post-retirement health benefits. This liability is not currently deductible for federal income tax purposes, and only $25,000 reverses within each of the next two calendar years. This is Company A's only DTA under SSAP No. 101, and there are no DTLs. Company A, absent any tax-planning strategies, would compute a DTA of $210~~350~~,000 ($1,000,000 X 21~~35~~%), and would admit $10~~17~~,500 ($50,000 X 21~~35~~%) under paragraph 11.a., and has no additional admitted DTA under paragraph 11.b.

13.10 Company A could implement a welfare benefit fund for tax purposes and contribute assets to the fund to cover qualifying welfare benefits. The contribution, subject to limitations, would be deductible for federal income tax purposes, and would have the effect of accelerating the deduction for Company A's post-retirement health benefits. Company A has computed that $300,000 could be contributed during 20X3 to the welfare benefit fund, and to implement this strategy, it would cost $15,000 on an after-tax basis. Company A management believe that this strategy is prudent and feasible, and the Company would be able to implement this strategy if necessary. Company A would be able to admit an additional $48~~90~~,000 of DTAs ($300,000 X 21~~35~~%, or $63~~105~~,000, less $15,000 in costs) under paragraph 11.a., with no additional admitted DTA under paragraph 11.b.

13.11 A tax-planning strategy would not be considered prudent or feasible if use of the strategy would be inconsistent with assumptions inherent in statutory or other accounting basis financial statements. For instance, a tax-planning strategy to sell securities identified as "held to maturity" for GAAP-basis financial statements at a loss would not be prudent or feasible. Additionally, if a potential tax planning strategy were to involve selling debt securities at a loss, it would not be prudent or feasible if the securities had not been identified as impaired and the loss recognized for statutory-basis financial statements. Additionally, a tax-planning strategy that could not be implemented to realize a tax benefit within the requisite period following the balance sheet date or is inconsistent with management's business plan objectives would not be prudent and/or feasible.

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

Issue: ***ASU 2014-17, Business Combinations – Pushdown Accounting, a Consensus of the FASB Emerging Issues Task Force***

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue:
ASU 2014-17, Business Combinations – Pushdown Accounting, a Consensus of the FASB Emerging Issues Task Force (ASU 2014-17) was issued to provide guidance on whether and at what threshold an acquired entity that is a business or nonprofit activity can apply pushdown accounting in its separate financial statements. Prior to the issuance of this ASU, pushdown accounting was only required under U.S. GAAP for SEC registrants. Pursuant to the provisions in the ASU, acquirees now have the option to apply pushdown accounting. Pushdown accounting is a convention of accounting for the purchase of a subsidiary at the purchase cost rather than its historical basis. In effect, the acquiree's assets and liabilities are written up (or down) to reflect the purchase price and, to the extent that the purchase price exceeds fair value, to recognize the excess as goodwill. In short, the total amount that is paid to purchase the subsidiary becomes the subsidiary's new book value on its financial statements.

To illustrate the difference in applying pushdown accounting:

- Acquiree's Book Value of Assets = $100 and Liabilities = $50.

- Acquiree's Fair Value of Assets = $120 and Liabilities = $30.

If the purchase price was $90:

- "Normal" Purchase Accounting = Recognize SCA at $50 with the parent recognizing goodwill of $40.

- "Pushdown" Purchase Accounting = Recognize SCA at $90 with no goodwill recognized by the parent.

Under U.S. GAAP, goodwill is calculated as the purchase price of the acquiree less the market value of the acquiree. Any gains and losses associated with the new book value are "pushed down" from the acquirer's income statement and balance sheet to the acquired company's income statement and balance sheet. ASU 2014-17 states that an acquired entity may elect the option to apply pushdown accounting in the reporting period in which the change-in-control event occurs, but it also has the option to apply pushdown accounting in a reporting period subsequent to its most recent change-in-control event. If pushdown accounting is applied in a subsequent reporting period, it will be considered a change in accounting principle.

Under statutory accounting, a business combination is accounted for as either a statutory purchase or a statutory merger. A business combination in which one entity is acquired by another, and a parent-subsidiary relationship is created, is accounted for as a statutory purchase. The acquirer reports its investment at cost, which is defined as the sum of (a) any cash payment, (b) the fair value of other assets distributed, (c) the fair value of any liabilities assumed, and (d) any direct costs of the acquisition. For acquired subsidiary, controlled and affiliated (SCA) entities valued under an equity method of accounting, goodwill is defined as the difference between the cost of acquiring the SCA and the reporting entity's share of the book value of the SCA. For U.S. insurance SCAs, the historical basis of the

SCA will continue to be used in preparing its statutory financial statements. As such, pushdown accounting is not permitted for this equity method of accounting.

While statutory accounting utilizes the framework that was established by U.S. GAAP, statutory accounting focuses on the balance sheet, as opposed to the income statement, and places additional emphasis on the concepts of consistency and conservatism due to this difference in reporting objectives. The use of pushdown accounting as an accounting method under statutory accounting is problematic for the reasons listed below.

- A change in the ownership of an entity should not result in a new basis of accounting for that entity in its separate financial statements as transactions affecting an entity's stock should not affect the entity's accounting.

- If the acquiree has entered into third-party agreements with terms related to financial statements presented on the existing basis of accounting, restatement under pushdown accounting could pose problems in determining or maintaining compliance with those requirements.

- In the event there are still minority ownership interests in the acquired entity, utilization of pushdown accounting would result in a different set of financial statements and these owners would not have a meaningful set of comparative financial statements.

- There isn't a reasonable way to determine which owner's transactions should qualify for pushdown accounting, in a scenario in which there are multiple owners who are deemed to control the acquiree (10%+ ownership of outstanding stock measured at the holding company level).

- Goodwill restrictions under statutory accounting, such as the admissibility of goodwill limited to 10% of the reporting entity's surplus and amortization over a ten-year span, would essentially be eluded.

<u>Example of U.S. GAAP with and without Pushdown Accounting versus Statutory Accounting</u>
Entity A purchases 100% of Entity Z (which has a fair value of 200 and is on the books for $100, Assets = $200 and Liabilities = $100) for $500.

Entity Z's Accounting on Standalone Financials:

	U.S. GAAP without Pushdown	**U.S. GAAP with Pushdown**	**Statutory Accounting**
Assets	**300**	**500**	**200**
Liabilities	**100**	**100**	**100**
Equity	**200**	**400**	**100**
Goodwill	**300**	**0**	**400**

Result: Pushdown accounting increases the basis of the acquired entity from $100 under statutory accounting to $400 under U.S. GAAP. It also circumvents the goodwill restrictions under statutory accounting by increasing the basis of the acquired entity on its standalone financial statements.

<u>Actual SCA Filing</u>
NAIC Staff also refer to an actual SCA Sub 2 filing that was submitted during 2018 under the 8.b.iii valuation method (Non-Insurance SCA Entity under GAAP Basis). This acquisition was completed under the pushdown accounting method for U.S. GAAP. Since the existing guidance in SSAP No. 97 values 8.b.iii entities on the audited "U.S. GAAP equity of the investee," the existing guidance does not allow for modifications/adjustments to remove the "pushdown accounting" impact. This allowed the parent reporting entity to avoid reporting goodwill for the acquired SCA. *(Entity names and values have been changed.)*

ABC purchased 50% of G for $500. G's book value was $105 (Assets = $205 and Liabilities = $100) and fair value was $290.

Entity G's Accounting on Standalone Financials:

	U.S. GAAP without Pushdown	U.S. GAAP with Pushdown	Statutory Accounting
Assets	**390**	**600**	**205**
Liabilities	**100**	**100**	**100**
Equity	**290**	**500**	**105**
Goodwill	**210**	**0**	**395**

The insurance reporting entity's investment in G was increased due to the goodwill that was paid as part of the acquisition of G. This results in a value of G that vastly differs between U.S. GAAP where pushdown accounting is used and statutory accounting, which is much more conservative.

Existing Authoritative Literature:

SSAP No. 68—Business Combinations and Goodwill

Statutory Purchases of SCA Investments

3. The statutory purchase method of accounting is defined as accounting for a business combination as the acquisition of one entity by another. It shall be used for all purchases of SCA entities including partnerships, joint ventures, and limited liability companies. The acquiring reporting entity shall record its investment at cost. Cost is defined as the sum of: (a) any cash payment, (b) the fair value of other assets distributed, (c) the fair value of any liabilities assumed, and (d) any direct costs of the acquisition.(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.

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.

6. For those acquired SCA entities accounted for in accordance with paragraph 8.b.i. of SSAP No. 97 under the statutory purchase method, the historical bases of the acquired entity shall continue to be used in preparing its statutory financial statements. Therefore, pushdown accounting is not permitted.

7. Positive goodwill recorded under the statutory purchase method of accounting shall be admitted subject to the following limitation: Positive goodwill from all sources, including life, accident and health, and deposit-type assumption reinsurance, is limited in the aggregate to 10% of the acquiring[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]. 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

Valuation of Investments in Downstream Holding Companies

22. SSAP No. 48 requires the financial statements of joint ventures, partnerships, and/or limited liability companies in which the downstream noninsurance holding company has a minor ownership interest or otherwise lacks control, i.e., ownership interest is less than 10% (hereinafter referred to as "non SCA SSAP No. 48 entities"), to be valued using U.S. GAAP basis financial statements. Valuation of a downstream holding company, including its investments in SCA entities, depends upon the nature of the SCA entities and non SCA SSAP No. 48 entities it holds in accordance with paragraph 8 of this statement. All liabilities, commitments, contingencies, guarantees or obligations of the downstream noninsurance holding company, which are required to be recorded under applicable statutory accounting guidance, shall be reflected in the parent insurance reporting entity's determination of the carrying value of the investment in the downstream noninsurance holding company, if not already recorded in the financial statements of the downstream noninsurance holding company. If an SCA investment of the downstream holding company does not meet the provisions of paragraph 8.a. or if it elects not to use the guidance in paragraph 8.a., and instead uses the guidance in paragraph 8.b., the downstream holding company would be valued as the sum of the following (if applicable):

a. Investments by a downstream holding company in U.S. insurance SCA entities are recorded based upon the guidance in paragraph 8.b.i.;

b. Investments by a downstream holding company in noninsurance SCA entities that are engaged in transactions or activities described in paragraph 8.b.ii., are recorded based upon the guidance in paragraph 8.b.ii.;

c. Investments by a downstream holding company in noninsurance SCA entities that do not qualify under paragraph 21.b. shall be recorded based upon the guidance in paragraph 8.b.iii.;

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

[1] The "acquiring" entity is intended to reflect the insurance reporting entity that reports the investment resulting in goodwill. The goodwill limitation test shall be completed at the individual reporting company level.

[2] This includes, but is not limited to, situations in which the investment is nonadmitted as the audited financial statements for the SCA, joint venture, partnership or limited liability company includes substantial doubt on the entity's ability to continue as a going concern, or on the basis/contents of the audit opinion pursuant to paragraph 21~~20~~ of SSAP No. 97.

e. Any other assets and/or liabilities of the downstream holding company (not addressed in paragraphs 21.a. through 21.d.) shall be valued in accordance with the applicable SSAP.

For purposes of applying paragraphs 21-26 of this statement, a downstream holding company shall be considered to be the parent reporting entity's investment in a SCA entity. See paragraphs 25 and 26 for a limited exception to the audited financial statements requirement for downstream noninsurance holding companies which meet specified conditions.

Admissibility Requirements of Investments in Downstream Holding Companies

23. To meet the admissibility requirements of this statement, unless the limited exception to the audited financial statements requirement discussed in paragraphs 25 and 26 applies, an annual audit of the financial statements of SCA entities, including the downstream holding company valued under paragraphs 8.b.i through 8.b.iv. must be obtained. The requirement for audited financial statements may be met by utilizing any one of the following methods:

a. Audited US GAAP financial statements of the downstream SCA holding company. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA's domiciliary state.) The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities and non-SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet shall then be adjusted for GAAP to SAP differences for paragraph 8.b.i., 8.b.ii. and 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or

b. Audited foreign GAAP-basis financial statements of the downstream SCA holding company. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA's domiciliary state.) The audited foreign GAAP basis financial statements shall include an audited footnote disclosure within the financial statements that reconciles each consolidated entity's net income and equity on a foreign basis of accounting to a U.S. GAAP basis. The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities non SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet shall then be adjusted for GAAP to SAP differences of the insurance entities and paragraph 8.b.ii., and 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or

c. Individual audits of the downstream holding company and the downstream holding company's investments in individual SCA entities.

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

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

Convergence with International Financial Reporting Standards (IFRS):
Currently, there is no guidance in IFRS on pushdown accounting as this is not a method of accounting that is accepted under IFRS.

Staff Recommendation:
Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose the proposed revisions to *SSAP No. 68—Business Combinations and Goodwill* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to reject *ASU 2014-17, Business Combinations – Pushdown Accounting* for statutory accounting. This agenda item also explicitly prohibits use of pushdown accounting under the statutory accounting basis, which includes all entities accounting for under *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* and SSAP No. 97. These revisions will explicitly prohibit insurance reporting entities that hold SCAs valued on the basis of U.S. GAAP (8.b.ii or 8.b.iii) to utilize a value for the SCA that reflects the impact of pushdown accounting. Insurance reporting entities that hold SCAs that utilized pushdown accounting for U.S. GAAP will be required to adjust their U.S. GAAP financial statements to remove the effect of pushdown accounting, and provide audited support of their modification. The insurance reporting entity shall recognize the difference between the purchase price and the net book value of the entity (prior to pushdown accounting) as goodwill in accordance with SSAP No. 68. This goodwill shall be admitted and amortized in accordance with the limitations and provisions of SSAP No. 68. The effective date of these revisions shall be Jan. 1, 2020.

Staff Note: Staff has considered that it will be more difficult to maintain separate sets of accounting records if multiple entities are acquired, especially with the complex nature of insurance company reporting structures. Staff also notes that the election to apply pushdown accounting under U.S. GAAP is irrevocable; as such, a grandfather provision will allow any SCAs acquired prior to December 31, 2019 to continue to use pushdown accounting in its financial statements.

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

Proposed Revisions:

SSAP No. 68—Business Combinations and Goodwill

Business Combinations

2. A business combination shall be accounted for as either a statutory purchase or a statutory merger. Business combinations that create a parent-subsidiary relationship shall be accounted for as a statutory purchase. Business combinations where equity of one entity is issued in exchange for the equity of another entity, which is then canceled, and prospectively only one entity exists, shall be accounted for as a statutory merger.

Statutory Purchases of SCA Investments

3. The statutory purchase method of accounting is defined as accounting for a business combination as the acquisition of one entity by another. It shall be used for all purchases of SCA entities including

partnerships, joint ventures, and limited liability companies. The acquiring reporting entity shall record its investment at cost. Cost is defined as the sum of: (a) any cash payment, (b) the fair value of other assets distributed, (c) the fair value of any liabilities assumed, and (d) any direct costs of the acquisition.(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. Pushdown accounting is not a permitted convention of accounting under statutory accounting, including the acquisition of an entity that follows U.S. GAAP as its basis of accounting.

6. For those acquired SCA entities accounted for using the equity method in accordance with paragraph 8.b.~~i.~~ of SSAP No. 97 under the statutory purchase method, the historical basi~~e~~s of the acquired entity shall continue to be used in preparing its statutory financial statements. Therefore, pushdown accounting is not permitted, as noted in paragraph 20.

20. This statement rejects *ASU 2017-04, Simplifying the Test for Goodwill Impairment*, *ASU 2016-03, Intangibles—Goodwill and Other, Business Combinations, Consolidation, Derivatives and Hedging*; *ASU 2014-17, Business Combinations – Pushdown Accounting, a Consensus of the FASB Emerging Issues Task Force;* *ASU 2014-02, Accounting for Goodwill (a consensus of the Private Company Council)*, *ASU 2012-02, Testing Indefinite-Lived Intangible Assets for Impairment*, *ASU 2011-08, Testing Goodwill for Impairment* and *ASU 2010-28, When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*; *Accounting Principles Board Opinion No. 16, Business Combinations*; *FASB Statement No. 38, Accounting for Preacquisition Contingencies of Purchased Enterprises, an amendment of APB Opinion No. 16*; *Accounting Principles Board Opinion No. 17*, *Intangible Assets*; *FASB Statement No. 79, Elimination of Certain Disclosures for Business Combinations by Nonpublic Enterprises*; *FASB Statement No. 141, Business Combinations*; and *FASB Statement No. 142, Goodwill and Other Intangible Assets.* The following related interpretative pronouncements are also rejected*:*

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

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

8. The admitted investments in SCA entities shall be valued using either the market valuation approach (as described in paragraph 8.a.), or one of the equity methods (as described in paragraph 8.b.) adjusted as appropriate in accordance with the guidance in *SSAP No. 25—Affiliates and Other Related Parties* (SSAP No. 25), paragraph 16.d.

a. In order to use the market valuation approach for SCA entities, the following requirements apply:

b. If a SCA investment does not meet the requirements for the market valuation approach in paragraph 8.a. or, if the requirements are met, but a reporting entity elects not to use that approach, the reporting entity's proportionate share of its investments in SCAs shall be recorded as follows:

i. Investments in U.S. insurance SCA entities shall be recorded based on either 1) the underlying audited statutory equity of the respective entity's financial statements, adjusted for any unamortized goodwill as provided for in *SSAP No. 68—Business Combinations and Goodwill* (SSAP No. 68)[3] or 2) the underlying audited statutory equity of the respective entity's financial statements, adjusted for any unamortized goodwill, modified to remove the impact of any permitted or prescribed accounting practices that depart from the NAIC *Accounting Practices*

[3] If the insurance SCA employs accounting practices that depart from the NAIC accounting practices and procedures, and the reporting insurance entity has not adjusted the valuation of the insurance SCA to be consistent with the NAIC accounting practices and procedures, (i.e., retains the effect of the permitted or prescribed practice in its valuation), disclosure about those accounting practices that affect the insurance SCA's net income and surplus shall be made pursuant to paragraph 36. If the reporting entity has adjusted the investment in the insurance SCA with the resulting valuation being consistent with the accounting principles of the AP&P Manual, the disclosures in paragraph 36 are not required.

and Procedures Manual. Reporting entities shall record investments in U.S. insurance SCA entities on at least a quarterly basis, and shall base the investment value on the most recent quarterly information available from the SCA. Entities may recognize their investment in U.S. insurance SCA entities based on the unaudited statutory equity in the SCAs year-end Annual Statement if the annual SCA audited financial statements are not complete as of the filing deadline. The recorded statutory equity shall be adjusted for audit adjustments, if any, as soon as the annual audited financial statements have been completed. Annual consolidated or combined audits are allowed if completed in accordance with the Model Regulation Requiring Annual Audited Financial Reports as adopted by the SCA's domiciliary state;

ii. Investments in both U.S. and foreign noninsurance SCA entities that are engaged in the following transactions or activities:

(a) Collection of balances as described in *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*

(b) Sale/lease or rental of EDP Equipment and Software as described in *SSAP No. 16R—Electronic Data Processing Equipment and Software*

(c) Sale/lease or rental of furniture, fixtures, equipment or leasehold improvements as described in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*

(d) Loans to employees, agents, brokers, representatives of the reporting entity or SCA as described in *SSAP No. 20—Nonadmitted Assets*

(e) Sale/lease or rental of automobiles, airplanes and other vehicles as described in *SSAP No. 20—Nonadmitted Assets*

(f) Providing insurance services on behalf of the reporting entity including but not limited to accounting, actuarial, auditing, data processing, underwriting, collection of premiums, payment of claims and benefits, policyowner services

(g) Acting as an insurance or administrative agent or an agent for a government instrumentality performing an insurance function (e.g. processing of state workers compensations plans, managing assigned risk plans, Medicaid processing etc).

(h) Purchase or securitization of acquisition costs

and if 20% or more of the SCA's revenue is generated from the reporting entity and its affiliates, then the underlying equity of the respective entity's audited U.S. Generally Accepted Accounting Principles (GAAP) financial statements shall be adjusted to a limited statutory basis of accounting in accordance with paragraphs 9 and 20[FN]. For purposes of this section, revenue means GAAP revenue reported in the audited U.S. GAAP financial statements excluding realized and unrealized capital gains/losses. Foreign SCA entities are defined as those entities incorporated or otherwise legally formed under the laws of a foreign country. Paragraphs 23~~2~~-28~~7~~ provide guidance for investments in holding companies;

New Footnote – If the audited U.S. GAAP financial statements reflect the pushdown method of accounting, the financial statements must first be modified to eliminate the effects of the pushdown accounting before applying the statutory basis adjustments.

iii. Investments in both U.S. and foreign noninsurance SCA entities that do not qualify under paragraph 8.b.ii., shall be recorded based on the audited U.S. GAAP equity of the investee, adjusted in accordance with paragraph 20. Foreign SCA entities are defined as those entities incorporated or otherwise legally formed under the laws of a foreign country. Additional guidance on investments in downstream holding companies is included in paragraphs 23~~2~~-28~~7~~. Additional guidance on the use of audited foreign GAAP basis financial statements for the U.S. GAAP equity valuation amount is included in paragraph 24~~3~~.b.

iv. Investments in foreign insurance SCA entities shall be recorded based on the underlying U.S. GAAP equity from the audited U.S. GAAP basis financial statements, adjusted to a limited statutory basis of accounting in accordance with paragraphs 9 and 20, if available. If the audited U.S. GAAP basis financial statements are not available, the investment can be recorded on the audited foreign statutory basis financial statements of the respective entity adjusted to a limited statutory basis of accounting in accordance with paragraph 9 and adjusted for reserves of the foreign insurance SCA with respect to the business it assumes directly and indirectly from a U.S. insurer using the statutory accounting principles promulgated by the NAIC in the *Accounting Practices and Procedures Manual*. The audited foreign statutory basis financial statements must include an audited footnote that reconciles net income and equity on the foreign statutory basis of accounting to the U.S. GAAP basis. Foreign insurance SCA entities are defined as alien insurers formed according to the legal requirements of a foreign country.

Pushdown Accounting

20. Pushdown accounting is a convention of accounting for the purchase of a subsidiary at the purchase cost rather than its historical cost. Under pushdown accounting, the acquiree's assets and liabilities are written up (or down) to reflect the purchase price and, to the extent that the purchase price exceeds fair value, to recognize the excess as goodwill. As such, the total amount that is paid to purchase the subsidiary becomes the subsidiary's new book value on its financial statements. Pushdown accounting is not permitted under statutory accounting, therefore all SCAs that utilize audited U.S. GAAP financial statements to determine the valuation method under this statement (SCAs valued in accordance with paragraphs 8.b.ii and 8.b.iii) that reflect pushdown accounting must be adjusted, in accordance with an audited reconciliation, to eliminate the effects of pushdown accounting. In addition to adjusting the equity basis of the SCA to eliminate pushdown accounting, the insurance reporting entity shall separately recognize goodwill, as appropriate based on the purchase price and net book value of the entity at acquisition (without pushdown accounting) and report the goodwill in accordance with the provisions of SSAP No. 68. Reporting entities that do not have audited support to eliminate the impact of pushdown accounting shall consider the SCA nonadmitted for statutory reporting purposes. Historical acquisitions of SCAs that have involved pushdown accounting shall continue admittance of the SCA with approval of the domiciliary commissioner. On a prospective basis for newly acquired SCAs, and for historical SCA acquisitions in which domiciliary commissioner approval is not received, reporting entities that do not have audited support to eliminate the impact of pushdown accounting shall report the SCA as a nonadmitted asset for statutory reporting purposes.

Valuation of Investments in Downstream Holding Companies

22. SSAP No. 48 requires the financial statements of joint ventures, partnerships, and/or limited liability companies in which the downstream noninsurance holding company has a minor ownership interest or otherwise lacks control, i.e., ownership interest is less than 10% (hereinafter referred to as "non SCA SSAP No. 48 entities"), to be valued using U.S. GAAP basis financial statements. Valuation of a downstream holding company, including its investments in SCA entities, depends upon the nature of the SCA entities and non SCA SSAP No. 48 entities it holds in accordance with paragraph 8 of this statement. All liabilities, commitments, contingencies, guarantees or obligations of the downstream noninsurance holding company, which are required to be recorded under applicable statutory accounting guidance, shall be reflected in the parent insurance reporting entity's determination of the carrying value of the investment in the downstream noninsurance holding company, if not already recorded in the financial statements of

the downstream noninsurance holding company. The historical basis of the acquired entity shall continue to be used in preparing its financial statements. If an SCA investment of the downstream holding company does not meet the provisions of paragraph 8.a. or if it elects not to use the guidance in paragraph 8.a., and instead uses the guidance in paragraph 8.b., the downstream holding company would be valued as the sum of the following (if applicable):

Admissibility Requirements of Investments in Downstream Holding Companies

23. To meet the admissibility requirements of this statement, unless the limited exception to the audited financial statements requirement discussed in paragraphs 26 and 27 applies, an annual audit of the financial statements of SCA entities, including the downstream holding company valued under paragraphs 8.b.i through 8.b.iv. must be obtained. The requirement for audited financial statements may be met by utilizing any one of the following methods:

a. Audited US GAAP financial statements of the downstream SCA holding company, where the historical basis of the SCA has been used to prepare its financial statements. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA's domiciliary state.) The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities and non-SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet shall then be adjusted for GAAP to SAP differences for paragraph 8.b.i., 8.b.ii. and 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or

b. Audited foreign GAAP-basis financial statements of the downstream SCA holding company. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA's domiciliary state.) The audited foreign GAAP basis financial statements shall include an audited footnote disclosure within the financial statements that reconciles each consolidated entity's net income and equity on a foreign basis of accounting to a U.S. GAAP basis. The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities non SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet shall then be adjusted for GAAP to SAP differences of the insurance entities and paragraph 8.b.ii., and 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or

c. Individual audits of the downstream holding company and the downstream holding company's investments in individual SCA entities.

48. This statement rejects *ASU 2014-17, Business Combinations – Pushdown Accounting, a Consensus of the FASB Emerging Issues Task Force, ASU 2011-10, Derecognition of in Substance Real Estate, APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock, AICPA*

> *Accounting Interpretations APB 18, The Equity Method of Accounting for Investments in Common Stock:* Accounting Interpretations of *APB Opinion No. 18, FASB Technical Bulletin No. 79-19, Investor's Accounting for Unrealized Losses on Marketable Securities Owned by an Equity Method Investee, FASB Emerging Issues Task Force No. 87-21, Change of Accounting Basis in Master Limited Partnership Transactions, FASB Emerging Issues Task Force No. 96-16, Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights*, *FASB Emerging Issues Task Force No. 98-2: Accounting by a Subsidiary or Joint Venture for an Investment in the stock of Its Parent Company or Joint Venture Partner* and *FASB Staff Position No. APB 18-1*, *Accounting by an Investor for Its Proportionate Share of Accumulated Other Comprehensive Income of an Investee Accounted for under the Equity Method in Accordance with APB Opinion No. 18 upon a Loss of Significant Influence.*

Status:
On April 6, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No 68—Business Combinations and Goodwill* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to reject *ASU 2014-17, Business Combinations – Pushdown Accounting* for statutory accounting as well as explicitly prohibit the use of pushdown accounting under statutory accounting, which includes all entities accounted for under *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* and SSAP No. 97.

Updated Summer 2019 Recommendation
Prior to the 2019 Summer National Meeting, information was shared noting that the SEC no longer requires pushdown accounting for SEC reporting. Previously, pushdown accounting was required for SEC purposes if an entity acquired 95% or more ownership of a subsidiary and was permitted if an entity acquired ownership between 80-95% of a subsidiary. If less than 80% was acquired, pushdown was prohibited. With the SEC reporting revisions, entities are permitted to elect pushdown with any acquisition of ownership.

NAIC staff believes that the historical guidance permitting pushdown for statutory filers was intended to allow companies that were required to use pushdown to mirror this approach. With the elimination of the SEC requirements and restrictions, NAIC staff is requesting Working Group direction on whether pushdown should continue to be permitted. **The options for Working Group consideration include:**

1) **Complete rejection of pushdown accounting**. As pushdown is now an election for SEC / U.S. GAAP filers, reporting entities can avoid use of pushdown if prohibited for statutory accounting. (NAIC staff would propose a prospective effective date if electing this option to avoid restatement of those entities that have previously elected pushdown.)

2) **Permission to use pushdown for all non-insurance entities.** This option would increase optionality into the statutory financial statements. If permitted, this approach would result in different SCA values and goodwill calculations for those that follow the guidance in SSAP No. 68 and those that utilize pushdown. Under SSAP No. 68, acquired SCAs do not write-up their assets or liabilities to fair value and goodwill is calculated as the difference between purchase price and book value. Under U.S. GAAP pushdown, acquired SCAs write-up their assets and liabilities to fair value, and goodwill is calculated as the difference between the purchase price and the fair value of the acquired entity. With pushdown, the goodwill is reported at the SCA level. As such, goodwill will be an indefinite asset unless it is identified as impaired. (Under U.S. GAAP, private entities and not-for-profit entities can elect to amortize goodwill over a 10-year period, but this is not an election for public entities.) **If this option is supported, NAIC staff would recommend that the goodwill admittance limitation capture goodwill from an insurance entity's acquisition of an SCA that is reported on the SCA financial statements.** (This option would not permit pushdown for insurance SCAs (8.b.i entities).

   (If this option is considered, NAIC staff would propose restrictions on the use of pushdown that differ from U.S. GAAP. For example, under U.S. GAAP, a reporting entity could subsequent elect pushdown accounting in any

reporting period after original acquisition. If pushdown was permitted, NAIC staff would propose to require the election at original acquisition and not allow subsequent elections.)

3) **Permit pushdown if elected by SEC Registrants, excluding non-insurance entities**. Although this option would introduce different accounting by type of reporting entity, it is consistent with when pushdown would have been applied under prior statutory accounting guidance. (Under the old SEC provisions, pushdown was only permitted when meeting certain SEC requirements.) This would seemingly allow the companies that have historically utilized pushdown under the SEC rules to continue acquisitions under that prior approach. **If this option is supported, NAIC staff would recommend that the goodwill admittance limitation capture goodwill from the acquisition of an SCA that is reported on the SCA financial statements.** *(Also, NAIC staff would propose restrictions to the provisions to ensure the election is made at the time of original acquisition.)* (This option would not permit pushdown for insurance SCAs (8.b.i entities).

NAIC staff recommends that the Working Group expose the agenda item with a request for comments on the three options above. Additionally, to ensure that goodwill resulting from an insurance reporting entity's acquisition of an SCA when pushdown is applied is captured within the goodwill admittance limitation, the exposure includes limited revisions to reference this goodwill in SSAP No. 68, paragraph 9. With exposure, NAIC staff will work with industry on alternative approaches. Comments are specifically requested on the extent that pushdown accounting has been applied, particularly with non-SEC filers.

Revisions Proposed in Accordance with 2019 Summer National Meeting Recommendation:

SSAP No. 68—Business Combinations and Goodwill

8. For those acquired SCA entities accounted for in accordance with paragraph 8.b.i. of SSAP No. 97 under the statutory purchase method, the historical bases of the acquired entity shall continue to be used in preparing its statutory financial statements. Therefore, pushdown accounting is not permitted.

9. Positive goodwill recorded under the statutory purchase method of accounting shall be admitted subject to the following limitation: Positive goodwill from all sources, including life, accident and health, and deposit-type assumption reinsurance and goodwill resulting from the acquisition of an SCA by the insurance reporting entity that is reported on the SCA's financial statements (resulting from the application of pushdown accounting), is limited in the aggregate to 10% of the acquiring[4] 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[5]. 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)

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[4] The "acquiring" entity is intended to reflect the insurance reporting entity that reports the investment resulting in goodwill. The goodwill limitation test shall be completed at the individual reporting company level.

[5] This includes, but is not limited to, situations in which the investment is nonadmitted as the audited financial statements for the SCA, joint venture, partnership or limited liability company includes substantial doubt on the entity's ability to continue as a going concern, or on the basis/contents of the audit opinion pursuant to paragraph 20 of SSAP No. 97.

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

Issue: Clarification of the Look-Through Approach

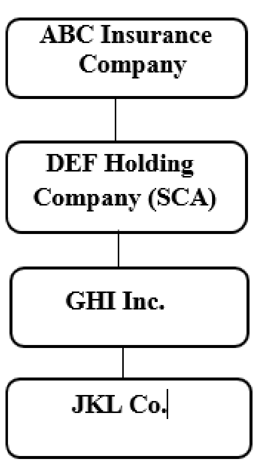
Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	☒	☒	☒
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.

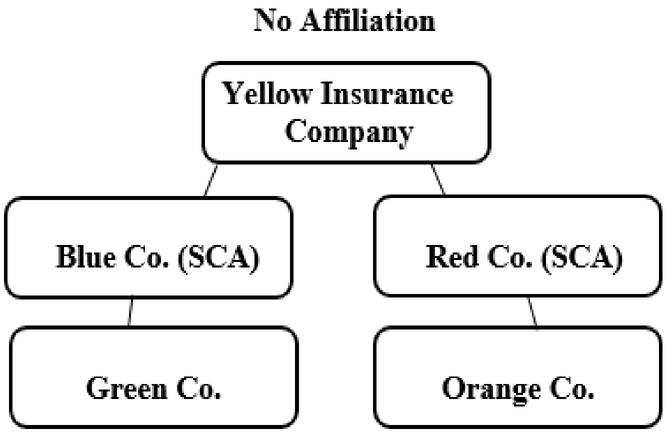
1. **<u>Levels to look-through</u>**: A look-through should only be performed for one direct line of ownership below the SCA entity to companies in which the SCA has direct ownership. Many companies have filed Sub 2 filings using the look-through approach to an entity that is located multiple levels 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.)

Multiple Levels Below



- 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.

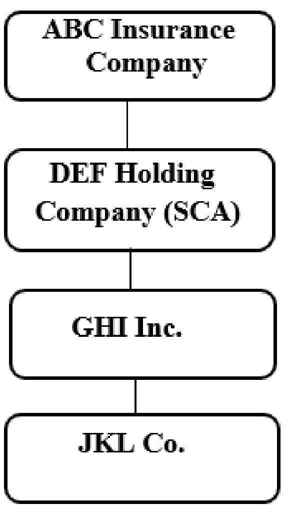
In this example, DEF Holding Company is an SCA of ABC Insurance Company. If DEF Holding Company is an 8.b.iii entity without any other material assets or liabilities, and does not have an audit report, a look-through can be performed to GHI Inc. GHI Inc.'s audit report should include its investment in 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.

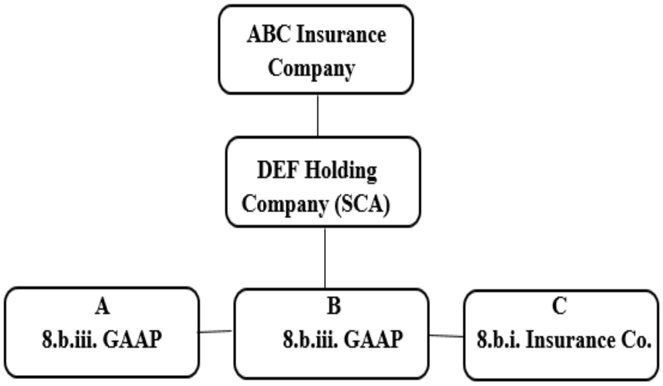
2. **<u>Admitted goodwill permitted for a look-through</u>**: If a company performs a look-through, goodwill may only be admitted for the audited look-through entity; a company may not add goodwill from the purchase of the unaudited holding company to the value of the look-through entity, even though 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.

3. **<u>Look-through approach to multiple entities</u>**: 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

26. 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.

27. The process of admitting audited investments in entities owned by an unaudited downstream noninsurance holding company SCA entity will be known as a "look through." In order to admit the investments in audited SCAs or the audited non SCA SSAP No. 48 entities owned by an unaudited downstream noninsurance holding company, a reporting entity may apply the look through approach, provided all of the following conditions are met:

a. The downstream noninsurance holding company is an 8.b.iii entity, and

b. The downstream noninsurance holding company does not own any other assets which are material to the downstream holding company other than the audited SCA entities and/or audited non SCA SSAP No. 48 entities, and

c. The downstream noninsurance holding company is not subject to liabilities, commitments, contingencies, guarantees or obligations which are material to the downstream noninsurance holding company.

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

41. If a reporting entity holds an investment in a downstream noninsurance holding company, the reporting entity may look-through the downstream noninsurance holding company to the value of (i) SCA entities having audited financial statements and/or (ii) joint ventures, partnerships, and/or limited liability companies having audited financial statements in which the downstream noninsurance holding company has a minor ownership interest or otherwise lacks control, i.e., ownership interest is less than 10% in lieu of obtaining an audit of the financial statements of the downstream noninsurance holding company (provided the limited exception to the audited financial statements requirement contained in paragraphs 26-27 applies).

42. If a reporting entity utilizes the look-through approach for the valuation of the downstream noninsurance holding company instead of obtaining audited financial statements of the downstream noninsurance holding company, the financial statements of the reporting entity shall include the following disclosures:

a. The name of the downstream noninsurance holding company;

b. The carrying value of the investment in the downstream non insurance holding company;

c. The fact that the financial statements of the downstream noninsurance company are not audited;

d. 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;

e. 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

27. The process of admitting audited investments in entities owned by an unaudited downstream noninsurance holding company SCA entity will be known as a "look through." In order to admit the investments in audited SCAs or the audited non SCA SSAP No. 48 entities owned by an unaudited downstream noninsurance holding company, a reporting entity may apply the look through approach, provided all of the following conditions are met:

a. The downstream noninsurance holding company is an 8.b.iii entity, and

b. The downstream noninsurance holding company does not own any other assets which are material to the downstream holding company other than the audited SCA entities and/or audited non SCA SSAP No. 48 entities, and

c. The downstream noninsurance holding company is not subject to liabilities, commitments, contingencies, guarantees or obligations which are material to the downstream noninsurance holding company.

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).

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

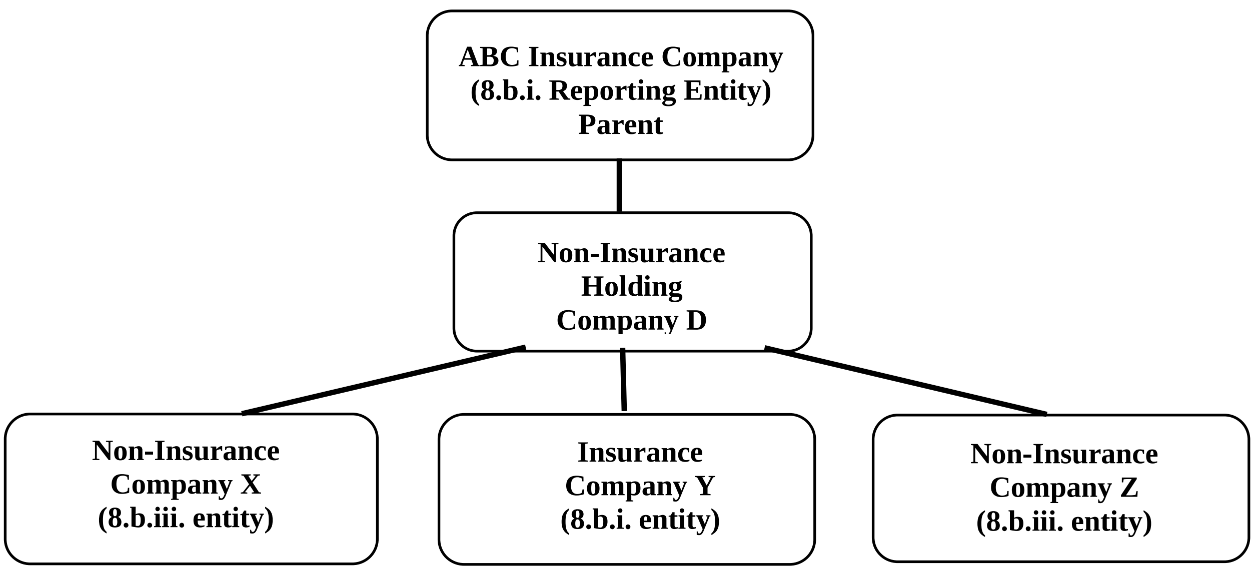
Issue: Attribution of Goodwill

Check (applicable entity):

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

- **Standalone financials -** If Companies X, Y and Z present standalone financials, the purchase price and goodwill will need to be allocated down from the acquisition of Holding Company D. Company Y will present its financial statements separately in the Annual Statement it is required to file.

- **Look-through -** If Holding Company D is not audited, the goodwill from the acquisition of Holding Company D may not be admitted as part of Holding Company D's value, but a look-through can be performed to one and/or all of the companies that D owns. With the look-through, the purchase price and goodwill would need to be allocated to each subsidiary that Holding Company D owns at the time of its acquisition and each subsidiary's equity could be admitted, along with the goodwill from the acquisition, subject to goodwill limitations.

- **Taxes -** The purchase price and goodwill would also need to be allocated down to each entity that Holding Company D owns for tax purposes. *SSAP No. 101—Income Taxes* permits an entity to admit its adjusted gross deferred tax assets (DTAs) against its own deferred tax liabilities (DTLs) but not against gross DTLs of other members of the affiliated or consolidated group. This must be done on an entity-by-entity basis.

- **Sale of entity -** If the insurance reporting entity subsequently sells one or more of the entities that Holding Company D owns, it would need the allocated purchase price and goodwill amount to calculate any gain or loss resulting from the sale.

Existing Authoritative Literature:

Bold and underlined guidance is for emphasis.

SSAP No. 68—Business Combinations and Goodwill

Statutory Purchases of SCA Investments

2. The statutory purchase method of accounting is defined as accounting for a business combination as the acquisition of one entity by another. It shall be used for all purchases of SCA entities including partnerships, joint ventures, and limited liability companies. The acquiring reporting entity shall record its investment at cost. Cost is defined as the sum of: (a) any cash payment, (b) the fair value of other assets distributed, (c) the fair value of any liabilities assumed, and (d) any direct costs of the acquisition.[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.

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

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

5. For those acquired SCA entities accounted for in accordance with paragraph 8.b.i. of SSAP No. 97 under the statutory purchase method, the historical bases of the acquired entity shall continue to be used in preparing its statutory financial statements. Therefore, pushdown accounting is not permitted.

7. Positive goodwill recorded under the statutory purchase method of accounting shall be admitted subject to the following limitation: Positive goodwill from all sources, including life, accident and health, and deposit-type

assumption reinsurance, is limited in the aggregate to 10% of the acquiring[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].** 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]). (This results in a reduction of the investment amount when dividends declared are in excess of the undistributed accumulated earnings attributable to the investee.)

Admissibility Requirements of Investments in Downstream Holding Companies

22. To meet the admissibility requirements of this statement, unless the limited exception to the audited financial statements requirement discussed in paragraphs 25 and 26 applies, an annual audit of the financial statements of SCA entities, including the downstream holding company valued under paragraphs 8.b.i through 8.b.iv. must be obtained. The requirement for audited financial statements may be met by utilizing any one of the following methods:

a. Audited US GAAP financial statements of the downstream SCA holding company. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA's domiciliary state.) The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities and non-SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet shall then be adjusted for GAAP to SAP differences for paragraph 8.b.i., 8.b.ii. and 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or

b. Audited foreign GAAP-basis financial statements of the downstream SCA holding company. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance

[1] The "acquiring" entity is intended to reflect the insurance reporting entity that reports the investment resulting in goodwill. The goodwill limitation test shall be completed at the individual reporting company level.

[2] This includes, but is not limited to, situations in which the investment is nonadmitted as the audited financial statements for the SCA, joint venture, partnership or limited liability company includes substantial doubt on the entity's ability to continue as a going concern, or on the basis/contents of the audit opinion pursuant to paragraph 20 of SSAP No. 97.

[3] Dividends are recognized in investment income when declared.

entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA's domiciliary state.) The audited foreign GAAP basis financial statements shall include an audited footnote disclosure within the financial statements that reconciles each consolidated entity's net income and equity on a foreign basis of accounting to a U.S. GAAP basis. The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities non SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet shall then be adjusted for GAAP to SAP differences of the insurance entities and paragraph 8.b.ii., and 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or

c. Individual audits of the downstream holding company and the downstream holding company's investments in individual SCA entities.

23. If the downstream noninsurance holding company does not meet the requirements of paragraph 25, audited GAAP financial statements, as described in paragraph 22, are required for the downstream noninsurance holding company and its SCA and non SCA investments in order for the investment in the downstream noninsurance holding company to be classified as an admitted asset.

24. A purchased downstream holding company is valued in accordance with the provisions of paragraphs 21-24 and the provisions of SSAP No. 68.

SSAP No. 101—Income Taxes

Exhibit A – Implementation Questions and Answers

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

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

8.11 Under paragraph 11.c., <u>**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.**</u>

Limited Exceptions to the Audit Requirements for Downstream Noninsurance Holding Companies

25. This statement requires that investments in SCA entities be recorded using one of the valuation methods described in paragraph 8 in order to be admitted assets. Each of the paragraph 8.b. valuation methods require the financial statements of SCA entities, including downstream noninsurance holding companies, to be audited in order for the investments in SCA entities to be admitted assets. Likewise, SSAP No. 48 requires the financial statements of joint ventures, partnerships, and/or limited liability companies in which the downstream noninsurance holding

company has a minor ownership interest or otherwise lacks control, i.e., ownership interest is less than 10% to be audited (U.S. GAAP) in order to be admitted assets. There is a limited exception to the requirement to have audited financial statements of a downstream noninsurance holding company, provided that the entities owned by the downstream noninsurance holding company (paragraph 8.b.iii. entity) have audited financial statements as described in paragraphs 25 and 26.

26. The process of admitting audited investments in entities owned by an unaudited downstream noninsurance holding company SCA entity will be known as a “look through.” In order to admit the investments in audited SCAs or the audited non SCA SSAP No. 48 entities owned by an unaudited downstream noninsurance holding company, a reporting entity may apply the look through approach, provided all of the following conditions are met:

a. The downstream noninsurance holding company is an 8.b.iii entity, and

b. The downstream noninsurance holding company does not own any other assets which are material to the downstream holding company other than the audited SCA entities and/or audited non SCA SSAP No. 48 entities, and

c. The downstream noninsurance holding company is not subject to liabilities, commitments, contingencies, guarantees or obligations which are material to the downstream noninsurance holding company.

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

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

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

Convergence with International Financial Reporting Standards (IFRS): None

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

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

Proposed Revisions:
SSAP No. 68—Business Combinations and Goodwill

Statutory Purchases of SCA Investments

3. The statutory purchase method of accounting is defined as accounting for a business combination as the acquisition of one entity by another. It shall be used for all purchases of SCA entities including partnerships, joint ventures, and limited liability companies. The acquiring reporting entity shall record its investment at cost. Cost is defined as the sum of: (a) any cash payment, (b) the fair value of other assets distributed, (c) the fair value of any

liabilities assumed, and (d) any direct costs of the acquisition.(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.

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

5. A business combination accounted for under the statutory purchase method and in which the acquired entity is valued in accordance with paragraphs 8.b.ii., 8.b.iii. or, 8.b.iv. of SSAP No. 97 shall determine the amount of positive goodwill or negative goodwill created by the combination using the reporting entity's share of the GAAP net book value of the acquired entity, adjusted to a statutory basis of accounting in accordance with paragraph 9 of SSAP No. 97 in the case of acquired entities valued in accordance with paragraphs 8.b.ii. or 8.b.iv. of SSAP No. 97. If the acquired entity is a holding company, the purchase price and goodwill shall be calculated to determine the amount of goodwill that should be attributed to the downstream entities that were acquired as part of the holding company acquisition. (This is required because a reporting entity that subsequently qualifies and elects to look-through the holding company pursuant to SSAP No. 97, paragraphs 25-26 is only permitted to admit the goodwill attributed to the downstream entities that are admitted through the SSAP No. 97 look-through approach.) Business combinations accounted for under the statutory purchase method and in which the acquired entity is valued in accordance with, paragraph 8.b.i. of SSAP No. 97 shall determine the amount of positive or negative goodwill created by the business combination using the insurer's share of the statutory book value of the acquired entity.

6. For those acquired SCA entities accounted for in accordance with paragraph 8.b.i. of SSAP No. 97 under the statutory purchase method, the historical bases of the acquired entity shall continue to be used in preparing its statutory financial statements. Therefore, pushdown accounting is not permitted.

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

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

Issue: Accounting for "Other" Derivatives

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue:
This agenda item has been drafted to consider statutory accounting guidance for derivatives that are not used in hedging transactions, income generation transactions or replication (synthetic asset) transactions. This agenda item was directed with the adoption of agenda item 2018-18, Structured Notes, as it was noted that structured notes captured within scope of *SSAP No. 86—Derivatives*, would be unlikely to be used in the transactions with existing recognition and measurement guidance in SSAP No. 86.

Although the guidance of SSAP No. 86 is limited to the derivatives captured in the noted transactions (hedging, income generation or replication), the reporting schedule for derivatives (Schedule DB) currently includes an "other" derivative reporting category. Although this agenda item clarifies the accounting (measurement) value for these derivatives, as detailed within the proposed revisions, "other" derivatives do not qualify as admitted assets under the SSAP. Derivatives classified as "other" shall only be admitted in accordance with state investment laws that provide prescribed practices that permit admittance. These prescribed practices shall be detailed in Note 1. Derivatives reported in the "hedging-other" are derivatives subject to the "hedging" guidance in SSAP No. 86 and are not intended to be captured by this agenda item. This agenda item is strictly for the derivatives reported as "other" derivatives.

Existing Authoritative Literature:
SSAP No. 86—Derivatives establishes statutory accounting principles for derivative instruments and hedging, income generation and replication (synthetic asset) transactions using selected concepts outlined in *FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities*.

Although the scope of SSAP No. 86 references "all derivative instruments" recognition and measurement provisions are only provided for specific transactions identified in paragraph 3:

3. This statement addresses the recognition of derivatives and measurement of derivatives used in:

    a. Hedging transactions;

    b. Income generation transactions; and

    c. Replication (synthetic asset) transactions.

4. "Derivative instrument" means an agreement, option, instrument or a series or combination thereof:

    a. To make or take delivery of, or assume or relinquish, a specified amount of one or more underlying interests, or to make a cash settlement in lieu thereof; or

    b. That has a price, performance, value or cash flow based primarily upon the actual or expected price, level, performance, value or cash flow of one or more underlying interests.

Activity to Date (issues previously addressed by the Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Revisions have recently adopted to SSAP No. 86 and additional revisions are expected to consider *ASU 2017-12, Derivatives and Hedging*. Recent revisions include:

- Ref # 2016-48 – Incorporated disclosures for financing derivatives.
- Ref# 2018-08 – Incorporate guidance to include structured notes in scope.
- Ref #2018-30 – Incorporated hedge documentation and assessment efficiencies from ASU 2017-12.

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

Convergence with International Financial Reporting Standards (IFRS):
U.S. GAAP and IFRS are consistent that all derivatives are reported at fair value, with changes recognized through income unless there is an election to apply hedge accounting. With hedge accounting, under IFRS and U.S. GAAP, derivatives are still reported at fair value, but the gain/loss may be recognized through other comprehensive income (instead of income).

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to *SSAP No. 86—Derivatives* to include recognition and measurement guidance for derivatives that do not qualify as hedging, income generation or replication transactions. In addition to the proposed revisions specific for "other" derivatives, revisions are reflected in the headers to separate the application of existing guidance.

Working Group Question – With the language proposed, admittance of "other" derivatives under state investment laws will require a prescribed practice disclosure in Note 1. Working Group comments are requested on whether the language in the SSAP should permit admittance under state investment law. If this language was included, then a prescribed practice detailed in Note 1 would not be required.

Proposed Revisions to SSAP No. 86—Derivatives:

3. This statement addresses the recognition of derivatives and measurement of derivatives used in:

   a. Hedging transactions;

   b. Income generation transactions; and

   c. Replication (synthetic asset) transactions.

   d. Other Derivatives – (Derivatives that are not used in hedging, income generation or replication transactions.)

Impairment

17. This statement adopts the impairment guidelines established by *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5R) for the underlying financial assets or liabilities.

Recognition of Derivatives ~~Recognition and Measurement of Derivatives Used in Hedging Transactions~~

18. Derivative instruments represent rights or obligations that meet the definitions of assets (*SSAP No. 4—Assets and Nonadmitted Assets*) or liabilities (SSAP No. 5R) and shall be reported in financial statements. In addition, derivative instruments also meet the definition of financial instruments as defined

in *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures* (SSAP No. 27). Should the cost basis of the derivative instrument be undefined (i.e., no premium is paid), the instrument shall be disclosed in accordance with paragraphs 44-48 of *SSAP No. 100R—Fair Value* (SSAP No. 100R). Derivative instruments used in hedging, income generation or replication (synthetic asset) transactions shall be recognized and measured in accordance with the specific provisions within this statement and are admitted assets to the extent they conform to the requirements of this statement.

19. Derivative instruments that are not used in hedging, income generation or replication (synthetic asset) transactions shall be considered "Other" derivatives. These derivatives shall be accounted for at fair value and the changes in fair value shall be recorded as unrealized gains or losses. These derivatives do not qualify as admitted assets.

Derivatives Used in Hedging Transactions

~~19.~~20. Derivative instruments used in hedging transactions that meet the criteria of a highly effective hedge shall be considered an effective hedge and are permitted to be valued and reported in a manner that is consistent with the hedged asset or liability (referred to as hedge accounting). For instance, assume an entity has a financial instrument on which it is currently receiving income at a variable rate but wishes to receive income at a fixed rate and thus enters into a swap agreement to exchange the cash flows. If the transaction qualifies as an effective hedge and a financial instrument on a statutory basis is valued and reported at amortized cost, then the swap would also be valued and reported at amortized cost. Derivative instruments used in hedging transactions that do not meet or no longer meet the criteria of an effective hedge, or that meet the required criteria but the entity has chosen not to apply hedge accounting, shall be accounted for at fair value and the changes in the fair value shall be recorded as unrealized gains or unrealized losses (referred to as fair value accounting).

~~Recognition and Measurement of~~ Derivatives Used in Income Generation Transactions

General

~~43.~~44. Income generation transactions are defined as derivatives written or sold to generate additional income or return to the reporting entity. They include covered options, caps, and floors (e.g., a reporting entity writes an equity call option on stock that it already owns).

~~Recognition and Measurement of~~ Derivatives Used in Replication (Synthetic Asset) Transactions

~~53.~~54. Replication (Synthetic Asset) transaction means a derivative transaction entered into in conjunction with other investments in order to reproduce the investment characteristics of otherwise permissible investments. A derivative transaction entered into by an insurer as a hedging or income generation transaction shall not be considered a replication (synthetic asset) transaction.

Staff Review Completed by: Julie Gann – April 2019

On May 29, 2019, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 86—Derivatives*, as shown above, to include recognition and measurement guidance for derivatives that do not qualify as hedging, income generation or replication transactions.

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Statutory Accounting Principles (E) Working Group
2019 Summer National Meeting
Comment Letters Received

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June 18, 2019

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: Interested Parties Comments on Items Exposed for Comment by the Statutory Accounting Principles (E) Working Group with Comments due June 12

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to provide comments on the items that were exposed by the Statutory Accounting Principles (E) Working Group (the "Working Group") during the NAIC National Meeting in Orlando with a comment deadline of June 12. We offer the following comments:

Ref #2016-02: ASU 2016-02: Leases (ASC Topic 842)

The Working Group exposed a substantively revised *SSAP No. 22R—Leases* and corresponding *Issue Paper No. 16X—Leases* to incorporate guidance from *ASU 2016-02, Leases*, but maintain the operating lease concept for statutory accounting.

Interested parties support the changes in the revised exposed draft.

Ref #2017-28: *Issue Paper 16X—Property and Casualty Reinsurance Credit*

The Working Group exposed an issue paper to document for historical purposes the adopted revisions to *SSAP No. 62R—Property and Casualty Reinsurance*.

Interested parties have no comment on this item.

Ref #2018-03: Reporting NAIC Designations as Weighted Averages Under 43R

The Working Group exposed revisions (as shown below) to *SSAP No. 43R—Loan-Backed and Structured Securities* to require securities with differing NAIC designations by acquisition lot to be reported in the aggregate at either the lowest NAIC designation or reported in groupings by differing NAIC designation. These concepts are consistent with the original exposure, but the proposed edits have been revised to reflect the updated guidance after adopting changes to eliminate Modified Filing Exempt (MFE) in agenda item 2018-19.

Interested parties have no comment on this item.

Ref #2018-04: VOSTF – Bank Loan Referral

The Working Group exposed revisions to *SSAP No. 21—Other Admitted Assets*, to clarify that a security in scope of another SSAP is not reclassified as a "collateral loan" because it is also secured with collateral. After considering comments on these proposed revisions, an assessment will occur on a referral response to the Valuation of Securities (E) Task Force. If these revisions are incorporated, it is anticipated that the referral response will request revisions to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* to reference the guidance.

Other key elements for discussion per the original exposure:

- Borrowing Base Loan – This loan appears to be a collateral loan backed by accounts receivable or inventory subject to the guidance in SSAP No. 21. Pursuant to that guidance, collateral loans secured by assets that do not qualify as investments shall be non-admitted. Neither accounts receivable nor inventory would qualify as an investment that supports admittance under SSAP No. 21.

- DIP Financing – This loan has been made to a company in bankruptcy, which may also be supported by collateral. As payment of the loan would be contingent on the company emerging from a going concern and attracting financing to repay the DIP loan, it seems that this lending structure should be restricted to a "collateral loan" classification, as defined in SSAP No. 21, with admittance limited to the qualifying investments securing the loan.

- Revolving Credit Facility – This structure should be clarified to indicate that a commitment to provide lending is not an asset that can be recognized on the financial statements. Rather, only the actual loaned amount would be considered an asset that could be recognized.

In addition, the exposure draft proposes the following footnote to be added to SSAP No. 21 *Other Admitted Assets*:

> New Footnote: For purposes of determining a collateral loan in scope of this statement, a collateral loan does not include investment securities captured in scope of other

statements. For example, SSAP No. 26R includes securities (as defined in that statement) representing a creditor relationship whereby there is a fixed schedule for one or more future payments. Securities captured in SSAP No. 26R that are also secured with collateral shall continue to be captured within scope of SSAP No. 26R.

Interested Parties Comments

As stated in our previous comment letter on this topic submitted on May 18, 2018, regarding Revolving Credit Facilities, interested parties agree that a commitment to provide lending is not an asset. Insurers report any loans under these facilities as a bank loan under SSAP No. 26R-*Bonds* only upon making an actual loan. Loans drawn under revolving credit facilities meet the definition of bank loans and should continue to be reported under SSAP No. 26R- *Bonds*.

Regarding Borrowing Base loans and DIP Loans, interested parties refer to the comments made in our May 18, 2018 letter where we stated that both types of loans have full recourse to the borrower, which is an operating company (similar to any other corporate bond). A borrowing Base Loan is a type of Revolving Credit Facility in all respects (including as to recourse, existence of financial covenants and remedies), except that a Borrowing Base Loan includes the added protection of requiring lenders to only extend funds up to a certain percentage of the value of certain assets (i.e., the Borrowing Base amount). Under an event of default by the borrower, as with secured corporate bonds, the Borrowing Base lender will have full recourse to the operating company borrower, as well as any collateral securing the applicable loan/bond (which, in the case of a Borrowing Base Loan would include collateral constituting the Borrowing Base, as well as any other assets of the borrower).

Like Borrowing Base Loans, DIP Loans are typically asset-based working capital facilities that provide both immediate cash as well as working capital during a corporate reorganization conducted under chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code"). Although it may seem counterintuitive to think of DIP Loans as safe investments, the Bankruptcy Code extends several powerful protections to DIP Lenders. DIP Loans are full recourse loans. However, the exposure makes no further proposals on these type of bank loans, so we make no further supporting comments in this letter as we firmly believe they are within the scope of SSAP No. 26R. Similarly, we offer no comments on the proposed referral to the VOSTF as the exposure offered no detail on the content of the proposed referral.

Interested parties generally support the proposed clarifications to SSAP No. 21. However, we propose the following change to the new proposed footnote to reflect the fact that some investments captured within the scope of other statements, may technically not be a security:

> New Footnote: For purposes of determining a collateral loan in scope of this statement, a collateral loan does not include investments ~~securities~~ captured in scope of other statements. For example, SSAP No. 26R includes securities (as defined in that statement) representing a creditor relationship whereby there is a fixed schedule for one or more future payments. Investments ~~Securities~~ captured in SSAP No. 26R that are also secured with collateral shall continue to be captured within scope of SSAP No. 26R.

Ref #2018-22: SSAP No. 37 – Participation Agreement in a Mortgage Loan

This agenda item has been drafted to clarify statutory accounting guidance in SSAP No. 37 – Mortgage Loans for a participation agreement in a mortgage loan. The guidance permitting a “participation agreement” was adopted in 2017 and intended to allow ownership in a single mortgage loan agreement with a sole borrower when the insurer is not named on the original mortgage loan agreement. With a participation agreement, the insurer would acquire the mortgage loan via an assignment or participation agreement between the selling lender and any co-lenders. There were subsequent exposures on August 4, 2018 and November 15, 2018 intending to clarify certain aspects of the scope of this statement.

In the latest exposure on April 6, 2019, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 37—Mortgage Loans*, to incorporate both regulator and interested parties’ comments from the previous exposures. These revisions incorporate minor technical edits and revise footnote 3 guidance and incorporate additional language to footnote 2 suggested by a regulator to specify requirements for participating mortgages. Those proposed revisions clarify that such participation agreements should provide the same rights and obligations as if the holder acquired the mortgage loan directly by adding the following requirements:

- Reporting entity must have a signed participation agreement with the original lender. (Must be in privity of contract with the original lender(s).)
- The rights acquired under the participation agreement must be pari-passu with the original lender.
- Mortgage loan proceeds under the participation agreement include 1) mortgage loan principal and interest payments to be made under the single mortgage loan by the borrower under the single mortgage loan, and 2) proceeds and rights received in foreclosure of mortgage, deed of trust, deed of foreclosure or similar proceedings
- Participation agreement must be properly and promptly recorded.

These characteristics have been incorporated into a revised exposure of footnote 2b of SSAP 37 as shown below with tracked changes:

b. Reporting entity has a “participation agreement” to invest in a single mortgage loan. ~~agreement mortgages(sole borrower) originally issued by another entityAlthough t~~The reporting entity is not an original lender named as a payee on the ~~original~~ mortgage loan~~agreement~~, but the original lender ~~issuer~~ sells a portion of the mortgage loan to the reporting entity ~~an incoming participant lender (co-lender) and the sale is documented by~~ through an assignment of a participation interest under the participation agreement. ~~or participation agreement between the selling lender and the co-lenderparticipant. With these agreements, the participantco-lender~~ Under a participation agreement, the reporting entity acquires an undivided ~~participation~~ interest in the single mortgage loan proceeds to be received by the original lender. Under a participation agreement, single mortgage loan proceeds include the periodic mortgage loan principal and interest payments received by the original lender, and all rights and proceeds received in the foreclosure of a mortgage, deed of trust, deed in lieu of foreclosure, or other similar proceeding by the original lender. The amount of the proceeds to be received by the reporting entity is based on the ratio of its participation interest to the then-outstanding single mortgage loan balance. To qualify as a mortgage loan under the scope of this statement, the reporting entity must have a signed participation agreement with the original lender named in the mortgage loan, ~~and will have rights related receive direct interest in the amount of their participation in the right to repayment of the loan based on its pro-rata share of the single mortgage loanand the collateral given to secure the loan. T~~the financial rights and obligations of the reporting entity under the participation agreement are the same as the original lender, the reporting entity's participation interest in the single mortgage loan proceeds must be pari-passu with the original lender named on the mortgage loan agreement, and the participation agreement must be properly and promptly recorded. ~~lenders participants in these agreements shall be similar to those in a direct loan.~~

In addition, footnote 3 was also re-exposed with the changes to clarify the definition of a bundle of mortgage loans:

[3] The scope of this SSAP is limited to single mortgage loan agreements. Although single mortgage loan agreements can potentially have more than one lender (e.g., co-lenders / participations) and more than one borrower (such as in a tenancy-in-common arrangement), the concept of a "single mortgage loan" does not include arrangements in which a reporting entity acquires more than one mortgage loan in a sole transaction. (For example, if a reporting entity was to acquire an interest in a "bundle" of mortgage loans with various unrelated borrowers and collateral, this agreement would be outside of the scope of this SSAP. However, a bundle of mortgage loans does not include a "bulk purchase" where the reporting entity's interest in each mortgage loan is legally separate and divisible and the purchase just facilitates the acquisitions of multiple single mortgage loan agreements.)

Interested Parties Comments

Interested parties continue to be appreciative that the Working Group included several small technical edits suggested in our previous comment letter. Additionally, we support the clarification that a "bundle of mortgage loans" does not include a "bulk purchase" where the reporting entity's interest in each mortgage loan is legally separate and divisible and the purchase just facilitates the acquisition of multiple single mortgage loan agreements.

While we agree with the spirit of the additional characteristics incorporated into exposed footnote 2b, there should be two amendments. First, regarding the requirement that there be a signed participation agreement with the original lender, it is not uncommon for an insurance company to acquire a mortgage loan from an originating lender so it would not technically be the original lender. This situation can be easily addressed by changing "original lender" to read "lender of record" everywhere in footnote 2b yet still be entirely consistent with the intent of the requirement.

Secondly, we want to make sure the requirement that the participation be recorded is understood. Participation agreements are not generally recorded in public records. However, we agree that they should be properly and promptly be recorded on the book and records of the lender. We recommended adding a phrase to the last line of proposed footnote 2b that "… the participation agreement must be properly and promptly recorded on the lender of record's books and records."

Interested Parties recommended footnote 2b:

b. Reporting entity has a "participation agreement" to invest in a single mortgage loan. The reporting entity is not the lender of record ~~an original lender~~ named as a payee on the mortgage loan, but the lender of record ~~original lender~~ sells a portion of the mortgage loan to the reporting entity through an assignment of a participation interest under the participation agreement. Under a participation agreement, the reporting entity acquires an undivided interest in the single mortgage loan proceeds to be received by the lender of record ~~original lender~~. Under a participation agreement, single mortgage loan proceeds include the periodic mortgage loan principal and interest payments received by the lender of record ~~original lender~~, and all rights and proceeds received in the foreclosure of a mortgage, deed of trust, deed in lieu of foreclosure, or other similar proceeding by the lender of record ~~original lender~~. The amount of the proceeds to be received by the reporting entity is based on the ratio of its participation interest to the then-outstanding single mortgage loan balance. To qualify as a mortgage loan under the scope of this statement, the reporting entity must have a signed participation agreement with the lender of record ~~original lender~~ named in the mortgage loan, the financial rights and obligations of the reporting entity under the participation agreement are the same as the lender of record ~~original lender~~, the reporting entity's participation interest in the single mortgage loan proceeds must be pari-passu with the lender of record ~~original lender~~ named on the mortgage loan agreement, and the participation agreement must be properly and promptly recorded on the lender of record's books and records.

Ref #2018-26: SCA Loss Tracking – Accounting Guidance

The Working Group exposed revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, as detailed below, to revise the existing reporting requirements for when a reporting entity has a negative value in an SCA investment when the reporting entity has provided a financial commitment or guarantee. Included in the proposal are illustrations from the existing *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses.*

Interested parties offer the following comments on the re-exposed proposed revisions.

The proposed revisions to SSAP No. 97 paragraph 13e include the following: "If the entire loss is recognized under SSAP No. 5R, it does not also need to be recognized under SSAP No. 97. However, if there is a guarantee or commitment, and the entire loss is not recognized under SSAP No. 5R, the reporting entity shall not stop at zero, and shall recognize the amount of loss, including losses that result in a negative value of the SCA." It appears the proposed wording is intended to provide for a potential loss under a guarantee that is exempted from the initial liability recognition guidance of paragraph 18f of SSAP No. 5R (i.e., guarantees made to/or on behalf of directly or indirectly wholly-owned insurance or non-insurance subsidiaries). If that is the case, then the term "entire loss" used in the context of the proposed wording appears to be inconsistent with the SSAP No. 5R loss recognition guidance for guarantees. As such, we recommend the following revisions:

> "If the ~~entire loss~~ guaranteed obligation is recognized under SSAP No. 5R, it does not also need to be recognized under SSAP No. 97. However, if there is a guarantee or commitment, and the ~~entire loss~~ guaranteed obligation is not recognized under SSAP No. 5R, the reporting entity ~~shall not stop at zero, and~~ shall recognize a liability for the guaranteed obligation measured in accordance with SSAP No. 5R paragraph 20 (i.e., fair value). This includes guarantees made to/or on behalf of directly or indirectly wholly-owned insurance or non-insurance subsidiaries that would otherwise be exempted from initial liability recognition guidance under paragraph 18f of SSAP No. 5R ~~negative value of the SCA~~."

Ref #2018-38: Prepayments to Service and Claims Adjusting Providers

The Working Group exposed modified language, developed with interested parties' input as described in the revised draft, which requires nonadmittance for prepaid loss and LAE. This guidance is consistent with existing statutory accounting principles and was revised from the previously exposed "expense and reclassify as amounts are paid" approach. In addition, guidance was exposed regarding flat fee bundled payments which indicates nonadmission of prepaid amounts and allocation to expense categories as benefits or services are rendered.

This proposal is intended to clarify that prepayments to providers of claims and adjusting services are recognized as non-admitted prepaid expenses and guidance regarding flat fee bundled payments. Interested parties previously commented recommending that the Working Group include qualifying language in SSAP No. 55 to exclude capitation payments since the guidance in SSAP No. 84 already addresses health contracts. Since health carriers expense loss adjustment expenses when claims are incurred, it is not necessary to establish an asset. The Accounting Practices and Procedures Manual already has rules that cover advances to providers that should not be overruled by the proposed guidance. Additionally, "miscellaneous underwriting expenses" is not a recognized expense category for health insurance. Therefore, interested parties recommend that qualifying language be included to exclude all payments under managed care contracts. Health carriers are concerned that the proposal changes how claims adjustment expenses are being recorded and do not believe the intent of the proposal is to add significant administrative burden to health carriers by requiring the recording of a non-admitted prepaid asset initially when claims are incurred and then expense the amounts when claims are adjudicated and/or paid. Following are suggested revisions to the proposed guidance.

> 4. Claims, losses, and loss/claim adjustment expenses shall be recognized as expenses when a covered or insured event occurs. In most instances, the covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs. For claims-made type policies, the covered or insured event is the reporting to the entity of

the incident that gives rise to a claim. Claim payments and related expense payments are made subsequent to the occurrence of a covered or insured event, and in order to recognize the expense of a covered or insured event that has occurred, it is necessary to establish a liability. Liabilities shall be established for any unpaid claims and unpaid losses (loss reserves), unpaid loss/claim adjustment expenses (loss/claim adjustment expense reserves) and incurred costs, with a corresponding charge to income.

a. All prepayments (i.e., variable, fixed or bundled amounts) to third party administrators, management companies or other entities for unpaid claims, losses and losses/claims adjustment expenses, except for capitated payments for managed care contracts, shall not reduce losses/claims and shall be initially reported as a prepaid asset and nonadmitted in accordance with SSAP No. 29—*Prepaid Expenses*. When the benefit has been provided to the policyholder or claimant, the claims prepayments to third party administrators, management companies or other entities (except for capitated payments for managed care contracts), are reclassified proportionately from the prepaid nonadmitted asset to claims, losses or loss/claim expenses paid based on the amount of losses/claims cost incurred to provide the benefit. <u>However, this guidance does not apply to health insurance and managed care contracts with respect to loans and advances to providers, which are addressed in another statement. This guidance also does not apply to loss/claim adjustment expenses for health insurance and managed care contracts, which are expensed when the corresponding losses/claims are incurred, not when they are paid.</u>

b. Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as miscellaneous underwriting expenses<u> for property and casualty contracts and as general administrative expenses for health insurance and managed care contracts</u>.

c. Claims related extra contractual obligations losses and bad-faith losses shall be included in losses. See individual business types for the accounting treatment for adjustment expenses related

5. The liability for unpaid LAE shall be established regardless of any payments made to third-party administrators, management companies or other entities except for capitated payments under managed care contracts. The liability for claims adjustment expenses on non-capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third-party administrators, etc. The liability for claims adjustment expenses on capitated payments under managed care contracts shall be established in an amount necessary to adjust all unpaid claims irrespective of payments to third parties with the exception that the liability is established net of capitated payments to providers.

a. When the prepaid benefit as described in paragraph 4 has been provided to the policyholder or the claimant, the associated prepayments to third party administrators, management companies or other entities (except for capitated payments for managed care contracts) are reclassified proportionately from the prepaid nonadmitted asset to paid loss /claim adjusting expenses based on the amount of losses/claims cost incurred to provide the benefit. <u>However, the foregoing is not applicable to health insurance and managed care contracts.</u> Prepayments to third party administrators or management companies or other entities that do not relate to services or adjusting for the underlying direct policy benefits are reported as miscellaneous underwriting expenses<u> for property and casualty contracts and as general administrative expenses for health insurance and managed care contracts</u>.

Ref #2019-03: Affiliate Transactions

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed the above revisions to *SSAP No. 25—Affiliates and Other Related Parties, SSAP No. 26R—Bonds, SSAP No. 32—Preferred Stock, SSAP No. 43R—Loan-backed and Structured Securities,* and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* to clarify the application of SSAP No. 25, as well as an "affiliated" classification, when a transaction is in substance a related party transaction, even if the transaction is conducted through a non-related intermediary.

Interested parties note that the revised wording uses the terms "affiliated" and "related party" interchangeably. Although the definitions for these terms overlap, they are not identical, and we recommend that the context in the revised wording be revised to ensure that the terms are being used properly.

Ref #2019-06: *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts*

This agenda item has been drafted to consider ASU 2018-12, *Targeted Improvements to the Accounting for Long-Duration Contracts,* for statutory accounting. The FASB issued ASU 2018-12 in August 2018 to improve the existing recognition, measurement, presentation and disclosure requirements for long-duration contracts issued by an insurance entity. The revisions captured in the ASU are summarized as follows:

1. **<u>Update Assumptions:</u>** The ASU requires assumptions to be updated and eliminates the U.S. GAAP provisions for risk of adverse deviation and premium deficiency testing.
2. **<u>Market Risk Benefits</u>:** The ASU requires all market risk benefits associated with deposit (or account balance contracts) to be measured at fair value.
3. **<u>Deferred Acquisition Costs:</u>** The ASU requires that deferred acquisition costs be amortized over a constant basis over the expected life of the contract.
4. **<u>Disclosures:</u>** The ASU requires disaggregated rollforwards of beginning to ending balance of the liability for future policy benefits, policyholder account balances, market risk benefits, separate account liabilities and deferred acquisition costs.

NAIC staff recommends that the Working Group move this item to the active list, categorized as nonsubstantive, and expose revisions as follows:

- Modifications to paragraph 20 of the Preamble to update the applicable U.S. GAAP guidance.
- Rejection of the ASU for the applicable accounting SSAPs.
- Consider new SAP disclosures to capture reconciliations of liabilities for life contracts,
    - Rollforward of the liability for future policy benefits.
    - Rollforward of the liability for policyholder's account balances (excluding separate accounts).
    - Rollforward of market risk benefits.

Interested parties agree that the ASU should be rejected for statutory purposes and both paragraph 20 of the Preamble and the applicable SSAPs should be adjusted accordingly. More specifically, interested parties agree with the objectives of statutory accounting that stress the ability to pay claims in the future by intentionally establishing conservative reserves that also emphasize the long-term nature of the liabilities.

U.S. GAAP serves different needs. "Market consistent" approaches are not suited for regulatory purposes due to the negative effects the unhelpful volatility they introduce can have on the ability of insurance companies to provide long-term insurance products critically relied upon by millions of Americans.

In a market consistent approach, such as with the ASU, a rollforward of balance sheet items (i.e., future policy benefits, policyholder account balances, and market risk benefits) can offer insights into the changes related to those balances. For entities not preparing their balance sheet on a market consistent basis, such as with statutory accounting, the rollforward of extraneous balances (i.e., non-balance sheet items) does not provide meaningful information to the users of the statutory financial statements. As such, interested parties recommend the NAIC reject the U.S. GAAP disclosures for statutory accounting for the following reasons:

1) Such a rollforward of extraneous balances (i.e., non-balance sheet balances) does not provide additional meaningful information to the users of statutory financial statements,
2) Such rollforwards would be prohibitively resource extensive (i.e., expensive) for preparers of statutory financial statements who are not required to prepare financial statements in accordance with U.S. GAAP (i.e., mutual companies, foreign private issuers and small companies), and
3) The NAIC is ahead of the FASB by currently requiring the rollforward of balance sheet reserve balances as required in the "Analysis of Increase in Reserves During the Year" for the balance sheet account of Aggregate Reserve for Life Contracts and in "Exhibit 7 – Deposit Type Contracts" for the balance sheet account of Liability for Deposit-Type Contracts. As such, rollforwards already exist that offer insights into the changes related to balance sheet reserve balances.

Additionally, we note that the list of SSAPs for which the guidance is to be rejected should include SSAP No. 54R, *Individual and Group Accident and Health Contracts*, and SSAP No. 55, *Unpaid Claims, Losses and Loss Adjustment Expenses*, as there is guidance in these SSAPs that is applicable to some health contracts that are considered long-duration.

Should regulators decide to "tweak" the existing NAIC rollforward disclosures, after their review of the disclosures in the ASU, the NAIC should reject the ASU in totality and start a separate disclosure project in that regards. While interested parties do not believe new disclosures are necessary, such an approach would ensure any OCBOA issues do not arise with auditors (i.e., where the auditing standards require auditors to enforce US GAAP disclosures for which companies may not be able to comply).

Ref #2019-08: Reporting Deposit-Type Contracts

The Working Group exposed an agenda item with a request for comments on why GICs, or other deposit-type contracts, are reported in Exhibit 5 – Life Contracts or Exhibit 6 – Accident and Health Contract, instead of Exhibit 7 – Deposit Type Contracts. The agenda item was drafted in response to questions identified by the Financial Stability Task Force in developing liquidity disclosure changes to the 2019 life blank.

Interested parties note that generally, deposit-type contracts such as GICs and supplemental contracts are reported in Exhibit 7 – Deposit Type Contracts. However, certain contracts (which have similar characteristics to deposit-type contracts) incorporate mortality or morbidity risk components which qualify those contracts to be reported in Exhibit 5 – Life Contracts or Exhibit 6 – Accident and Health Contracts. A common example is a supplemental contract which provides for a life-contingent payout. Because the contract was life-contingent at issue, it is reported in Exhibit 5 and remains in Exhibit 5 after the death of the annuitant as remaining guaranteed payments continue to the beneficiary. Additionally, state insurance departments have the discretion to approve or require a contract to be classified as a life / A&H insurance contract.

For further clarification as to why certain contracts are reported in Exhibit 5 due to mortality or morbidity risk, we want to note that the guidance in paragraph 44 of SSAP 50 is generally what is used to infer guidance around the classification of these contracts. This paragraph includes the below definition of what is a Deposit Type Contract (i.e. Exhibit 7) [emphasis added]:

"Funding Agreements **without** well-defined class-based (e.g. age, gender) annuity purchase rates defining either specific or maximum purchase rate guarantees (see SSAP No. 15, paragraph 19, paragraph 20 of this statement and SSAP No. 52—Deposit-Type Contracts, paragraph 20.)"

While the above definition does not explicitly define where contracts with these features (i.e. well-defined class-based annuity purchase rates defining specific or maximum purchase rate guarantees) should be classified, it is clear that they should not be included in Exhibit 7. Therefore, another supportable classification is to include them within Exhibit 5 due to the mortality and morbidity risk components within these features.

Ref #2019-09: SSAP No. 101 – Q&A Updates - TCJA

Ref #2019-10: SSAP No. 101 – DTL Offset

In December 2018, interested parties submitted two comment letters and two sets of proposed revisions to update the Q&A. One comment letter and set of revisions were directed toward Federal income tax law changes enacted in December 2017 by the Tax Cuts and Jobs Act ("TCJA").[1] The second comment letter and proposed revisions were directed toward clarification of post-TCJA application of SSAP No. 101, paragraph 11.c., admittance of deferred tax assets ("DTAs"). Interested Parties had observed that varying interpretations of how the paragraph 11.c. admittance test should be applied had led to inconsistent treatment among reporting entities.

The Working Group moved two agenda items (categorized as nonsubstantive) to the active listing, and exposed revisions to the SSAP No. 101 Q&A. The two agenda items are Ref #2019-09 - *SSAP No. 101 - Q&A Updates - TCJA*, and Ref #2019-10, *SSAP No. 101 - DTL Offset*.[2] To a large extent, these exposures reflect the revisions proposed by interested parties in its December 2018 submissions; however, in some instances NAIC staff and/or interested parties' representatives had proposed modifications to interested parties original recommended revisions.

Interested Parties Comments

Ref #2019-09 includes modifications to the Q&A for TCJA tax law changes such as reduction in the corporate tax rate (and elimination of the graduated corporate tax rates), repeal of the corporate alternative minimum tax, repeal of the small life insurance company deduction, and elimination of the operating loss carryback for life insurance companies (but allowance of an unlimited carryforward period). Interested Parties agree with the Q&A revisions exposed in Ref #2019-09, and we have no further comments with respect to that exposure.

As previously noted, Ref #2019-10 is directed toward eliminating inconsistent application among reporting entities of the SSAP No. 101 paragraph 11.c. DTA admission test. Interested parties agree with the Q&A revisions exposed in Ref #2019-10, but we have one suggestion for an additional clarification in paragraph 4.13 of the Q&A, which deals specifically with the SSAP No. 101 DTA paragraph 11.c. DTA admission test. As exposed, paragraph 4.13 includes some of interested parties originally recommended revisions, plus some pre-exposure modifications made by NAIC staff and/or Interested Parties representatives.

Interested parties propose one other change to the modifications to paragraph 4.13 which we believe will further support Ref #2019-10's objective of clarification and elimination of inconsistent treatment - that being, addition of the following sentence after the first sentence in the footnote to Q&A paragraph 4.13:

> Thus, for example, if a reporting entity had considered the reversal patterns of $100 of existing DTLs in the determination of any statutory valuation allowance adjustment, it

[1] Officially, H.R. 1, An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018.

[2] Paragraph 11.c. of SSAP No. 101 provides the rules for admittance of adjusted gross DTAs that can be offset against existing gross deferred tax liabilities ("DTLs").

shall consider the reversal patterns of that same $100 of existing DTLs in the paragraph 11.c. DTA admission test but shall not be required to do further scheduling.

Ref #2019-11: SSAP No. 62R Effective Date

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 62R—Property and Casualty Reinsurance*, as detailed above, to further clarify the effective date guidance regarding the updates to SSAP No. 62R, which were adopted on November 15, 2018. The exposed guidance clarifies that it applies to contracts in effect as of Jan. 1, 2019. If a change is required to prior application, it shall be applied as a change in accounting principle.

Interested parties have no comment on this item.

Ref #2019-12: *ASU 2014-17, Business Combinations – Pushdown Accounting, a Consensus of the FASB Emerging Issues Task Force*
Ref #2019-13: Clarification of the Look-Through Approach
Ref #2019-14: Attribution of Goodwill
Ref #2019-16: *ASU 2015-08, Business Combinations – Pushdown Accounting, Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115*

The first three exposures relate to the accounting for subsidiaries under SSAP No. 97, *Investments in Subsidiary, Controlled and Affiliated Entities* (SSAP No. 97), particularly as it relates to goodwill. As such, the adoption and implementation of these three proposals will impact each other. The fourth exposure rejects ASU 2015-08 as non-applicable for statutory accounting. Interested parties have no comment on rejecting the ASU 2015-08 that removes superseded SEC guidance about when push-down accounting was required.

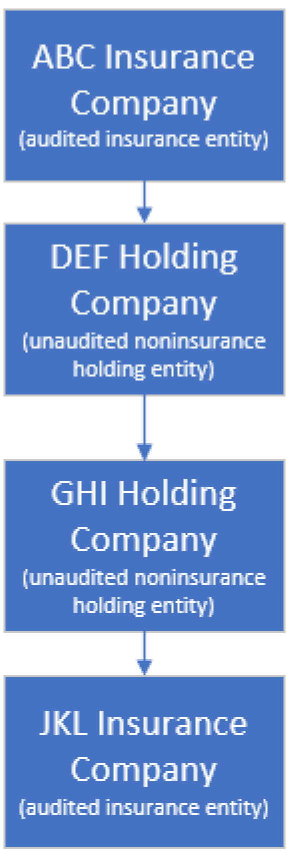
Interested parties have concerns about the proposal to reject pushdown accounting in determining the valuation of a subsidiary of an insurance entity that uses GAAP as its basis of accounting. Overall, interested parties disagree with the approach to addressing goodwill in the suite of proposals as the proposed changes would cause a significant number of insurers to change their accounting for subsidiaries and incur additional audit costs. We believe there are more direct approaches to addressing the concerns about goodwill that would be less confusing to preparers and auditors. Additionally, depending on the approach used, it may be necessary for the new guidance to be applied prospectively so that companies can make the necessary changes without having to restate previous year's valuations. We welcome the opportunity to discuss alternative approaches with staff.

Due to the complexities of applying SSAP No. 97 and the interrelationship of the three issues, we recommend that these proposals be deliberated "one-at-a-time" and in a logical sequence. We believe the logical sequence is to first address Ref #2019-12, *Business Combinations – Pushdown Accounting*, followed by Ref #2019-14, *Attribution of Goodwill*, and finally Ref #2019-13, *Clarification of a Look-Through Approach*.

- Ref #2019-12 proposes the rejection of pushdown accounting in the underlying GAAP-basis financial statements of acquired subsidiary, controlled and affiliated entities (SCAs) for purposes of statutory accounting reporting.

- The changes recommended to SSAP No. 97 in Ref #2019-12 are far-reaching, would be difficult to operationalize and costly to implement and maintain, and raise several audit questions/issues that will need to be addressed by the public accounting firms. Without knowing how widespread the issue is, it is unclear what, if any, changes should be made until additional clarity is provided around the issues and quantification of the targeted goodwill is obtained.

Interested parties believe that the spirit of the "look through" guidance in SSAP No. 97 is to avoid unnecessary audits and related audit fees by providing reporting entities the ability to admit audited SCA entities that happen to be owned by unaudited downstream noninsurance holding companies that are immaterial to the reporting entity. This concept is unaffected by a multiple holding company structure. Consider the following example.



Per SSAP No. 97 paragraph 26(b) and 26(c), Holding Company DEF and GHI do not have material GAAP assets or liabilities, the ultimate value of these companies is equal to the underlying audited statutory surplus of Insurance Company JKL. Therefore, none of the assets or liabilities subject to the GAAP audit of Holding Company DEF or GHI would be reflected in the investment in subsidiary. Thus, an audit of Holding Company DEF or GHI would be an audit of no material balances other than the assets and liabilities of JKL, which are already audited, and therefore, would be an inefficient use of policyholder surplus. Further, audits of Holding Company DEF or GHI would provide neither transparency nor additional meaningful, comparable financial information to policyholders or regulators. We do not believe requiring an audit of these immaterial noninsurance subsidiaries solely for admittance to be in the spirit of the SSAP No. 97 "look through" guidance or an efficient use of policyholder surplus.

For the reasons stated above, interested parties believe that the "double look through" approach applied to immaterial downstream noninsurance holding companies is an appropriate interpretation of SSAP No. 97 and consistent with the spirit of the guidance, which is to eliminate unnecessary costly audits that would not yield any additional assurance on investment valuation.

Interested parties recommend that the scope of the issue be identified prior to proposing any changes to SSAP No. 97. This should include the number of SCAs in which pushdown accounting is used, the amount of goodwill and other intangibles that are included in the pushdown basis, and the types of entities which have been acquired at values that materially exceeded the respective book values.

Once the scope and magnitude is identified, a decision can be made whether the targeted issue is widespread or limited to a few companies and whether there is a cost/benefit to requiring a complicated/costly approach or whether more targeted guidance would be more effective.

Once an approach is decided upon for Ref #2019-12, the next logical step would then be to address how goodwill should be attributed to legal entities in an ownership chain and finally, how the look-through approach should be applied.

Ref #2019-15EP: Editorial and Maintenance Update

The Working Group exposed editorial changes to SSAP No. 62R, SSAP No. 63, SSAP No. 86, and SSAP No. 103R.

Interested parties have no comment on this item.

Ref #2019-17: *ASU 2019-02, Improvements to Accounting for Costs of Films and License Agreements for Program Materials*

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *Appendix D—Nonapplicable GAAP* Pronouncements to reject *ASU 2019-02, Improvements to Accounting for Costs of Films and License Agreements for Program Materials* as not applicable for statutory accounting.

Interested parties have no comment on this item.

*   *   *

Thank you for considering interested parties' comments. If you have any questions in the interim, please do not hesitate to contact either one of us.

Sincerely,

D. Keith Bell   Rose Albrizio

Date: 06/03/2019

To: Mr. Jake Stultz, Senior Accounting Policy Advisor

From: Carey Brown, Executive Director, Kaiser Permanente
Ritu Shah, Technical Accounting Director, Kaiser Permanente

Re: August 2018 Exposure Draft SSAP No. 22R Leases

Dear Mr. Stultz,

We are submitting our comments on the exposure draft for SSAP No. 22R – Leases during the open comment period. We thank you for all the time you have provided us in the past in discussing our earlier feedback on this standard. We would appreciate an opportunity to discuss any questions you may have on our latest proposal described below.

We would like to propose amendments to Paragraph 16 of SSAP 22R to provide further clarity, make this practical expedient operational, and minimize GAAP to STAT differences. We believe the NAIC's primary concern is around stakeholders being able to take advantage of optionality around the treatment of nonlease components when material and not closely related to the lease. We believe that our proposal below does not compromise this risk.

First, we think the guidance can be enhanced to further emphasize the "closely related" concept by providing examples in parenthesis as shown in our proposed revisions below. This will help to provide clarity that this expedient is only intended for these items and stakeholders do not have the option of using it for other types of components not related to the lease. We then propose to change "insignificant part of lease agreement" to "not the predominant components" because often times common area maintenance (a closely related lease element) for instance can be more than insignificant (i.e. more than 10% of overall contract value) but is still not a predominant part of the lease and can be accounted for as a single lease under GAAP. We believe such situations should still be able to apply the practical expedient to keep GAAP & STAT aligned. By limiting the expedient to only nonlease components that are closely related to elements of the lease and where they are not predominant, this still prevents stakeholders from being able to arbitrarily combine nonlease related elements with lease elements and minimizes optionality.

Below are three proposed options for treatment of nonlease components in paragraph 16. Each of these are meant to accomplish the same objectives but just worded/presented in a different way. Our thought process is further described below.

Proposed Option #1

16. As a practical expedient, when nonlease components are closely related to the elements of the lease (eg. common area maintenance, utilities, labor) and are not the predominant components in a ~~an insignificant part of a~~ lease agreement, a lessee and a lessor may, as an accounting policy election by class of underlying asset, choose not to separate nonlease components from lease components and instead to account for each separate lease component and the nonlease components associated with that lease component as a single lease component. ~~The nonlease components must be closely~~

~~related to the elements of the lease to be recognized as a single lease component.~~ For lease agreements between related parties, lease and nonlease components must be separated.

Proposed Option #2

16. As a practical expedient, when nonlease components are not the predominant components in ~~an insignificant part of~~ a lease agreement, a lessee and a lessor may, as an accounting policy election by class of underlying asset, choose not to separate nonlease components from lease components and instead to account for each separate lease component and the nonlease components associated with that lease component as a single lease component. The nonlease components must be closely related to the elements of the lease to be recognized as a single lease component (eg. common area maintenance, utilities, labor). For lease agreements between related parties, lease and nonlease components must be separated.

Proposed Option #3

16. As a practical expedient, for lease contracts between unrelated parties~~when nonlease components are an insignificant part of a lease agreement~~, a lessee and a lessor may, as an accounting policy election by class of underlying asset, choose not to separate nonlease components from lease components and instead to account for each separate lease component and the nonlease components associated with that lease component as a single lease component if both of the following are met:

a) ~~.~~ The nonlease component(s) ~~must be~~are closely related to the lease component (eg. common area maintenance, utilities, labor); and,
~~a)~~b) The nonlease component(s) are not the predominant component(s) in the contract. ~~elements of the lease to be recognized as a single lease component. For lease agreements between related parties, lease and nonlease components must be separated~~

Additional Thoughts

The change we are proposing is use of the term "predominant" instead of "insignificant", which provides consistency with the term used in ASC 842 for GAAP. We feel that "insignificant" would be too strong and stakeholders would have little benefit at the end of the day from the practical expedient even being in place. Here are the considerations for Predominant vs. Insignificant:

1. Predominant
    a. The guidance within ASC 842 (lessor practical expedient) uses "predominant" so language is consistent with US GAAP
    b. There is interpretive guidance for ASC 842 that allows entities to perform more of a qualitative assessment rather than a detailed quantitative analysis to support whether

nonlease or lease components are predominant within a contract, making the expedient more operational.

c. Would allow more leases to qualify for the practical expedient, and therefore, reduce/mitigate STAT to GAAP differences.

d. If concern is that entities will design contracts to include non-lease components that are "not" related to lease components, this risk is still addressed by the closely related criterion being in place. The combination of both criteria would appear to still address concerns about undesired nonlease components being accounted for under the leasing guidance.

2. Insignificant

   a. Including such a strong limitation on the significance of non-lease components, can make this practical expedient non-operational for many entities. It can put significant operational burdens on preparers and systems to comply with the guidance. Additionally, it can result in STAT to GAAP differences.
   b. From a contract perspective under US GAAP, insignificant is typically viewed as ~10% or less. Within Real Estate contracts, common items such as utilities/common area maintenance would likely exceed 10% of total contract value. It is likely the expedient would not apply to these contracts if "insignificant" is used.

Again, we appreciate your efforts to bring consistency to accounting of leases between STAT and GAAP and stand ready to assist. The following individuals can be contacted to discuss further:

- Carey Brown at (510) 433 6718 or carey.brown@kp.org
- Ritu Shah at (510) 267 4516 or ritu.x.shah@kp.org

Thank you for your time and consideration.

Sincerely yours,

Carey Brown, Executive Director, Kaiser Permanente
Ritu Shah, Technical Accounting Director, Kaiser Permanente

Dale Bruggeman Chair of the Statutory Accounting Principles (E) Working Group

Members of the AICPA NAIC Task Force (Task Force) would like to informally request clarifications on the following exposed Statutory Accounting Principles Working Group (SAPWG) documents:

Ref: 2019-09: SSAP No. 101 - Q&A Updates - TCJA and Ref 2019-10: SSAP No. 101 - DTL Offset

The Task Force's only comment for these two exposures is to request that transition guidance be provided (for example, the guidance is to be applied as of December 31, 2019 as a change in accounting principle). We believe this is necessary as the proposed guidance may be a change in interpretation of the current guidance by companies and auditors.

Ref No. 2019-12: ASU 2014-17, Business Combinations - Pushdown Accounting, a Consensus of the FASB EITF

The Task Force believes the proposed revisions could be a significant change to current SAP and requests clarification of the following: we request that the working group clarify what is meant by "audited reconciliation" and "audited support" in the proposed new paragraph 20 of SSAP 97. Would this be similar to adjustments made to the audited U.S. GAAP carrying value for par. 8.b.ii and 8.b.iv entities? For these adjustments, there is no "audited reconciliation" included in any financial statements. An insurance entity prepares a schedule to determine the required adjustments for purposes of its carrying value of the SCA, which is subject to audit procedures in relation to the insurer's financial statements taken as a whole, but there is no reconciliation included in the audited financial statements of the SCA.

We also request that the working group clarify, for companies that receive approval from their domiciliary commissioner to continue to admit the existing goodwill that has been pushed down on or before December 31 2019, whether this goodwill is subject to amortization and the 10% of surplus limitation. In addition, we request that specific transition guidance be added for companies that do not obtain approval from their domiciliary regulator to continue to admit goodwill pushed down from acquisitions prior to January 1, 2020.

Ref No. 2019-13: Clarification of the Look-Through Approach

This Form A is classified as non-substantive, which would result in adopted revisions being effective upon adoption unless otherwise noted. The Task Force suggests the proposal include specific transition guidance.

Ref No. 2019-14 Issue: Attribution of Goodwill

The Task Force requests clarification of the method or methods that should be used to attribute goodwill to the acquired downstream entities. Different methods could include attribution based on the relative percentage of net book value, fair value, or another amount applicable to the individual entities at the acquisition date.

This Form A is also classified as non-substantive; we suggest this proposal include specific transition guidance.

We appreciate your consideration of our comments. Jean Connolly, chair of the AICPA NAIC Task Force, and I would be happy to discuss any questions.

Regards

Kim

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RE: Interested Parties Comments on Ref #2019-18: *Accounting for "Other" Derivatives*

Dear Mr. Bruggeman:

In reviewing recent the recent exposure drafts issued by the Statutory Accounting Principles (E) Working Group (the "Working Group"), interested parties noted some proposed amendments in Ref #2019-07 that were not consistent with our understanding of the intent of the changes. We offer the following comments:

Ref #2019-18: Accounting for "Other" Derivatives

This agenda item has been drafted to consider statutory accounting guidance for derivatives that are not used in hedging transactions, income generation transactions or replication (synthetic asset) transactions. This agenda item was directed with the adoption of agenda item 2018-08, Structured Notes, as it was noted that structured notes captured within scope of SSAP No. 86 – Derivatives ("SSAP No. 86"), would be unlikely to be used in the transactions with existing recognition and measurement guidance in SSAP No. 86. Agenda item 2018-08 required that structured notes, as defined, would be reported as derivatives under SSAP No. 86 on Schedule DB instead of as bonds under SSAP No. 26R – Bonds (SSAP No. 26R) on Schedule D.

Although the guidance of SSAP No. 86 is limited to the derivatives captured in the noted transactions (hedging, income generation or replication), the reporting schedule for derivatives (Schedule DB) currently includes an "other" derivative reporting category. Although this agenda item clarifies the accounting (measurement) value for these derivatives, as detailed within the proposed revisions, “other” derivatives do not qualify as admitted assets under the SSAP No. 86. Derivatives classified as “other” shall only be admitted in accordance with state investment laws that provide prescribed practices that permit admittance. These prescribed practices shall be detailed in Note 1. Derivatives reported in the “hedging-other” are derivatives subject to the “hedging” guidance in SSAP No. 86 and are not intended to be captured by this agenda item. This agenda item is strictly for the derivatives reported as “other” derivatives.

Interested parties were surprised by three aspects of this proposal:

1) The structured notes definition within SSAP No. 86 was not amended to conform to the adopted definition within SSAP No. 26R as agreed to by interested parties, NAIC staff and regulators,
2) This proposal attempts to address derivative items, beyond the scope of structured notes, which were not the impetus for this exposure, and
3) This proposal suggests that structured notes would be non-admitted assets which is inconsistent with the interested party understanding upon adoption of agenda item 2018-08.

First, interested parties have always been concerned about the unintended consequences of having to mark to market, and report as derivatives, bonds that have an embedded derivative as highlighted in the definition of structured notes. Specifically, the potential to have a derivative that is clearly minor, but nonetheless meets the structured note definition, whereby the whole bond is required to be marked to market as a derivative. Therefore, interested parties believe the definition within SSAP No. 86 (as noted in our February 15, 2019 comment letter) should be aligned with the definition in SSAP No. 26R or, maybe more appropriately, just reference the definition in SSAP No. 26R. Interested parties believe having the exact same definition in both SSAPs, will help prevent any potential confusion surrounding the scope of structured notes, which is important given the cliff effect penalty of marking them to market as derivatives. This concern takes on further added importance as the SVO is currently exposing a definition of structured notes to be included in their P&P Manual, based upon the definition currently proposed for SSAP No. 86. Having two, or possibly three, different definitions (however trivial the difference may appear to be) serves no purpose and has potential unintended consequences. All three definitions should be the same (exactly) to help eliminate any further potential confusion on a very technical area.

Second, the exposure attempts to address structured notes within the broader context of a new category of “other” derivatives. It is quite possible (and likely, given the exposure draft) that interested parties, NAIC staff and/or regulators have differing opinions on the treatment of structured notes versus “other” derivatives. This is (in part) related to the interested party concern, expressed in our February 15, 2019 comment letter of the items needing to be addressed to make the structured notes proposal viable. More specifically, that structured notes need to be addressed holistically and not on a piecemeal basis. The remainder of the interested party comments will address structured notes, within the context of SSAP No. 86. Interested parties believe that if NAIC staff want to address “other” derivatives that is best addressed separately.

Third, and closely related to our second concern expressed above, interested parties do not support the proposed language in SSAP No. 86 stating that structured notes are non-admitted assets. This was not understood to be part of the proposal, for which interested parties agreed with the adoption of agenda item 2018-08. Further, this is a substantive change and significantly risks, because statutory accounting does not bifurcate derivatives, the non-admission of potentially billions of dollars of bonds with minor embedded derivatives that technically do (or could in the future) meet the definition of structured notes but are not in substance similar to the examples NAIC staff included in the Ref #2018-08 proposal. Therefore, the interested party comments below reflect the incorporation of structured notes (only) within SSAP No. 86 under the assumption they are admitted assets. After reviewing these suggested changes, should NAIC staff or regulators continue to believe structured notes should be non-admitted, interested parties request that agenda item 2018-08 be reopened so minor embedded derivates can be addressed given evolving markets and the real potential for future unintended consequences and/or disruption of capital markets. Interested parties' suggested amendments to the NAIC staff proposed changes are shown below as <u>additions</u> or ~~deletions~~.

<u>Proposed Revisions to SSAP No. 86—Derivatives:</u>

3. This statement addresses the recognition of derivatives and measurement of derivatives used in <u>(or that are)</u>:

a. Hedging transactions;

b. Income generation transactions; ~~and~~

c. Replication (synthetic asset) transactions~~.~~; and

d. Structured notes. ~~Other Derivatives – (Derivatives that are not used in hedging, income generation or replication transactions.)~~

Impairment

17. This statement adopts the impairment guidelines established by SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5R) for the underlying financial assets or liabilities.

Recognition of Derivatives

18. Derivative instruments represent rights or obligations that meet the definitions of assets (SSAP No. 4—Assets and Nonadmitted Assets) or liabilities (SSAP No. 5R) and shall be reported in financial statements. In addition, derivative instruments also meet the definition of financial instruments as defined in SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures (SSAP No. 27). Should the cost basis of the derivative instrument be undefined (i.e., no premium is paid), the instrument shall be disclosed in accordance with paragraphs 44-48 of SSAP No. 100R—Fair Value (SSAP No. 100R). Derivative instruments ~~used in hedging, income generation or replication (synthetic asset) transactions shall be recognized and measured in~~

~~accordance with the specific provisions within this statement and~~ are admitted assets to the extent they conform to the requirements of this statement.

19. ~~Derivative instruments that are not used in hedging, income generation or replication (synthetic asset) transactions shall be considered "Other" derivatives. These derivatives~~ Structured notes shall be accounted for at fair value and the changes in fair value shall be recorded as unrealized gains or losses. These derivatives ~~do not~~ qualify as admitted assets.

Derivatives Used in Hedging Transactions

20. Derivative instruments used in hedging transactions that meet the criteria of a highly effective hedge shall be considered an effective hedge and are permitted to be valued and reported in a manner that is consistent with the hedged asset or liability (referred to as hedge accounting). For instance, assume an entity has a financial instrument on which it is currently receiving income at a variable rate but wishes to receive income at a fixed rate and thus enters into a swap agreement to exchange the cash flows. If the transaction qualifies as an effective hedge and a financial instrument on a statutory basis is valued and reported at amortized cost, then the swap would also be valued and reported at amortized cost. Derivative instruments used in hedging transactions that do not meet or no longer meet the criteria of an effective hedge, or that meet the required criteria but the entity has chosen not to apply hedge accounting, shall be accounted for at fair value and the changes in the fair value shall be recorded as unrealized gains or unrealized losses (referred to as fair value accounting).

Derivatives Used in Income Generation Transactions

General

44. Income generation transactions are defined as derivatives written or sold to generate additional income or return to the reporting entity. They include covered options, caps, and floors (e.g., a reporting entity writes an equity call option on stock that it already owns).

Derivatives Used in Replication (Synthetic Asset) Transactions

54. Replication (Synthetic Asset) transaction means a derivative transaction entered into in conjunction with other investments in order to reproduce the investment characteristics of otherwise permissible investments. A derivative transaction entered into by an insurer as a hedging or income generation transaction shall not be considered a replication (synthetic asset) transaction.

Lastly, also as noted in our February 15, 2019 comment letter, interested parties believe future referrals to the Blanks and Investment RBC Working Groups will be necessary to establish the appropriate classification for these derivatives as well as any related impacts to AVR. As agenda item 2018-08 is currently perceived as a non-substantive change, which is effective immediately upon adoption, these changes will need to occur prior to year-end. Otherwise, agenda item 2018-08 will need to be changed to substantive with an appropriate effective date. Interested parties believe getting this done right is more important than getting this done quickly. Interested parties further note that a separate line item for structured notes within the Schedule DB reporting schedule for derivatives would be beneficial so it is clear to regulators the number and magnitude of structured notes, if any, which take on very different risk characteristics amongst bonds (structured notes), due to varying significance of such embedded derivatives, as well as other derivatives that are not structured notes.

* * *

Thank you for considering interested parties' comments. If you have any questions in the interim, please do not hesitate to contact us.

Sincerely,

D. Keith Bell Rose Albrizio

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