

Draft Pending Adoption

Draft: 8/28/23

Statutory Accounting Principles (E) Working Group
Seattle, Washington
August 13, 2023

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met in Seattle, WA, Aug. 13, 2023. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Sheila Travis (AL); Kim Hudson (CA); William Arfanis (CT); Rylynn Brown (DE); Cindy Andersen (IL); Stewart Guerin and Melissa Gibson (LA); Judy Weaver and Steve Mayhew (MI); Doug Bartlett and Pat Gosselin (NH); Bob Kasinow (NY); Diana Sherman (PA); Jamie Walker and Amy Garcia (TX); David Smith (VA); and Amy Malm (WI).

1. Adopted its July 5, June 28, May 16, April 12, April 10, and Spring National Meeting Minutes

The Working Group conducted an e-vote that concluded July 5 to expose revisions to *Interpretation (INT) 23-01T: Net Negative (Disallowed) Interest Maintenance Reserve*. During its June 28 meeting, the Working Group took the following action: 1) heard comments and received Working Group direction on revisions to INT 23-01T. During its May 16 meeting, the Working Group took the following action: 1) heard comments and considered action on three items exposed during the Spring National Meeting, one of which has corresponding 2023 year-end blanks reporting revisions; and 2) exposed three agenda items. The Working Group conducted an e-vote that concluded April 12 to expose revisions to *INT 22-02: Third Quarter 2022 through Second Quarter 2023 Reporting of the Inflation Reduction Act - Corporate Alternative Minimum Tax*. The Working Group also conducted an e-vote that concluded April 10 to expose tentative INT 23-01.

Additionally, the Working Group met Aug. 8 in regulator-to-regulator session, pursuant to paragraph 3 (specific companies, entities or individuals) and paragraph 6 (consultations with NAIC staff related to NAIC technical guidance) of the NAIC Policy Statement on Open Meetings, to discuss the Summer National Meeting agendas.

Walker made a motion, seconded by Travis, to adopt the Working Group's July 5, (Attachment One-A), June 28 (Attachment One-B), May 16 (Attachment One-C), April 12 (Attachment One-D), April 10 (Attachment One-E) and March 22 (*see NAIC Proceedings – Spring 2023, Accounting Practices and Procedures (E) Task Force*) minutes. The motion passed unanimously.

2. Adopted Non-Contested Positions

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

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

A. Agenda Item 2023-02

Bruggeman directed the Working Group to agenda item 2023-02: Statement of Statutory Accounting Principles (SSAP) No. 43R – CLO Financial Modeling (Attachment One-G). Wil Oden (NAIC) stated that during the Spring National Meeting, the Working Group exposed statutory accounting principle (SAP) clarifications to *SSAP No.*

Draft Pending Adoption

43R—Loan-backed and Structured Securities to incorporate changes to add collateralized loan obligations (CLOs) to the financial modeling guidance and to clarify that CLOs are not included as legacy securities.

B. Agenda Item 2023-05

Bruggeman directed the Working Group to agenda item 2023-05: ASU 2022-06, Reference Rate Reform (Topic 848), Deferral of the Sunset Date of Topic 848 (Attachment One-H). Jake Stultz (NAIC) stated that the Financial Accounting Standards Board (FASB) issued *Accounting Standards Update (ASU) 2022-06, Reference Rate Reform (Topic 848), Deferral of the Sunset Date of Topic 848* to extend the sunset date of the reference rate reform guidance that was included in *ASU 2020-04, Reference Rate Reform (Topic 848) Facilitation of the Effects of Reference Rate Reform on Financial Reporting* and *ASU 2021-01, Reference Rate Reform (Topic 848), Scope*. As background, reference rate reform refers to the transition away from referencing the London Interbank Offered Rate (LIBOR) and other interbank offered rates (IBORs), and moving toward alternative reference rates that are more observable or transaction-based. To address ASU 2020-04, the Working Group issued *INT 20-01: Reference Rate Reform*, and this INT was then revised to incorporate guidance from ASU 2021-01 (Attachment One-I). Stultz recommended adoption of the exposed revisions, which revise INT 20-01 to include the updated sunset date of Dec. 31, 2024, from ASU 2022-06.

C. Agenda Item 2023-07

Bruggeman directed the Working Group to agenda item 2023-07: *ASU 2019-08, Codification Improvements to Topic 718 and Topic 606* (Attachment One-J). Oden stated that in November 2019, the FASB issued *ASU 2019-08 Compensation, Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606): Codification Improvements—Share-Based Consideration Payable to a Customer*, which includes amendments to Topics 718 and 606. The changes to Topic 718 include share-based payment transactions for acquiring goods and services from non-employees and superseded guidance in Subtopic 505-50, Equity—Equity-Based Payments to Non-Employees. The changes to Topic 606 expand the scope to include share-based payment awards granted to a customer in conjunction with selling goods or services. The exposed revisions were as follows: 1) revisions to *SSAP No. 104R—Share-Based Payments* to adopt ASU 2019-08, with modification, for statutory accounting; 2) revisions to *SSAP No. 95—Nonmonetary Transactions* to adopt ASU 2019-08, with modification by updating previously adopted U.S. generally accepted accounting principles (GAAP) guidance; and 3) revisions to *SSAP No. 47—Uninsured Plans*, which reject Topic 606 guidance in ASU 2019-08. For statutory accounting assessments, prior U.S. GAAP guidance related to share-based payments has been predominantly adopted with modification in SSAP No. 104R.

D. Agenda Item 2023-08

Bruggeman directed the Working Group to agenda item 2023-08: *ASU 2019-07, Codification Updates to SEC Sections* (Attachment One-K). Oden stated that the FASB issued *ASU 2019-07, Codification Updates to SEC Sections: Amendments to SEC Paragraphs Pursuant to SEC Final Rule Releases No. 33-10532, Disclosure Update and Simplification, and Nos. 33-10231 and 33-10442, Investment Company Reporting Modernization, and Miscellaneous Updates*, which primarily affects the codifications of Financial Services—Depository and Lending (Topic 942), Financial Services—Insurance (Topic 944), and Financial Services—Investment Companies (Topic 946). The update amends and supersedes certain U.S. Securities and Exchange Commission (SEC) sections in Topic 942, Topic 944, and Topic 946 to align codification guidance with SEC Releases No. 33-10532, 33-10231, and 33-10442. These SEC releases amend a wide range of disclosure requirements that were determined to be redundant, duplicative, overlapping, outdated, or superseded by other relevant literature. Additionally, the SEC releases include several miscellaneous updates and corrections intended to clarify SEC guidance. Historically, SEC guidance

Draft Pending Adoption

from ASUs has been rejected as not applicable for statutory accounting in *Appendix D—Nonapplicable GAAP Pronouncements*.

E. Agenda Item 2023-09

Bruggeman directed the Working Group to agenda item 2023-09: ASU 2020-09—Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470) (Attachment One-L). Oden stated that the FASB issued *ASU 2020-09, Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)*, which affects the codification in debt (Topic 470). The update amends and supersedes certain SEC sections in Topic 470 to align codification guidance with SEC Release No. 33-10762. No. 33-10762 amends the SEC financial disclosure requirements for guarantors and issuers of guaranteed securities registered or being registered, and issuers' affiliates whose securities collateralize securities registered or being registered in Regulation S-X to improve those requirements for both investors and registrants. The changes are intended to provide investors with material information given the specific facts and circumstances, make the disclosures easier to understand, and reduce the costs and burdens to registrants. Oden recommended adoption of the exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2020-09, Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)* as not applicable to statutory accounting. This action is consistent with previous Working Group actions regarding similar SEC guidance.

F. Agenda Item 2023-10

Bruggeman directed the Working Group to agenda item 2023-10: *ASU 2022-05, Transition for Sold Contracts* (Attachment One-M). Oden stated that this agenda item has been drafted to consider *ASU 2022-05, Transition for Sold Contracts* for statutory accounting. The FASB issued the ASU in December 2022 to amend specific sections of *ASU 2018-12, Targeted Improvements for Long-Durations Contracts (LDTI)*. The amendments made by ASU 2022-05 are intended to reduce implementation costs and complexity associated with the adoption of LDTI for contracts that have been derecognized in accordance with the ASU before the LDTI effective date. The amendments in ASU 2022-05 amend the LDTI transition guidance to allow an insurance entity to make an accounting policy election on a transaction-by-transaction basis. An insurance entity may elect to exclude contracts that meet certain criteria from applying the amendments in the LDTI. Oden recommended adoption of the exposed revisions to reject ASU 2022-05 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*.

G. Agenda Item 2023-13

Bruggeman directed the Working Group to agenda item 2023-13: PIK Interest Disclosure Clarification (Attachment One-N). Oden stated that this agenda item has been developed to further clarify, and incorporate a practical expedient, to the paid-in-kind (PIK) interest aggregate disclosure adopted in *SSAP No. 34—Investment Income Due and Accrued*. In response to questions received on how paydowns or disposals would affect PIK interest included in the cumulative balance, it was noted that clarifying guidance would assist with consistent application. Furthermore, without clarification, it was identified that companies and investment software vendors may interpret the need to detail the retrospective PIK allocations and paydowns or disposals as evidence for the resulting amount. The previously adopted disclosure in *SSAP No. 34* is not intended to change, but the proposed clarification and practical expedient guidance would also be included in the annual statement instructions. This agenda item will be used to subsequently provide a memo to blanks for year-end 2023 application and to formally revise the instructions for 2024.

Draft Pending Adoption

3. Reviewed Comments on Exposed Items

A. Agenda Item 2019-21

Bruggeman directed the Working Group to agenda item 2019-21: Principles-Based Bond Definition. Stultz stated that during the Spring National Meeting, the Working Group exposed revisions that reflect most of the interested parties' comments to the statutory accounting guidance that details the bond definition and the accounting and reporting guidance for bonds, including asset-backed securities (ABS), debt securities that do not qualify as bonds, and other SSAPs that were also affected or that referenced the prior bond guidance. The revisions exposed for comment included documents related to *SSAP No. 26R—Bonds*, *SSAP No. 43R—Loan-Backed and Structured Securities*, *SSAP No. 21R—Other Admitted Assets*, and other SSAPs that were affected. Stultz stated that in addition to the documents proposing SAP revisions, during the Spring National Meeting the Working Group exposed a proposal to revise the reporting lines on Schedule BA to include debt securities that do not qualify as bonds, as well as to consolidate existing reporting lines.

Stultz noted that interested parties had no comment on the last exposed revisions to SSAP No. 26R, SSAP No. 43R, and the other SSAPs, and he recommend that those be adopted.

Stultz noted that interested parties provided comments on the exposed revisions to SSAP No. 21R. As a result, NAIC staff had further revised the SSAP No. 21R, and Stultz recommended that it be re-exposed for public comment, along with the bond project issue paper that details the direction and discussions in developing this project.

Finally, Stultz also recommended that the Working Group sponsor a blanks proposal to revise Schedule BA for debt securities that do not qualify as bonds, with formal notice to the Valuation of Securities (E) Task Force and the Capital Adequacy (E) Task Force.

Mike Reis (Northwestern Mutual), representing interested parties, stated that interested parties support adoption of the revisions SSAP No. 26R, SSAP No. 43R, and the other affected SSAPs.

Walker made a motion, seconded by Clark, to adopt the bond definition revisions in SSAP No. 26R (Attachment One-O) and SSAP No. 43R (Attachment One-P) and the other impacted SSAPs document (Attachment One-Q), with an effective date of Jan. 1, 2025. The motion passed unanimously.

Clark made a motion, seconded by Hudson, to expose the revised SSAP No. 21R and the bond project issue paper as recommended by NAIC staff. The motion passed unanimously.

Walker made a motion, seconded by Weaver, for the Working Group to sponsor a blanks proposal to revise Schedule BA in accordance with the bond project for debt securities that do not qualify as bonds and to provide notice of the actions to the Valuation of Securities (E) Task Force and to the Capital Adequacy (E) Task Force. The motion passed unanimously.

B. Agenda Item 2022-01

Bruggeman directed the Working Group to agenda item 2022-01: Conceptual Framework – Updates. Marcotte stated that during the Spring National Meeting, the Working Group exposed additional revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets* and *Issue Paper No. 168—Updates to the Definition of a Liability* related to the definition change of a liability. The revisions incorporate the definition of a liability

Draft Pending Adoption

from FASB *Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 7, Presentation*, and *Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which updates the definition of an asset and of a liability. For U.S. GAAP, the FASB Conceptual statements definitions are not authoritative, but rather are concepts to consider when developing and applying guidance.

Marcotte stated that the Spring National Meeting exposure also included revisions to add an additional footnote to the definition of a liability in SSAP No. 5R, which defers to more topic-specific contradictory guidance in an SSAP, revises the relevant literature section of SSAP No. 5R to note the modification, and the additional exposure action in the issue paper. These clarifications were because of the authoritative treatment that statutory accounting provides to the definition of a liability SSAP No. 5R. The FASB basis for conclusions noted that some existing authoritative FASB literature regarding liabilities is inconsistent with the updates to Concepts Statement No. 8. Therefore, a modification regarding topic-specific liabilities guidance was incorporated to address variations from the definition of a liability.

Hudson made a motion, seconded by Weaver, to adopt the exposed revisions to SSAP No. 5R (Attachment One-R) and *Issue Paper No. 168—Updates to the Definition of a Liability* (Attachment One-S). The motion passed unanimously.

C. Agenda Item 2022-11

Bruggeman directed the Working Group to agenda item 2022-11: Collateral for Loans. Marcotte stated that during the Spring National Meeting, the Working Group re-exposed revisions to SSAP No. 21R to clarify that invested assets pledged as collateral for admitted collateral loans must qualify as admitted invested assets. She stated that interested parties support the proposed changes but that the Working Group also received two comment letters from Security Benefit Life Insurance Company (SBL) that opposed the changes, noting that in some cases the fair value of the collateral of these types of investments was higher than audited book value. Marcotte stated that the second comment letter from SBL was asking for an accounting policy election to use fair value. She stated that normally collateral is measured at fair value. However, when this issue was initially brought to the Working Group, one of the concerns was that using Level 3 fair values for a related party loan could essentially admit a greater amount than if the assets were directly held.

Weaver stated that optionality is not consistent with the general practice of statutory accounting, noting that there had been some recent receiverships and exam reports with significant comments regarding this type of investment.

Smith agreed with Weaver and stated that the proposed fair value election would be left to the discretion of the commissioner, which would lead to inconsistencies between states.

Caleb Brainerd (SBL) stated that SBL supports the clarification that collateral loan secured by *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* investments require audits of the underlying collateral to be admissible assets under statutory accounting. He stated that the basis used to test the sufficiency of collateral for these types of collateral loans is a substantive change and recommended that the Working Group reconsider the issue prior to adopting this exposure. Specifically, SBL believes fair value is the most appropriate basis for determining the sufficiency of collateral. Fair value is the measure that reflects the value of assets that would be available to support policyholder liabilities in the event of foreclosure on collateral loans. Brainerd stated that fair value is also the basis upon which insurers have historically, and currently underwritten, collateral loans and aligns with covenants entered into

Draft Pending Adoption

between the insurer and the borrowers within the corresponding loan agreements. Finally, continuing to use fair value will retain consistency across all collateral loans under statutory accounting and with the tests used for other types of collateralized financial instruments. He asked the Working Group to extend the exposure period to Sept. 12 to allow industry and the Working Group to further consider whether fair value should be retained as the basis for testing the sufficiency of collateral for collateral loans.

Bruggeman asked if the audited value of SSAP No. 48 and SSAP No. 97 entities which are pledged as such collateral approximates fair value in instances when the collateral was from investment entities. He noted that in his understanding, the audits of the pledged collateral from non-investment type entities, such as operating entities, may result in audited value that might not be a good proxy for fair value. That is, for such entities, the audited book value does not approximate fair value because many of the underlying assets are not reported as fair value.

Brainerd stated that in most instances, the SSAP No. 48 and SSAP No. 97 underlying collateral investments would likely be from entities that are considered investment companies. He noted that for investment entities, net asset value (NAV) is calculated, which approximates fair value. As such, audited equity and fair value of investment companies would be similar or the same. However, for some of the SSAP No. 48 and SSAP No. 97 investments that are not considered investment companies, their assets are not held at fair value. He noted that the investment company guidance is complex. As a result, the book value is often significantly lower than the fair value for non-investment entities. He stated that using book value could result in non-admitting loans that are in good standing that have been underwritten on the fair value of the collateral basis. In cases where collateral is not an investment company, SBL obtains independent fair value calculations or independent reviews of the fair value calculations, which are also subject to audit.

Bruggeman questioned whether a distinction needs to be made between affiliated and non-affiliated investments. He noted that the Working Group choice today was whether to adopt what was exposed or extend the exposure until after the Sept. 12 deadline. Additionally, he clarified that the question is whether non-investment companies should be allowed to use audits and measure the collateral at fair value instead of book value.

Clark stated that he agreed with the prior comments that there should not be optionality. He questioned what additional information should be provided if the decision-making process was extended. He asked if the rest of industry was willing to provide input.

Andrew Morse (Global Atlantic), representing interested parties, noted support for the current exposed guidance, but he stated that given the comments that fair value might be a better measurement for asset collateral adequacy, interested parties as a group feel that there are good arguments for using either the fair value measurement or the U.S. GAAP equity measurement. He stated that interested parties would support exposure until Sept. 12.

Bruggeman stated that for the non-investment entities, there would need to be more support for obtaining fair value. He noted that this agenda item originated because of a lack of support for the valuation of collateral, especially for level three fair values. Clark stated that he did not see the harm in allowing additional time for industry to build consensus on the issue.

Malm stated that as part of the extended comment period, industry should provide not just a consensus view, but if the consensus view is to use fair value, then also provide language around documentation and expectations of the valuations at fair value. She also requested that interested parties' comments also include details on the regulatory arbitrage related to going from book value to fair value, as well as the risk-based capital (RBC) impact.

Draft Pending Adoption

Morse stated that the asset in question is a collateral loan, which has a value as a loan. That value does not change based on the underlying collateral unless part of the asset is nonadmitted. He stated that the asset itself is not fluctuating regularly based on the valuation of the collateral; it is typically carried at cost or amortized cost. He stated that the proposed revisions are just a check to see if there is sufficient collateral to support the collateral loan.

The Working Group noted no objections to re-exposing this agenda item until Sept. 12 to allow industry the opportunity to provide support for using fair value measurement.

D. Agenda Item 2022-12

Bruggeman directed the Working Group to agenda item 2022-12: Review of INT 03-02: Modifications to an Existing Intercompany Pooling Arrangement. Marcotte stated that on March 22, the Working Group re-exposed the intent to nullify INT 03-02, effective Dec. 31, 2023. The nullification is proposed because INT 03-02 is inconsistent with *SSAP No. 25—Affiliates and Other Related Parties* guidance regarding economic and non-economic transactions between related parties. Treatment of transfers of assets between affiliates should be consistent for all intercompany transactions, and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions. Marcotte stated that this agenda item was re-exposed to allow more time for comments. She recommended deferral of this agenda item to allow more time to review interested parties' comments and have further discussions with industry.

Hudson expressed support for the deferral recommendation.

Keith Bell (The Travelers Companies), representing interested parties, noted support for deferral and that he has started work on examples of when intercompany plan agreements would be modified. He stated that if INT 03-02 was nullified and the assets were changed to fair value, there would be a significant impact. He noted that changing interest rate environments could affect the amounts transferred. He stated that Travelers will provide a specific example to show the Working Group the mechanics of how it works.

Bruggeman requested that interested parties include examples to break out the differences between amending a pooling arrangement for existing members versus adding a company that was recently acquired and added to the pool. He stated that there are some definite distinctions between those situations.

The Working Group members had no objections to deferring action and re-exposing this item.

E. Agenda Item 2022-14

Bruggeman directed the Working Group to agenda item 2022-14: New Market Tax Credits. Oden stated that on May 16, the Working Group exposed revisions to *SSAP No. 93—Low-Income Housing Tax Credit Property Investments* and *SSAP No. 94R—Transferable and Non-Transferable State Tax Credits*.

Bruggeman stated that this agenda item was drafted in response to the federal Inflation Reduction Act and the subsequent issuance of ASU 2023-02, which amended U.S. GAAP guidance on the application of the proportional amortization method for income tax equity investments. Oden stated that since the project was started, its scope has been expanded in response to comments received. *SSAP No. 93* is proposed to include all qualifying tax credit investments irrespective of structure or tax credit program, and *SSAP No. 94R* is proposed to include all purchased and certain allocated state and federal tax credits. He stated that on June 30, the Working Group received comments from interested parties on the May 16 exposure drafts. Oden stated that the comments were included

Draft Pending Adoption

in the hearing agenda for exposure in the Summer National Meeting, and staff responses were included in the agenda item. Oden provided a summary of the comments received and the proposed recommendations. He recommended the Working Group expose the revisions to SSAP No. 93 and SSAP No. 94R and direct staff to begin working with industry on revisions to the annual statement Schedule BA reporting lines, as well as how those reporting lines flow through to the asset valuation reserve.

Angelica Sanchez (New York Life), representing interested parties, commented that they agree with what has been proposed and reiterated the need for uniformity in accounting and reporting for tax credit investments and other types of tax credit certificates. She stated they also agree that the proportional amortization method is the right accounting to follow for investments where earnings are returned primarily through tax credits. She stated they appreciate the Working Group incorporating some of the interested parties' comments and providing such detailed explanations of issues where they did not necessarily agree with industry. She stated that interested parties agree with most of the changes made. Sanchez stated that there are two main items on which they will focus. First is that they did not intend to confuse things about referring to the retrospective accounting under U.S. GAAP. She stated that they will continue to work to obtain consensus with both industry and the Working Group on what makes the most sense for adoption and what the transition requirements should be. Second, currently all low-income housing tax credit investments are reported in a dedicated section on Schedule BA that allows them to have specific RBC charges that are different from most other investments on Schedule BA. She stated that interested parties recommend that the same should happen for any other type of tax credit investment that is within the scope of SSAP No. 93 since those investments tend to be very high credit quality investments.

Walker made a motion, seconded by Hudson, to direct NAIC staff to expose the additional revisions and to work with the Blanks (E) Working Group on drafting proposed revisions for Schedule BA. The motion passed unanimously.

F. Agenda Item 2022-19

Bruggeman directed the Working Group to agenda item 2022-19: Negative IMR (Attachment One-T). Marcotte stated this agenda item has been developed to discuss the interest maintenance reserve (IMR) within statutory accounting, specifically the current guidance for the nonadmittance of disallowed negative IMR. Although the statutory accounting guidance has been in place for several years, the rising interest rate environment has created an increased likelihood for reporting entities to move to a negative IMR position. Discussion of this topic began after receipt of an American Council of Life Insurers (ACLI) comment letter dated Oct. 31, 2022. Marcotte stated that since the receipt of the ACLI letter, the Working Group has discussed this issue and directed various actions. Most recently, on June 28, 2023, the Working Group met to hear comments on *INT 23-01: Net Negative (Disallowed) Interest Maintenance Reserve*, which was exposed to permit limited admittance of net negative (disallowed) IMR. As a result of that meeting, the Working Group directed NAIC staff to incorporate several revisions to the proposed INT 23-01. The revised INT was exposed via e-vote on July 5 for a shortened comment period ending July 21. Marcotte noted that interested parties provided three editorial revisions to the most recent exposure that were included in the meeting materials.

Marcotte recommended adoption of the exposed INT 23-01 with the editorial revisions noted. She stated that INT 23-01 would be automatically nullified on Jan. 1, 2026. NAIC staff would also provide the Blanks (E) Working Group with a disclosure memorandum for posting on its website. Marcotte stated that NAIC staff recommend the Working Group continue to work on a long-term solution. She stated that the ACLI suggested forming an ad hoc technical group, which would include members from the Working Group, the Life Actuarial (A) Task Force, industry, and the American Academy of Actuaries (Academy) as part of the long-term solution. She stated that

Draft Pending Adoption

because INT 23-01 creates overrides of existing statutory accounting and annual statement instructions, the policy statement would require a two-thirds super majority vote of the Working Group present and voting to adopt.

Reis thanked state insurance regulators for working on an interim solution to not disincentivize prudent investment or risk management activity until the longer-term solution can be finalized. He said interested parties look forward to working with the Working Group or an ad hoc group. He stated that interested parties are supportive of the Life Actuarial (A) Task Force and the Academy being part of that group.

Bruggeman stated that this interpretation does not place any key reliance on asset adequacy testing. The asset adequacy testing will still use the interest maintenance reserve (IMR) as its natural process. He noted that, the larger the admitted asset within the asset adequacy testing, the greater the chance of an asset adequacy additional reserve requirement. He stated that the Working Group is not placing primary reliance on asset adequacy testing (AAT).

Hudson made a motion, seconded by Malm, to adopt *INT 23-01: Net Negative (Disallowed) Interest Maintenance Reserve*, reflecting the editorial revisions to the recent exposure discussed during the meeting (Attachment One-U). With this motion, the Working Group also agreed to form an ad hoc technical group, which would continue to work on this topic. The motion passed unanimously.

G. Agenda Item 2023-01

Bruggeman directed the Working Group to agenda item 2023-01: Review Annual Statement Instructions for Accounting Guidance. Stultz stated that this agenda item was developed to establish a project to review the annual and quarterly statement instructions to ensure that all accounting guidance is primarily reflected within the SSAPs. The focus of this project is to ensure that the annual or quarterly statement instructions are not the primary source of statutory accounting guidance. This agenda item and project was proposed due to limited situations in which the annual statement instructions have been identified as containing more detailed accounting guidance than the SSAPs.

Bruggeman directed NAIC staff to continue with this project.

H. Agenda Item 2023-04

Bruggeman directed the Working Group to agenda item 2023-04: Corporate Alternative Minimum Tax Guidance. Marcotte stated that this agenda item is to provide guidance regarding the corporate alternative minimum tax (CAMT) for year-end 2023 and after. Interested parties of the Working Group have submitted comments and a draft interpretation, which is included with the comment letters.

Marcotte provided a summary of the CAMT that is in effect for tax years beginning after 2022, noting that the CAMT is very different from the prior alternative minimum tax. She noted that the requirement to calculate the CAMT only applies to corporations on a tax-controlled basis with an average adjusted book income in excess of \$1 billion on average for the prior three years (with a \$100 million threshold for certain foreign-owned entities).

Marcotte stated that because the CAMT will only apply to a limited number of reporting entities, *INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax* had been developed separately from *SSAP No. 101 – Income Taxes*. She noted that INT 23-03 was organized to provide guidance for: 1) non-applicable reporting entities, which do not have to do the calculation; 2) applicable reporting entities, which must do the calculation

Draft Pending Adoption

to determine the tax; and 3) applicable reporting entities with tax sharing agreements that exclude the entities from having to pay the CAMT.

Marcotte stated that the proposed INT 23-03 follows many of the principles in SSAP No. 101. For example, the consideration of the statutory valuation allowance assessment for the CAMT is determined on a group basis, and the statutory valuation allowance for other non-CAMT deferred tax assets (DTAs) is computed on a separate entity basis. She stated that INT 23-03 uses the applicable realization threshold limitations tables in SSAP No. 101, paragraph 11b. For example, most reporting entities will be above the 300% ex DTA RBC threshold in the tables and will admit CAMT credits in the admittance calculation that can be used within three years and up to 15% of statutory capital and surplus as adjusted in the SSAP No. 101 admissibility calculation. Marcotte stated that one of the exceptions to SSAP No. 101 that was proposed is to not require such entities (three-year/15%) to have to do the “with and without” calculation. She noted that the proposed guidance relies on tax allocation agreements for treatment of the CAMT and requires disclosures.

Marcotte highlighted that proposed transition guidance, which would allow reporting reliance on unapproved filed tax sharing agreements at year-end with domiciliary department of insurance consent, was not as specific as requested by industry because of *Insurance Holding Company System Regulatory Act* (Model #440) concerns. She noted that the transition guidance is focused on the subsequent events reporting exceptions. She noted that the meeting materials contained an updated attachment that tracked minor edits to the INT 23-03 since the initial materials posting.

Marcotte recommended exposure of INT 23-03 after the Working Group provides direction regarding paragraph 11.c. of SSAP No. 101. She stated that the third step in the SSAP No. 101 admissibility test admits DTAs to the extent of deferred tax liabilities (DTLs) if the DTAs can be offset on a tax return; this requires consideration of tax character. She stated that Working Group direction was requested on which version of paragraph 34 in the INT 23-03 discussion draft to include in the exposure. The first version would follow SSAP No. 101, paragraph 11.c. and admit CAMT credits to the extent of offsetting DTLs. The second version, which is a departure from SSAP No. 101, would not allow the admission of any CAMT credits under SSAP No. 101, paragraph 11.c.

Marcotte noted that Working Group direction was requested because although the CAMT credit does not expire, it has additional contingencies that make the use of the credit more questionable. The CAMT credit can only be used for non CAMT tax liabilities that are greater than the CAMT tax liability. She also noted that that if the tax-controlled group is a CAMT payor, the CAMT credit cannot be used. The CAMT is a credit, like a net operating loss carry forward, which does not have a reversal pattern. Instead, the entity must be eligible to use the CAMT credit. She also noted that while having more DTLs reverse increases the likelihood that the regular taxable income will exceed the CAMT liability, the result is not guaranteed.

Bruggeman stated that much of the INT 23-03 follows a general pattern of what is already in SSAP No. 101 with some subtle differences. He stated that he prefers to continue to follow the general pattern of SSAP No. 101, including allowing DTL offset in SSAP No. 101, paragraph 11.c. He stated that this avoids some misinterpretation by companies and auditors by continuing a pattern that has already been in place.

Hudson expressed support for the use of language consistent with SSAP No. 101, paragraph 11c. He stated that as the Working Group receives comments, it can evaluate them. Clark, Walker and Sherman also stated support following SSAP No. 101, paragraph 11.c.

Aimee Hoke (Nationwide), representing interested parties, stated that CAMT is a unique accounting consideration as the tax is consolidated in nature and applies an applicability test. She stated that industry supports the position

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that the CAMT credits should be admitted against deferred tax losses under SSAP No. 101, paragraph 11.c. She stated that the CAMT credit operates in the same way as the prior alternative minimum tax (AMT) that was in place before 2018. The AMT DTAs were allowed to be used on the tax return and admitted against DTLs for that prior AMT. She stated that CAMT DTAs are no different from the other DTAs. They represent a future tax benefit. The premise of admitting DTAs against DTLs rests on the fact that DTLs will create future taxable income. In the case of CAMT DTAs, regular tax must exceed CAMT to be used. But for all other DTAs to be admitted, that entity would also need taxable income, so the basic mechanics are the same. A good example of a similar DTA is net operating losses (NOLs). NOL DTAs can only be used if the taxable group has taxable income but cannot be used to offset DTLs in the tax return. CAMT DTAs are evaluated for a valuation allowance, meaning that if the CAMT DTA is not expected to be realized, a valuation allowance would be set up.

Bruggeman asked whether industry supports having an earlier comment deadline for this exposure. He noted that tax sharing agreements for some entities will need to be updated prior to year-end. He summarized the proposed transition guidance, noting that statutory accounting cannot override Model #440 in the states but that the Working Group was trying to provide acceptable subsequent events transition guidance for the recognition of needed pending agreement updates, which may not be final until after the first of the year. Hoke stated support for the earlier comment deadline of Sept. 12.

Hudson made a motion, seconded by Walker, to expose INT 23-03 with the revisions to paragraph 34, which incorporate allowing admittance of the CAMT credits following the concepts in SSAP No. 101, paragraph 11.c. This exposure has a Sept. 12 comment deadline. Marcotte stated that because INT 23-03 creates overrides of existing guidance, the policy statement would require a two-thirds super majority vote of the Working Group present and voting to adopt. The motion passed unanimously.

I. Agenda Item 2023-06

Bruggeman directed the Working Group to agenda item 2023-06: Additional Updates on ASU 2021-10, Government Assistance. Marcotte stated that on Aug. 10, 2022, the Statutory Accounting Principles (E) Working Group adopted revisions to *SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items* in agenda item 2022-04. The revisions incorporated certain disclosures, adopted with modification from ASU 2021-10, to supplement existing disclosures regarding unusual or infrequent items.

Marcotte stated that with the follow-up questions about the adoption of the disclosures, most were regarding whether adoption with modification of the disclosures were intended to allow insurers to use the grant and contribution model. She stated that the intent was not to change accounting but to adopt the disclosures. The most recent exposure is to reject ASU 2021-10 instead of adopting it with modification, but still maintain government assistance disclosures. Marcotte stated that interested parties indicated they agreed with the proposed revisions but noted that some entities were using the grant and contribution model, and the discussion did not indicate whether it should be applied. She stated that there is no specific accounting guidance addressing accounting for government assistance transactions, and some of the health industry noted that in the absence of specific guidance, companies have looked to non-authoritative GAAP guidance, which supports the use of that model. Marcotte recommended adopting the exposed revisions to SSAP No. 24 to reject the ASU 2021-10 and include certain government assistance disclosures. She stated that the alternative is the disclosures could also be wholly rejected.

Hudson made a motion, seconded by Sherman, to adopt revisions to SSAP No. 24 as exposed (Attachment One-V). These revisions include the rejection of ASU 2021-10, while also maintaining government assistance disclosures. The motion passed unanimously.

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J. Agenda Item 2023-12

Bruggeman directed the Working Group to agenda item 2023-12: *Residuals in SSAP No. 48 Investments*. Stultz stated that this agenda item proposes revisions to clarify the scope and reporting for investment structures that represent residual interests within statutory accounting principles. Previously, revisions have been incorporated in SSAP No. 43R to address the reporting of residual interests within securitization structures. With these revisions, residual interests, as defined within SSAP No. 43R, were required to be reported on Schedule BA on designated reporting lines beginning year-end 2022. After reviewing the 2022 reporting results, it was identified that the information for residuals may be underrepresented because of the various legal forms that residual investments can take. For example, a reporting entity could hold investments that have the substance of residual interests in the form of limited partnerships, joint ventures, or other equity fund investments. To ensure consistent reporting of all residual interests, this agenda item proposes guidance to clarify the reporting of in-substance residuals regardless of the structure of the investment vehicle in SSAP No. 48. Stultz stated that the application is really the issue, not the definition itself, and NAIC staff believe that these proposed changes address those issues. NAIC staff recommend the Working Group expose the agenda item with the expanded update proposal to reflect revisions to the interim discussions and coordination with interested parties, and they recommend this exposure have a shortened deadline of Sept. 12 with the intent of this agenda item being adopted for 2023 reporting.

Rose Albrizio (Equitable), representing interested parties, agreed with the shortened comment period.

Clark stated that he wanted to make clear that there are two separate agenda items discussing residuals at this meeting. He noted that this agenda item is more focused on reporting. The other agenda item provides more accounting and is also exposed.

Clark made a motion, seconded by Sherman, to expose the clarifying guidance for residuals in SSAP No. 48 until Sept. 12. The motion passed unanimously.

4. Considered Maintenance Agenda – Active Listing

Hudson made a motion, seconded by Kasinow, to expose the following agenda items for a public comment period. The motion passed unanimously. The comment deadline for exposures was Sept. 29 for all exposures except INT 23-02, which had a comment deadline of Sept. 12. The motion passed unanimously.

A. Agenda Item 2023-14

Bruggeman directed the Working Group to agenda item 2023-14: *Asset Valuation Reserve and Interest Maintenance Reserve*. Marcotte stated that this agenda item is a broad concept agenda item developed with the goal of incorporating accounting guidance for the AVR and the IMR into *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. Historically, this statement has included a brief overview of the AVR and IMR with the calculation and reporting guidance determined as directed by individual SSAPs or in accordance with the *Annual Statement Instructions for Life, Accident and Health/Fraternal Companies*. It has also been noted that there are some disconnects between the SSAPs and the IMR/AVR guidance included in the Annual Statement Instructions and that there are limited financial reporting cross-checks to the reporting within the AVR. Marcotte recommended the Working Group move this item to the maintenance agenda as a new SAP concept and expose this agenda item with an overall concept for a long-term project to capture accounting and reporting for IMR/AVR in SSAP No. 7.

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B. Agenda Item 2023-15

Bruggeman directed the Working Group to agenda item 2023-15: IMR/AVR Specific Allocations. Marcotte stated that this agenda item has been developed to update guidance for IMR/AVR in the Annual Statement Instructions that currently establish specific allocation guidance. The principal concept of the IMR and AVR is that interest-related losses go to IMR, and non-interest-related losses go to AVR. This agenda item is to correct instructions that appear to direct an entity to allocate non-interest-related losses to IMR rather than correctly to the AVR.

Although the presence of examples for illustration are beneficial, the current annual statement instructions permit unintended allocations that do not reflect the intent of the principles. These have been specifically noted through inquiries to NAIC staff, particularly within the last year. NAIC staff believe these inquiries have been spurred by the discussions regarding the industry request to admit net negative IMR, therefore creating an incentive to allocate losses to IMR instead of AVR. This agenda item will focus on specific allocations within the annual statement instructions for NAIC designation changes for debt securities (excluding loan-backed and structured securities [LBSS]) and mortgage loans. Marcotte recommended the Working Group move this item to the maintenance agenda as a new SAP concept and expose the annual statement revisions to remove guidance that permits specific allocation and non-interest-related losses to IMR.

C. Agenda Item 2023-16

Bruggeman directed the Working Group to agenda item 2023-16: *Schedule BA Reporting Categories*. Oden stated that this agenda item has been developed to incorporate more detailed definitions for the annual statement reporting categories of SSAP No. 48 and residual interests on Schedule BA: Other Long-Term Invested Assets. Discussions identified that variations exist across industry on the types of investments included within each of the existing categories shown in Schedule BA. Oden stated that it was also noted that the annual statement instructions provide limited guidance, and the examples were not helpful for determining the reporting classifications. The intent of the recommended changes is to reduce reporting difficulty, improve consistency, and allow regulators to better assess the type and volume of investment types. Oden recommended that the Working Group move this item on the maintenance agenda as an SAP clarification and potential blank reporting change and expose the agenda item with a request for industry and regulator feedback. Specifically, comments were requested on what should be included as an investment with the underlying asset characteristics of the following categories: fixed income instruments, common stocks, real estate, mortgage loans, and others.

Bruggeman stated that as part of the discussion on this exposure, NAIC staff should coordinate with NAIC staff for the RBC items.

D. Agenda Item 2023-17

Bruggeman directed the Working Group to agenda item 2023-17: Short-Term Investments. Oden stated that this agenda item has been developed to review the guidance in SSAP No. 2R—*Cash, Cash Equivalents, Drafts, and Short-Term investments* and establishes principal concepts for the types of investments that should be permitted for reporting as either cash equivalents or short-term investments. This agenda item is in response to noted situations in which certain types of investments, particularly collateral loans or other Schedule BA items, have been specifically designed to meet the parameters for short-term reporting. Effectively, this agenda item, and the prior revisions to exclude certain investments from SSAP No. 2R, which were discussed as part of the bond project, will eliminate investments (except money market mutual funds and cash pooling dynamics) from being reported as cash equivalents or short-term investments unless they would qualify under SSAP No. 26R as an issuer credit obligation. Such investments will then only qualify as a cash equivalent or short-term investment if they have a

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maturity date within three months (cash equivalents) or 12 months (short-term) from the date of acquisition or meet the specific requirements for money market mutual funds or cash pooling arrangements. This agenda item proposes to retain the guidance in SSAP No. 2R that prevents cash equivalent or short-term reporting for related party investments if the reporting entity does not reasonably expect to terminate the investment, the original maturity time has passed, and if the reporting entity reacquired a substantially similar investment. Oden recommended the Working Group move this item to the maintenance agenda as a new SAP concept and expose this agenda item with proposed revisions to further restrict the investments that are permitted to be reported as cash equivalent or short-term investments. With the adoption consideration of the bond definition, including the edits to exclude ABS and debt securities that do not qualify as bonds from SSAP No. 2R, this agenda item proposes edits to reflect the bond project changes, and it is proposed to have an effective date of Jan. 1, 2025. Additionally, subsequent blanks reporting changes will be considered to modify the cash equivalent and short-term reporting lines accordingly.

E. Agenda Item 2023-18

Bruggeman directed the Working Group to agenda item 2023-18: ASU 2016-19, *Technical Corrections and Improvements*. Oden stated that In December 2016, the FASB issued *ASU 2016-19, Technical Corrections and Improvements*, as part of a standing project on its agenda to address suggestions received from stakeholders on FASB codifications and to make other incremental improvements to U.S. GAAP. The changes made by ASU 2016-19 included minor clarifications, corrections, the addition of codification references, guidance relocations, and removal of redundant, outdated, or superseded guidance. Oden recommended that the Working Group move this item to the active listing as an SAP clarification and expose revisions to adopt with modification *ASU 2016-19, Technical Corrections and Improvements* for statutory accounting. The agenda item includes the details of the revisions to be exposed and the rationale for which guidance is recommended for inclusion and which was recommended for rejection. Unless noted otherwise, Oden recommended that all other amendments made within ASU 2016-10, as detailed in the agenda item, be rejected for statutory accounting in SSAP No. 5R, *SSAP No. 92—Postretirement Benefits Other Than Pensions*, *SSAP No. 102—Pensions*, and *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

F. Agenda Item 2023-19

Bruggeman directed the Working Group to agenda item 2023-19: ASU 2018-09, *Codification Improvements*. Oden stated that in July 2018, the FASB issued *ASU 2018-09, Codification Improvements*. This ASU is part of its standing project to facilitate FASB codification updates for technical corrections, clarifications, and other minor improvements. The changes made by ASU 2018-09 included minor clarifications, corrections, the addition of codification references, guidance relocations, and the removal of redundant, outdated, or superseded guidance. NAIC staff recommended that the ASU be rejected in *Appendix D—Nonapplicable GAAP Pronouncements* as not applicable for statutory accounting purposes.

G. Agenda Item 2023-20

Bruggeman directed the Working Group to agenda item 2023-20: *ASU 2020-10, Codification Improvements*. Oden stated that in October 2020, the FASB issued *ASU 2020-10 Codification Improvements*. The changes made by the ASU either move disclosure guidance to the disclosure section of the codification or add codification references to direct readers to the disclosure section, and this ASU does not provide any relevant new guidance. NAIC staff recommended that the ASU be rejected in *Appendix D—Nonapplicable GAAP Pronouncements* as not applicable for statutory accounting purposes.

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H. Agenda Item 2023-21

Bruggeman directed the Working Group to agenda item 2023-21: *Removal of Transition Guidance from SSAP No. 92 and SSAP No. 102*. Stultz stated that on Dec. 18, 2012, the Statutory Accounting Principles (E) Working Group adopted SSAP No. 92 and SSAP No. 102. The adopted SSAPs included transition guidance that expired after 10 years, and this agenda item intends to remove that expired transition guidance from SSAP No. 92 and SSAP No. 102.

I. INT 23-02

Bruggeman directed the Working Group to *INT 23-02: Third Quarter 2023 Inflation Reduction Act – Corporate Alternative Minimum Tax*. Marcotte stated that this proposed new interpretation, *INT 23-02: Third Quarter 2023 Corporate Alternative Minimum Tax* is to provide temporary guidance for third quarter 2023 reporting for the corporate alternative minimum tax (CAMT). The Working Group has previously adopted *INT 22-02: Third Quarter 2022 through Second Quarter 2023 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax*, which requires disclosure if the reporting entity is an applicable entity but does not require accrual of CAMT payable amounts, noting that a reasonable estimate is not possible. The Inflation Reduction Act was passed in August 2022, and it provides that the CAMT is effective beginning with the 2023 tax year. The proposed INT recommends that for third-quarter 2023, reporting entities should disclose whatever information is available regarding their applicable reporting entity status. If the reporting entity is able to make a reasonable estimate regarding the CAMT 2023 liabilities, such an estimate should be disclosed for third-quarter 2023. If a reasonable estimate is not possible because of pending material information, the fact that a reasonable estimate is not feasible should be disclosed. This agenda item is proposed to be exposed with a comment deadline of Sept.12. Marcotte stated that because INT 23-02 creates overrides of existing SSAP and annual statement instructions, the policy statement would require a two-thirds super majority vote of the Working Group present and voting to adopt.

J. Agenda Item 2023-22

Bruggeman directed the Working Group to agenda item 2023-22: Actuarial Guideline 51 and Appendix A-010 Interaction. Marcotte stated that this agenda item addresses the Feb. 23 request from the Financial Reporting and Solvency Committee of the Health Practice Council to the Long-Term Care Actuarial (B) Working Group of the American Academy of Actuaries, and to the Statutory Accounting Principles (E) Working Group requesting clarifications regarding some observed diversity in practice across issuers of long-term care insurance (LTCI) with regard to how the guidance in *Actuarial Guideline LI—The Application of Asset Adequacy Testing to Long Term Care Insurance Reserves* (AG 51), specifically Section 4.C, on determining when additional reserves may be necessary interacts with existing guidance on accident and health insurance reserve adequacy in *SSAP No. 54R—Individual and Group Accident and Health Contracts*, and Appendix A-010, *Minimum Reserve Standards for Individual and Group Accident and Health Insurance Contracts*. The Academy referenced a survey that provided examples of the diversity of practices that have been observed. The fundamental question is regarding whether gross premium valuation only, cash-flow testing only, or both cash-flow testing and gross premium valuation are required. Marcotte recommended the Working Group add this agenda item to the maintenance agenda classified as an SAP clarification and expose clarifying revisions and an illustration to SSAP No. 54 to clarify that gross premium valuation under *Appendix A-010* and cash-flow testing under AG 51 are both required if indicated. In addition, Marcotte recommended providing notice of the exposure to the Long-Term Care Actuarial (B) Working Group and the Valuation Analysis (E) Working Group.

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5. Discussed Other Matters

A. Review of U.S. GAAP Exposures

Marcotte identified two GAAP exposures with comment deadlines from July to August that are recommended for review by the Working Group in the normal maintenance process (Attachment One-W).

B. Comment Deadline

Marcotte stated that the comment deadline for exposures is Sept. 29 for all exposures except INT 23-02 (CAMT third quarter), INT 23-03 (CAMT year-end 2023); agenda item 2022-11: Collateral for Loans; and agenda item 2023-12: Residuals in SSAP No. 48 Investments, which have a comment deadline of Sept. 12.

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

[https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/APPTF/2023-2 Summer/Summary and Minutes/SAPWG/Att1-SAPWG Minutes 08.13.23.docx](https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member%20Meetings/E%20CMTE/APPTF/2023-2%20Summer/Summary%20and%20Minutes/SAPWG/Att1-SAPWG%20Minutes%2008.13.23.docx)

Draft: 7/11/23

Statutory Accounting Principles (E) Working Group
E-Vote
July 5, 2023

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded April 10, 2023. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Kim Hudson (CA); Bill Arfanis (CT); Rylynn Brown (DE); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Jamie Walker (TX); David Smith (VA); and Amy Malm (WI).

1. Exposed INT 23-01

The Working Group considered an e-vote exposure of a revised *Interpretation (INT) 23-01: Net Negative (Disallowed) Interest Maintenance Reserve*. This tentative INT proposes a limited-time, optional exception to statutory accounting to admit net negative (disallowed) interest maintenance reserve (IMR) up to 10% of adjusted capital and surplus. Revisions from the prior exposure as directed by the Working Group on June 28, include:

- Requirement for RBC over 300% after adjustment to remove admitted positive goodwill, EDP equipment and operating system software, DTAs and admitted IMR.
- Allowance to admit up to 10% of adjusted capital and surplus – first in the GA, and then if all disallowed IMR in the GA is admitted and the percentage limit is not reached, then to the SA account proportionately between insulated and non-insulated accounts. (The adjustments are the same that occur for the RBC adjustment and reduce capital and surplus before applying the 10% percentage limit.)
- There is no exclusion for derivatives losses included in negative IMR if the company can demonstrate historical practice in which realized gains from derivatives were also reversed to IMR (as liabilities) and amortized.
- Inclusion of a new reporting entity attestation.
- Effective date through Dec. 31, 2025, with a note that it could be nullified earlier or extended based on WG actions to establish specific guidance on net negative (disallowed) IMR.
- Application guidance for admitting / recognizing IMR in both the general and separate accounts.

Clark made a motion, seconded by Hudson, to expose the revised INT 23-01T for a public comment period ending July 21. The motion passed with 11 Working Group members responding with affirmative votes, meeting the NAIC Policy Statement on Statutory Accounting Principles Maintenance Agenda Process requirement for a 2/3 vote of the membership for INTs that conflict with existing statutory accounting.

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

<https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/APPTF/2023-2 Summer/SAPWG/Attachments/Att1A-SAPWG 7.5.23 E-vote.docx>

Draft: 7/26/23

Statutory Accounting Principles (E) Working Group
Virtual Meeting
June 28, 2023

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met June 28, 2023. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Sheila Travis (AL); Kim Hudson (CA); William Arfanis (CT); Rylynn Brown and Tom Hudson (DE); Cindy Andersen (IL); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett and Pat Gosselin (NH); Bob Kasinow and Bill Carmello (NY); Diana Sherman (PA); Amy Garcia (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI). Also participating was: David Wolf (NJ).

1. Reviewed Comments on Exposed Items

a. INT 23-01T

Bruggeman directed the Working Group to *Interpretation (INT) 23-01T: Net Negative (Disallowed) IMR* (Attachment One-B1) and the corresponding agenda item 2022-19: Negative IMR (Attachment One-B2). He directed Julie Gann (NAIC) to summarize the Life Actuarial (A) Task Force response letter dated June 15 (Attachment One-B3). Gann stated that the Task Force is moving forward with the development of an interest maintenance reserve (IMR) template, drafting guidance for 2023 and 2024 for the Working Group's potential admittance of some portion of aggregate negative IMR, and a recommendation to the Working Group to not rely on asset adequacy testing (AAT) as the sole or primary guardrail for aggregate negative IMR. Bruggeman noted that the key part of the recommendation was using AAT as the "sole or primary" guardrail, and the Working Group has been discussing the usage of AAT as the first-level safeguard and how it should be used in combination with other safeguards. IMR is included as a long-term agenda item for the Task Force as one of its primary concerns, which means it should be captured in the valuation documentation for the years ending 2022 and 2023.

Gann stated that in April, the Working Group exposed the limited-time optional INT to allow the admittance of net negative disallowed IMR in the general account up to 5% of adjusted capital and surplus. That 5% limit was directed by the Working Group at the Spring National Meeting. The exposed INT proposed restrictions as to what is permitted to be captured specifically for derivatives that have been reported at fair value and then for only general account IMR, with an exclusion for separate accounts. Detailed comments were received from the American Council of Life Insurers (ACLI), and NAIC staff request that the Working Group hear, discuss, and provide direction on the requested revisions to the INT. If the INT is revised, NAIC staff anticipate exposing a revised INT with a shortened comment period to allow for potential adoption consideration at the Summer National Meeting. Gann recommended that the Working Group defer the adoption of the INT until the Summer National Meeting, as there are a significant number of comments to consider. She then noted that the ACLI comment letter broke out eight key topics, and the first two topics—Surplus Considerations and Exclusion of Fair Value Derivatives from Determining Admitted Net Negative IMR—appeared to be the most significant. She also requested that the Working Group provide direction on the effective duration of the INT and whether there should be a sunset time frame. Bruggeman requested that the ACLI provide its overall comments to the Working Group prior to going through each of the eight topics individually.

Mike Reis (Northwestern Mutual), representing the ACLI, stated that he would like to begin by reading from the Financial Condition (E) Committee's *Asset Valuation Reserves and Interest Maintenance Reserves Blue Book* report from December 2002, which can be found at <https://naic.soutrounglobal.net/Portal/Public/en-US/RecordView/Index/547>, as it includes some foundational concepts. He stated that the main driver of the development of IMR

and asset valuation reserve (AVR) is that without these mechanisms, many circumstances gave rise to inappropriate results from the statutory formula valuation methods. For example, changes in value due to interest rate swings were recognized inconsistently on the asset and liability sides of the balance sheet. Liabilities are valued using interest rates fixed at issue, while some assets may be valued using current interest rates through trading activities. The development of AVR and IMR also recognized that trading gains and losses were transitory with reinvestment, where they are offset with new lower-yielding and higher-yielding assets, respectively; IMR should, theoretically, apply symmetrically. So, all points in the ACLI letter and items discussed today emanate from these concepts; consequently, with the non-admittance of negative IMR, the financial statements are not fairly represented. Reis continued by stating that to avoid incentivizing companies to manage the financial reporting outcomes rather than affect appropriate risk management practices, the ACLI believes an interim solution should have a surplus cap of at least 10% or greater, along with no adjustments to surplus or exclusions. The rationale for this is that IMR is different from other intangibles, and it is more akin to unrealized losses on bonds with no change in immediate claims-paying ability after trading.

Reis stated that for the interim solution, non-hedge accounting derivatives, which are still economically effective hedges and appropriate for the duration and risk management, should not be changed from current industry practice. The industry has been deferring effective hedge gains to IMR for decades. For the interim solution, book value separate accounts, both insulated and non-insulated, have the same products and risk management issues as the general account and should not be excluded. Also, any proof of reinvestment should be on a macro basis looking at the totality of the NAIC framework and recognizing the fungibility of cash. Reis suggested that a new technical working group with members of the Working Group, the Life Actuarial (A) Task Force, the American Academy of Actuaries (Academy), and industry members may be needed to help develop a long-term solution to these issues. Beyond this, the ACLI does not believe it is in the collective best interest to make interim changes to current IMR deferral practices, as this would drastically change longstanding and important risk management practices.

Bruggeman stated that the Working Group will begin its discussion of the second topic—Exclusion of Fair Value Derivatives from Determining Admitted Net Negative IMR—and he noted that non-accounting-effective hedges are recorded at fair value, and the unrealized gain/loss would already be in surplus. Disposal of a fair value hedge would result in an immediate adjustment to surplus via the IMR irrespective of the IMR's positive/negative position. This issue is one of the discussion points that the Working Group wants to understand better, as there is a difference between accounting-effective hedges and economic-effective hedges, and if it is not one of those two, then it would likely be a speculative hedge.

Mike Huff (Teachers Insurance and Annuity Association of America—TIAA), representing the ACLI, stated that Bruggeman made a good distinction between hedges that are accounting-effective versus economic-effective. He also noted that he would not even consider speculative hedges to be a hedge derivative position, as speculative hedges are not allowed under insurance law or company derivative use plans. The industry's interpretation is that accounting-effective and economic-effective hedges are both considered equally economically effective, but accounting-effective just happens to be specifically defined within the accounting guidance. All interest rate derivatives, both hedge accounting and fair-valued interest rate derivatives, are instruments that industry uses interchangeably with fixed-rate bonds as asset and liability management tools. As these instruments are used interchangeably, consistent treatment is considered important and within the spirit of the development of IMR. Historical industry practice has been to defer gains from fair value derivatives when the gain is related to a change in interest rates, and that has previously resulted in a significant deferral of gains into IMR and not into surplus. Huff noted that industry's position is that this is the appropriate accounting treatment, as it does not artificially inflate surplus, given the fact that there is then reinvestment into lower-rate assets. He stated that the ACLI wants to avoid the potentially adverse outcome of disincentivizing the prudent use of derivatives in asset-liability management (ALM) and risk management to ensure that financial statements reflect the fairest representation

of financial condition for companies, particularly in surplus. He then discussed the examples included in the ACLI's comment letter.

Bruggeman noted that the example scenarios place an emphasis on the income statement impact, whereas the Working Group has noted that the hedge is at fair value, which means that surplus has already been affected irrespective of whether the derivative has been disposed of. He then inquired as to whether disposals occur when derivatives are still economically effective or if that occurs after effectiveness has lapsed. Additionally, he requested clarification on what industry considers a derivative that is not economically effective. Huff stated that a hedge will occasionally become economically ineffective, but for the most part, this does not happen. Hedges that industry feels have become speculative are immediately taken off the books; likewise, industry would never put a derivative on the books that was not an economically effective hedge.

Bruggeman asked if, in the second scenario described in the ACLI comment letter, the hedge was to become economically ineffective, whether industry would dispose of the hedge before or after it became ineffective, and whether the gain/loss would be recorded through IMR. Huff responded that in all three scenarios, the hedge would be considered effective, as it has locked in the rate at 5%. Bruggeman clarified that he is trying to assess industry's practice for recording through IMR in the event that the hedge did become ineffective. Huff responded that he believes that while the hedge is effective, any realized gain/loss would go to IMR, and after it becomes ineffective, it would not. Bruggeman stated that there is a distinction that needs to be made between when there is an ineffective hedge that has been disposed of/terminated based on when it became ineffective. If the derivative is not interest-rate sensitive, it would not meet the blanks instructions on interest-rate sensitivity. The issue is gaining a proper understanding of what happens when a derivative becomes ineffective and how state insurance regulators would get assurance that when a derivative was disposed of it would roll through IMR only if it was still effective. He stated that he believes there is a breakpoint where, once it is ineffective, it is no longer an interest-rate-sensitive type of disposal that qualifies for IMR. Bruggeman stated that there is a need for these detailed discussions as part of a long-term IMR assessment, but he does not want to put reporting entities in a whipsaw position where they have been deferring all derivative gains to IMR over the years; now the derivative losses are not permitted through IMR.

Gann noted that due to the complexity of this discussion, she would like to make some clarifying comments. In the scenarios presented by the ACLI, she clarified that these are not actual hedges of specific assets. Rather, these are derivative hedges for the portfolio, which is why they do not qualify as accounting-effective hedges under statutory accounting. Industry considers these to be economic-effective hedges because they are in line with a company's derivative use plan; however, there is no metric or assessment that could occur to prove that the derivative is effective as required for accounting-effective hedges. So, if the hedge is in accordance with a company's derivative use plan, then industry considers them to be effective, and there would be very limited situations, if any, where a derivative would move from being considered an effective hedge. Gann noted that what industry is identifying as an effective hedge is not an accounting-effective hedge. As such, industry's interpretation would encompass many more derivatives than are considered effective hedges for accounting purposes under *Statement of Statutory Accounting Principles (SSAP) No. 86—Derivatives*. Gann stated that she just wants to make sure that that was clear because the example appears to reflect a hedge of a single asset, but hedges of single assets could be designed to qualify as accounting-effective. Reis noted that hedges from the example scenarios could be assigned to assets that are subsequently purchased, and if that is to occur, the derivative arrangement could qualify as accounting-effective. The company would have to end up buying those assets for them to be assigned to the hedge, so the hedge is not assigned to a specific asset when it is initiated, but if assets are purchased, the hedge could be assigned. If the assets were purchased with a maturity duration of two years instead of a planned 10-year time frame, this could be a situation in which the hedge becomes ineffective.

Tom Karafin (Prudential) noted that hedges generate a gain or loss while they are effective, and the moment a derivative is to become ineffective, they take them off. However, the gain or loss was in existence during the hedge's effective life, and the current model says that gain/loss has become permanent and should follow the hedged item. As such, the gain/loss would continue to be reported through IMR.

Smith asked how certain the industry representatives are that during the periods in which interest rates were decreasing, everyone in industry was consistently applying this approach to defer gains in IMR over the life of the hedge versus recognizing all gains in surplus at the time of disposal. Reis responded that while no one would suggest that this is an absolute statement, all attendees to the ACLI working group meeting (approximately 30–40 representatives) responded that they were deferring hedge gains through IMR. Smith reiterated his concern that some of the more aggressive companies were not involved in the industry's discussion. For companies that have been deferring the gains, it would be punitive to not defer the losses, but there is a concern that some companies historically recognized the gains and now want to defer the losses. Bruggeman noted that they are looking to avoid an imbalance in which gains are recognized immediately in surplus, but the realized losses are deferred through IMR. He proposed a solution to have companies that have been following the approach in which derivative gains were historically taken to IMR continue doing so with derivative losses, but companies that have not previously recognized derivative gains through IMR would not be permitted to begin that practice under the INT with derivative losses. He stated that while it is a bit inconsistent, it would avoid the imbalance issue of reporting gains and losses differently.

Huff stated that he believes he can safely state that all the major players have been deferring derivative gains through IMR, and the big four accounting firms agreed with that treatment. Bruggeman noted that the Working Group wants to provide some kind of direction for NAIC staff, and in the long-term, they will need to work with the Life Actuarial (A) Task Force for a solution; however, for the short-term, there needs to be some kind of assurance that hedges were disposed of while they were still economically effective in order for gains or losses to go through IMR. This would provide state insurance regulators with some amount of comfort that ineffective hedges are not being run through IMR, especially if resulting in a loss. That said, economically effective hedges do not have any kind of metric for determining if the hedge is still economically effective, so state insurance regulators need more assurance that something was not deferred through IMR that should not have been. Huff stated that the vast majority of the time when hedges are unwound, as illustrated in the example scenarios, they are done so on a schedule, and the company will know the approximate time at which the hedge would be disposed of. While it is possible that a hedge may be unexpectedly unwound, it would be quite unusual for a company to have a hedge become ineffective prior to disposal because of this.

Clark stated that it does not make any sense to have different accounting treatment between unrealized and realized changes. The concept of IMR exists to create consistency for bonds for unrealized and realized losses. The same should hold for derivatives. It does not make sense to mark derivatives to market (fair value) when it is open (unrealized) only to reverse that treatment at termination (realized). This disconnect is one of the two things, at least in the long-term, that need to change to get accounting consistency. The second thing is the lack of measurement parameters around the effectiveness of a hedge. There is a reason U.S. generally accepted accounting principles (U.S. GAAP) and statutory accounting have a concept of effective hedge accounting, but with industry's interpretation, there is essentially a way around effective hedge accounting without any kind of overarching parameters, and that is a concern. Given the historical practice, the least disruptive thing to do would be to allow companies to continue with the practices they have already been doing. Clark stated that as for Smith's point, a company should not change its practice because of this interpretation, and in the interim, it would be appropriate for companies to continue with the practices they have already been doing.

Wolf stated that he supports that approach, and the guidance must specify that the company needs to continue following its past practices. If a company has been amortizing gains in IMR for similar derivative positions in the

past based on documented internal accounting policies, then it can continue to do so with like derivative positions that are now resulting in losses, but allowing new practices permitting derivative losses in IMR to go forward at this point should be avoided.

Bruggeman then directed the Working Group to discuss book value guaranteed separate accounts. He stated that he believes it makes sense to permit admitted IMR in a separate account. Although there is a distinction between insulated and non-insulated, he would like to avoid that discussion for this interpretation. Separate accounts for certain products are still general accounts affected, but that is not relevant for IMR purposes. Bruggeman then recapped the annual statement blanks instructions of how IMR from separate and general accounts are presented. He then inquired about the operational mechanics, such as if there was a cap based on surplus, whether it was 5% or 10%, and how that would affect the instructions for reporting negative IMR within general and separate accounts. Specifically, he inquired about whether the cap should first apply to the general account, with the separate account only admitting if the admittance in the IMR does not exceed the percentage permitted. He stated that he believes there is support for book value guaranteed separate accounts recognizing negative IMR, but it is an order of operations question between the general and separate accounts.

Brad Caprari (Prudential), representing the ACLI, stated that there has been a bit of back and forth on what the order of operations should be. The initial discussion was for negative IMR to be applied to the general account first and then to the extent that there remains availability within that 10% surplus limit, which would then apply to the separate account. This is also to say that the ACLI supports a 10% surplus limit. That said, the ACLI believes there should be proportionate admittance between insulated and non-insulated separate accounts. Caprari noted that he does not see any distinction between insulated versus non-insulated as it relates to the discussion of IMR, and there should be proportionate admittance there to the extent that someone has negative IMR that can be captured within the available cap of 10%.

Carmello asked for clarification on whether it is an insulated account with the negative IMR asset and whether the IMR would be held in that insulated account. Caprari replied that any admitted negative IMR asset or contra-liability would be held in the insulated account. Carmello noted that this does not really help the customers that have the insulated accounts, as they can only acquire real assets in the event of an insolvency, and he is concerned that this may be somehow benefiting the insulated customers, but that does not appear to be the case. Caprari said he agrees, and he noted that it is only tangible if taken into consideration with the reinvestment of funds, which will make up for the initial loss over time. Carmello then asked for clarification on how the order of operations would proceed if the general account is negative but the separate account is positive in excess of the general account. Caprari responded that it would be the cumulative total of the two accounts to determine the net negative position. If there is a cumulative net negative position, then it depends on whether one or both accounts are negative to determine how the cap is applied. If both accounts are negative, then the general account would apply first, and the separate account would be eligible for any amount of the cap left over.

Gann noted that the concept of admitted and non-admitted assets does not exist in the separate accounts, and the current process in the separate accounts is to take negative IMR as a direct charge to surplus. So, if the direction of the Working Group is to include separate accounts in the interpretation, NAIC staff will include this order of operation that was discussed. NAIC staff will also detail how to reflect this asset in the separate accounts, which would likely be a reversal of the prior hit to surplus, with a recognition of a miscellaneous aggregate write-in asset to reflect what is going to be permitted as admitted. NAIC staff do not recommend reporting it as a contra-liability, as it could be commingled with the non-disallowed negative IMR. Gann stated that it can be identified in the financial statements when reported separately as miscellaneous aggregate assets. When there are changes on what is permitted to be admitted in the separate account, the entry would be to remove the asset with a charge in surplus. As such, companies may be reversing and re-entering entries as the balance in IMR changes based on what is permitted to be admitted from percentage limitations. Gann stated that if separate accounts are

captured, the interpretation will include the recognition process to ensure consistency across industry. Bruggeman stated that there should be a proportional allowance in the insulated and non-insulated separate accounts if IMR is permitted without exceeding the percentage cap. He noted that there are separate account surpluses, and he asked if that counts when adding up all the surpluses.

Caprari stated that if you look at the general account blank, the reported surplus is the surplus the ACLI believes should be used for the cap, and it is inclusive of a separate account surplus. As such, there would not need to be any aggregation, and the ACLI prefers to use it as the cap instead of trying to aggregate out a separate account cap versus a general account cap. Gann stated that NAIC staff should have what they need to move forward with updating the interpretation, and she noted that the agenda does identify other things that may need to be considered in the future, perhaps as a long-term project for separate accounts with regard to the products that are used for book value. She also noted that on a broad scale, variations from what is permitted for book value under *SSAP No. 56—Separate Accounts* are not detailed, identifying that only three permitted practice disclosures were reported for items that were held at book value beyond what was permitted in SSAP No. 56. She also noted the need to assess overall accounting, reporting, and risk-based capital (RBC), if the separate account blanks are being used as an extension of the general account or a segregated general account, as the accounting and reporting in the separate account is not designed with that original intent. Bruggeman noted that this might represent an add-on to the current project, but IMR interpretation will proceed with IMR to be recognized from book value guaranteed separate accounts, whether insulated or non-insulated; and, as proposed by Caprari, if there is net negative IMR, then the amount admitted by the surplus cap goes to the general account first, and then whatever is left will be allocated to the insulated and non-insulated separate accounts proportionally.

Linus Waelti (New York Life Insurance Company), representing the ACLI, noted that state insurance regulators understand the importance of being able to distinguish between what they refer to as the good scenario, where the sale proceeds from the asset sale are going into a reinvestment, versus what they call the bad scenario, where that is happening inadequately and the proceeds from asset sales go to pay major cash outflows, whether they are expenses, claims, or withdrawals. To do a granular asset-to-asset mapping of proof of reinvestment is not going to be practical and will be highly challenging. So, the question comes down to what the package of safeguards should be that would give state insurance regulators comfort that the reinvestments are occurring adequately and appropriately. The ACLI recommended that state insurance regulators use existing safeguards, like AAT, to provide comfort in the activity. While AAT would not be considered the sole or primary safeguard, it certainly should play a role in combination with other safeguards, at least in the context of proof of reinvestment, to ensure that assets and reinvested assets are generating returns adequate to cover claim liabilities. The ACLI's position is that if claims payments become compromised by inadequate reinvestment or inappropriate reinvestment, the AAT analysis would identify that shortfall. The AAT shortfall would cause reserve strengthening, which would result in a direct impact on surplus, much like what would be seen if negative IMR was written off.

Waelti noted that in terms of other recommendations, the ACLI proposes the inclusion of a macro demonstration of reinvestment. This could involve the use of the cash flow statement to provide an aggregate view of cash activity, with a comparison of investment proceeds to the cost of investments acquired. This also helps navigate some of the problems with the fungibility of cash that would plague other demonstrations of proof of reinvestment. There are some imperfections with using a macro demonstration, as proceeds reported in the cash flow include maturities, and the amount reported as reinvestments includes cash in-flows from other sources, but at least at a high level, this would provide state insurance regulators with a view of the reinvestment occurring and whether it is at a healthy level. Another proposal from the ACLI is a company attestation that confirms that investment activities are in line with documented investment strategies and policies of the company. This company attestation could also be expanded to provide additional comfort to state insurance regulators as needed. Additionally, the ACLI suggests that a company will attest that asset sales are not being compelled by liquidity pressures, whether they are coming from collateral calls or from excess withdrawal activity.

Carmello asked if companies could potentially capture the information needed to perform granular asset-to-asset mapping as proof of reinvestment as a goal of the long-term project. Waelti responded that while some of this information is available on Schedule D, it would still be very difficult to perform asset-to-asset mapping due to the complexity and volume of activity. Carmello noted that in his mind, he is envisioning a short report that maps together and provides comfort to state insurance regulators that there is not a situation where asset sale proceeds are being used to cover claims instead of being reinvested. He stated that it seems Waelti is proposing that state insurance regulators would be able to get this type of report prepared by the companies if requested. Waelti responded that this would likely include some information from Schedule D, and they would need to work with state insurance regulators to determine what other information and commentary state insurance regulators are looking for. Bruggeman noted that this conforms with what is in the instructions; if there are excess withdrawal situations, those asset sale gains/losses do not go through IMR. The bigger question of the fungibility of cash is when a company sells a newly purchased asset, but they are not buying a fixed-income instrument with the proceeds. This may be something better addressed in the long term, but for the short term, what Carmello is requesting is a more distinct disclosure of the transactions or how they are done.

Carmello said he agrees, and he noted that on the long-term project, they should consider looking at the 150% factor to determine if it is still appropriate since it was a factor developed around 30 years ago when IMR was established. Bruggeman then asked Gann if state insurance regulators could ask for additional disclosure within AAT or if it would require a referral to the Life Actuarial (A) Task Force. Gann stated that this would likely require a referral to the Task Force. She also noted that the exposed interpretation was drafted with reference to an “immediate” investment of sale proceeds in another fixed-income instrument. While this language has been identified as potentially problematic, she noted that it was not intended to imply instantaneous action, but the company is investing directly in fixed-income instruments, not holding onto the cash, and investing six months down the road or in equities. Gann stated that the industry-proposed attestation can be included as an additional disclosure. Bruggeman clarified that he is not sure where this attestation disclosure would actually be reported. Gann noted that this could be done as a narrative disclosure for year-end 2023, but it is too late in the year for a data-captured disclosure. If the INT were to go on for a period of time, the disclosure could be included in the financial statements as a general interrogatory or as a new data-captured disclosure. Bruggeman noted that he would like to see some kind of distinct matching as part of the long-term solution and an assessment of whether the 150% factor for excess withdrawals still makes sense.

Bruggeman noted that there was not any disagreement on the topic of special surplus accounts, and the only comment he has is that the wording should be specific to ensure that everyone is using the same terminology so information entered can be easily aggregated. He noted that as soon as a “write-in” line is provided, state insurance regulators tend to lose all ability to aggregate data by line and column number. Specific wording should also be developed to make it easier to consistently identify and aggregate year-end data.

Bruggeman directed the Working Group to the topic of existing safeguards. Reis noted that industry is not opposed to additional safeguards, but he wants to make sure the rationale for each safeguard is clearly understood. Gann stated that the Life Actuarial (A) Task Force has communicated that AAT should not be relied on as the sole safeguard for the admittance of negative IMR. There is the ability for permitted practices, but there is the desire for a uniform standard, and there were only two permitted practices for year-end 2022. For derivatives, there is the reliance on a company’s filed derivative use plan, but NAIC staff do not receive these plans and cannot comment on what is included or how much is included regarding interest rate derivatives or what is going through IMR. For the long-term project, the Working Group could potentially expand Schedule DB to get more information, but that is not something that could be done for this year-end. NAIC staff are requesting comments on the ACLI proposed safeguards and direction on whether there are other safeguards that should be incorporated. Bruggeman noted that the Working Group’s direction is that what is included in the exposure is sufficient for consideration; although, it should be noted that AAT should not be the primary safeguard, and individual

circumstances that vary from what is permitted in the ultimate interpretation can still go through the permitted practice process. States should also be aware that derivative use plans are key components for the potential admittance of net negative IMR, as they review and assess those submissions. Wolf asked whether there would still be a safeguard around minimum RBC. Bruggeman confirmed that the 300% threshold for potential action would still be in place. Wolf stated that negative IMR should not be permitted for admittance when a reporting entity hits the 300% threshold. Wolf also noted support for calculating the 300% threshold with the removal of admitted negative IMR, goodwill, operating system software and electronic data processing equipment, and deferred tax assets similar to the calculation of adjusted capital and surplus.

Bruggeman noted that to have a line on RBC sensitivity would require a structure change to RBC, which cannot be completed for year-end 2023, as it would have needed to be exposed by at least the end of January. He noted that RBC sensitivity would be appropriate, especially if it resulted in an email sent to the domestic regulators, noting that the company's RBC, with or without this IMR, is well above 300%. Hudson noted that his understanding of Wolf's request was regarding whether the Working Group wants to include language that companies could not admit negative IMR if RBC was below 300%. Bruggeman responded that this should be included. Gann responded that this is included in the INT, but the comment was to calculate 300% after adjustments. Wolf agreed that this was his comment, as he wants to make sure that the 300% RBC is determined after adjustments to remove admitted negative IMR, goodwill, operating system software and electronic data processing equipment, and deferred tax assets. Reis noted that the industry is not opposed to providing disclosures, but he wants to make sure that the disclosures are discussed in the context of the cap.

Bruggeman asked the Working Group whether there should be a termination date for the INT, and he proposed a termination date three years after adoption. Hudson agreed with Bruggeman on including an end date on the INT, as it will provide pressure to resolve the issue. Bruggeman suggested an end date of Jan. 1, 2026. Reis stated that the industry is also supportive of an end date, and while the ACLI has not discussed a three-year end date, his opinion is that this time frame sounds reasonable for developing a long-term solution. Bruggeman said that three years is the best option, as it allows for that extra year that is often needed to develop and put the structure in place.

Bruggeman then directed the Working Group to discuss the proposed 5% cap on adjusted capital and surplus, and he asked if this cap should be adjusted surplus or straight surplus without any adjustments. He noted that the Working Group had previously discussed and settled on 5%, but he believes 10% makes more sense, as it would line up with the goodwill admittance limitation. Hudson asked whether the prior concern about the 300% company action level RBC was that the soft assets, including negative IMR, could not be used by the company after reaching the action level, which Wolf confirmed. Reis stated that negative IMR is akin to unrealized losses, and it is deferred because they are transitory due to the company reinvesting the proceeds in a higher or lower-yielding asset, and it does not change the claims accountability. It can be distinguished from other soft assets, and it is more akin to the soft asset of unrealized gains/losses that are on the balance sheet. Reis expressed that it is cleaner and more theoretically appropriate not to lump IMR in with other soft assets, as to do so would miss the point of why IMR was developed. Clark agreed and noted that the interim proposal to cap IMR based on capital and surplus is more related to the fact that the Working Group is not comfortable enough with all the existing safeguards to allow unlimited admittance of negative IMR. He noted that he would be ok with the 10% cap and no adjustments, as this is a different type of intangible compared to other soft assets.

Weaver stated concern that these intangibles are starting to add up, and if a company were in trouble, it would not be able to pay claims right away with some of these intangible assets. Reis responded that in the ACLI's comment letter, it details its position that the bonds are on the books at amortized cost, which is not the sales price at which bonds could be sold to pay claims, and IMR is no different. Clark stated that the 300% RBC threshold is intended to address this, as once the company reaches the solvency concern, it no longer gets to report IMR as

a soft asset, and the accounting becomes closer to a liquidation basis of accounting. Hudson stated that a reasonable compromise would be to go up to 10% but to use adjusted surplus and capital, noting that he would be uncomfortable going up to 10% using unadjusted surplus and capital. Bruggeman noted that the reason the ACLI is trying to make the distinction of using the RBC below 300% and then using adjusted surplus is if a company did get to 300% without all those soft assets and without negative IMR, then the company has to eliminate IMR as an admitted asset earlier as opposed to using the 10% of surplus as a cap.

Bruggeman then requested further comments and questions from the Working Group, noting that NAIC staff need to be provided with direction for drafting an updated INT for exposure, specifically requesting responses from members on the 10% cap and unadjusted versus adjusted surplus. Bartlett, Brown, Andersen, and Arfanis stated support for a 10% cap with adjusted surplus and capital. Smith stated that he prefers 5% with adjusted surplus and capital but could live with 10% adjusted surplus and capital, and Sherman agreed. Kasinow requested clarification on the calculation of adjusted surplus and capital. Gann clarified which items are excluded, and she noted that the calculation is further detailed in the meeting materials, found in paragraph 9a of the exposed INT. Kasinow stated support for 10% with adjusted surplus and capital. Reis asked the Working Group members voting for the use of adjusted surplus and capital what their theoretical basis for this was and if a higher cap could be considered since adjusted surplus and capital would further reduce the admitted amounts of IMR. He stated that the ACLI agreed that the 10% cap is reasonable, but he does not understand the foundation for using adjusted surplus and capital outside of a desire to be conservative. Malm stated support for 10% with unadjusted surplus and capital. Bruggeman noted that at this point, the vote is approximately eight for 10% adjusted versus two for 10% unadjusted out of 15 members.

Bruggeman noted that this majority vote would indicate that the Working Group is directing NAIC staff to draft the exposure with a 10% limitation using adjusted surplus and capital. Clark asked if Working Group members could change their minds when the vote for the adoption of the INT comes up. Bruggeman stated that members could, as this was originally exposed with a 5% limitation of adjusted capital and surplus, and now the Working Group is directing NAIC staff to draft an exposure with 10% using adjusted capital and surplus. Bruggeman noted that the Working Group will perform an e-vote exposure vote on the updated draft exposure.

2. Discussed Other Matters

Bruggeman requested any additional comments or discussion on other matters. Gann noted that the other items on the agenda are just notices. First, NAIC staff received an extension for comments from the June 1 referral from the Valuation of Securities (E) Task Force (Attachment One-B4) until July 7. The second thing is letting everyone know that the Insurance Core Principals (ICPs) 14 and 17 have been released for comments, both of which are available for review and comment on the International Association of Insurance Supervisors (IAIS) website.

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

[https://naiconline.sharepoint.com/sites/naicsupportstaffhub/member meetings/e cmte/apptf/2023-2 summer/summary and minutes/sapwg/attachments/att1b-sapwg 6.28.23 minutes.docx](https://naiconline.sharepoint.com/sites/naicsupportstaffhub/member%20meetings/e%20cmte/apptf/2023-2%20summer/summary%20and%20minutes/sapwg/attachments/att1b-sapwg%206.28.23%20minutes.docx)

Interpretation of the Statutory Accounting Principles (E) Working Group

2023 Net Negative (Disallowed) Interest Maintenance Reserve

INT 23-01T Dates Discussed

March 22, 2023

INT 23-01 References

Current:

*SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve
Annual Statement Instructions*

INT 23-01T Issue

1. The statutory accounting guidance for interest maintenance reserve (IMR) and the asset valuation reserve (AVR) is within *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*, but the guidance within *SSAP No. 7* is very limited. It provides a general description, identifies that IMR/AVR shall be calculated and reported per the guidance in the applicable SSAP, and if not explicit in the SSAP, in accordance with the annual statement instructions. The SSAPs most often simply direct allocation to (or between) IMR and AVR, with the bulk of the guidance residing within the annual statement instructions.

2. As detailed in *SSAP No. 7*, paragraph 2, the guidance for IMR and AVR applies to life and accident and health insurance companies and focuses on IMR and AVR liability recognition and distinguishing between IMR and AVR:

2. Life and accident and health insurance companies shall recognize liabilities for an AVR and an IMR. The AVR is intended to establish a reserve to offset potential credit-related investment losses on all invested asset categories excluding cash, policy loans, premium notes, collateral notes and income receivable. The IMR defers recognition of the realized capital gains and losses resulting from changes in the general level of interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the investments sold. The IMR also applies to certain liability gains/losses related to changes in interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the liability released.

3. The IMR guidance in the annual statement instructions provides information on the net balance. A positive IMR represents net interest rate realized gains and is reported as a liability on a dedicated reporting line. A negative disallowed IMR represents net interest rate realized losses and is reported as a miscellaneous other-than-invested write-in asset in the general account and nonadmitted.

4. IMR balances between the general account and separate accounts are separate and distinct. Meaning, a net negative IMR in the general account only represents activity that occurred in the general account that was allocated to IMR. However, the net positive or negative balance of the general account influences how the net positive or negative balances are reported in separate account statements (and vice versa). (A net negative IMR balance in the general account may not be disallowed if there is a covering net positive IMR in the separate account. Negative IMR that is not disallowed is reported as a contra-liability.) The instructions for reporting the net negative and positive balances are detailed in the annual statement instructions:

Line 6 – Reserve as of December 31, Current Year

Record any positive or allowable negative balance in the liability line captioned “Interest Maintenance Reserve” on Page 3, Line 9.4 of the General Account Statement and Line 3 of the Separate Accounts Statement. A negative IMR balance may be recorded as a negative liability in either the General Account or the Separate Accounts Statement of a company only to the extent that it is covered or offset by a positive IMR liability in the other statement.

If there is any disallowed negative IMR balance in the General Account Statement, include the change in the disallowed portion in Page 4, Line 41 so that the change will be appropriately charged or credited to the Capital and Surplus Account on Page 4. If there is any disallowed negative IMR balance in the Separate Accounts Statement, determine the change in the disallowed portion (prior year less current year disallowed portions), and make a direct charge or credit to the surplus account for the “Change in Disallowed Interest Maintenance Reserve” in the write-in line, in the Surplus Account on Page 4 of the Separate Accounts Statement. The following information is presented to assist in determining the proper accounting:

| General Account IMR Balance | Separate Account IMR Balance | Net IMR Balance |
|--------------------------------|---------------------------------|-----------------------|
| Positive | Positive | Positive (See rule a) |
| Negative | Negative | Negative (See rule b) |
| Positive | Negative | Positive (See rule c) |
| Positive | Negative | Negative (See rule d) |
| Negative | Positive | Positive (See rule e) |
| Negative | Positive | Negative (See rule f) |

Rules:

- a. If both balances are positive, then report each as a liability in its respective statement.
- b. If both balances are negative, then no portion of the negative balances is allowable as a negative liability in either statement. Report a zero for the IMR liability in each statement and follow the above instructions for handling disallowed negative IMR balances in each statement.
- c. If the general account balance is positive, the separate accounts balance is negative and the combined net balance is positive, then all of the negative IMR balance is allowable as a negative liability in the Separate Accounts Statement.
- d. If the general account balance is positive, the separate account balance is negative, and the combined net balance is negative, then the negative amount not covered by the positive amount is not allowable. Report only the allowable portion as a negative liability in the Separate Accounts Statement and follow the above instructions for handling the disallowed portion of negative IMR balances in the Separate Accounts Statement.
- e. If the general account balance is negative, the separate account balance is positive, and the combined net balance is positive, then all of the negative IMR balance is allowable as a negative liability in the General Account Statement.
- f. If the general account balance is negative, the separate account balance is positive, and the combined net balance is negative, then the negative amount not covered by the positive amount is not allowable. Report only the allowable portion as a negative liability in the General Account Statement and follow the above instructions for handling the disallowed portion of negative IMR balances in the General Account Statement.

5. In October 2022, the ACLI requested the Statutory Accounting Principles (E) Working Group to reassess the guidance for net negative (disallowed) IMR, with a request to consider admittance of those amounts. The ACLI noted that the nonadmittance of disallowed negative IMR can have adverse negative ramifications for insurers with two key themes:

- a. In general, rising interest rates are favorable to the financial health of the insurance industry and policyholders. However, with negative IMR, there is an inappropriate perception of decreased financial strength through lower surplus and risk-based capital.
- b. Negative IMR could impact the rating agency view of the industry or incentivize companies to avoid prudent investment transactions that are necessary to avoid mismatches between assets and liabilities. In either scenario, negative IMR encourages short-term non-economic activity that is not in the best long-term interest of a reporting entity's financial health or its policyholders.

6. In considering the request, the Working Group concluded that for year-end 2022, there would be no change to statutory accounting guidance and deviations from statutory accounting principles would need to be approved via a permitted or prescribed practice. The Working Group then held company-specific educational sessions in January 2023 to receive detailed information regarding negative IMR and received a subsequent comment letter from the ACLI.

7. During the 2023 Spring National Meeting, the Working Group further discussed the topic of negative IMR and directed NAIC staff to proceed with drafting guidance for both a 2023 solution and to begin work towards a long-term solution.

INT 23-01T Discussion

8. This tentative interpretation prescribes limited-time, optional, statutory accounting guidance, as an exception to the existing guidance detailed in SSAP No. 7 and the annual statement instructions that requires nonadmittance of net negative (disallowed) IMR in the general account as a short-term solution for 2023. This interpretation is specific for general account treatment only and assessment of possible revisions for the separate account will be considered as part of the long-term solution. Specifically, this interpretation impacts the annual statement instruction rules regarding disallowed negative IMR in the general account, detailed in rules 'b' and 'f' shown in paragraph 4. (As detailed within, admittance in the general account does not impact the determination or reporting of IMR in the separate accounts.) As this interpretation overrides existing guidance, it will require a 2/3rd vote.

9. Reporting entities are permitted to admit net negative (disallowed) IMR in the general account with the following restrictions:

- a. Reporting entities with an RBC greater than 300% are permitted to admit net negative (disallowed) IMR, as defined in paragraph 9.b., up to 5% of the reporting entity's general account 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, net deferred tax assets and admitted net negative IMR. Reporting entities with a 300% or lower RBC are not permitted to admit net negative (disallowed) IMR.
- b. Negative (disallowed) IMR admitted pursuant to paragraph 9.a. is limited to IMR generated from losses incurred from the sale of bonds, or other qualifying fixed income investments, that were reported at amortized cost prior to the sale, and for which the proceeds of the sale

were immediately used to acquire bonds, or other qualifying fixed income investments, that will be reported at amortized cost. (This provision intends to explicitly exclude derivative losses from derivatives reported at fair value that have been allocated to IMR from being admitted under this guidance¹.)

10. Reporting entities that admit net negative disallowed IMR in the general account pursuant to paragraph 9 shall report the admittance in the balance sheet as follows:

- a. Reporting entities shall report the net negative (disallowed) IMR as a write-in to miscellaneous other-than-invested asset (named as “Disallowed IMR”) on the asset page. The net negative (disallowed) IMR shall be admitted to the extent permitted per paragraph 9, with the remaining net negative (disallowed) IMR balance nonadmitted.
- b. Reporting entities shall allocate an amount equal to the general account admitted net negative (disallowed) IMR to special surplus. Although dividends are contingent on state specific statutes and laws, the intent of this reporting is to provide transparency and preclude the ability for admitted negative IMR to be reported as funds available to dividend.

11. Reporting entities admitting net negative (disallowed) IMR are required to complete the following disclosures in the annual and quarterly financial statements for IMR:

- a. Reporting entities that have allocated gains/losses to IMR from derivatives that were reported at fair value prior to the closing / termination / settlement / expiration of the derivative shall disclose the non-amortized impact to IMR from these allocations separately between gains and losses. This disclosure shall illustrate the removal of these balances from the total general account IMR to determine the net negative amount that is permitted to be admitted under paragraph 9.b.
- b. Reporting entities shall complete a note disclosure that details the gross negative (disallowed) IMR, the amounts of negative IMR admitted and nonadmitted, adjusted capital and surplus per paragraph 9.a. and the percentage of adjusted capital and surplus for which the admitted negative IMR represents.

12. The provisions in this interpretation intend to be specific on the following prohibitions:

- a. Negative IMR permitted to be admitted shall not include losses from derivatives that were reported at fair value prior to settlement / termination / expiration / closing of the derivative. (Only derivative losses from derivatives that qualified as effective hedges (and reported under ‘hedge accounting’ as detailed in *SSAP No. 86—Derivatives*), which hedged an item that had offsetting adjustments to IMR, are permitted to be included in the admittance calculation.) The allocation of derivative losses to IMR, for derivatives held at fair value and were not offset by a hedged asset that was also subject to IMR, is not in line with the original intent of the IMR guidance in *SSAP No. 86* or the annual statement instructions.

¹ It has been identified that some reporting entities have allocated derivative losses to IMR for derivatives that were reported at fair value throughout the derivative life, as they did not qualify as effective hedges under statutory accounting, and that were not hedging assets with offsetting amounts to the IMR. As detailed in paragraph 9.b., these losses shall be removed from the IMR balance in determining the net negative (disallowed) IMR balance permissible for admittance.

Consideration of this industry interpretation and clarification of derivatives through the IMR will be addressed as part of the long-term proposal.

- b. The admittance of net negative (disallowed) IMR in the general account shall have no impact on the reporting of IMR in the separate account. The comparison of general account and separate account IMR shall occur on the gross positive and negative balances prior to any admittance in the general account. Disallowed negative IMR in the separate account shall continue to be fully disallowed as a direct charge to surplus. The IMR annual statement instructions predate current guidance that requires insulated and non-insulated separate account blanks. Consideration of separate account treatment of IMR will be addressed in a long-term proposal that will assess the concepts of insulated separate accounts and whether the balances of the general account shall have any influence on how IMR shall be reported in those separate account statements.

INT 23-01T Status

13. The consensuses in this interpretation were adopted on _____, to provide limited-time exception guidance to SSAP No. 7 and the annual statement instruction for the reporting of negative (disallowed) IMR in the general account. The provisions within this interpretation are permitted until _____ and will be automatically nullified on _____.

14. Further discussion is planned.

[https://naiconline.sharepoint.com/sites/naicsupportstaffhub/member meetings/e cmte/apptf/2023-2 summer/sapwg/attachments/att1b1-int 23-01t-imr.docx](https://naiconline.sharepoint.com/sites/naicsupportstaffhub/member%20meetings/e%20cmte/apptf/2023-2%20summer/sapwg/attachments/att1b1-int%2023-01t-imr.docx)

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

Issue: Negative IMR

Check (applicable entity):

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

Description of Issue: This agenda item has been developed to discuss the interest maintenance reserve (IMR) within statutory accounting, specifically the current guidance for the nonadmittance of disallowed negative IMR. Although the statutory accounting guidance has been in place for several years, the rising interest rate environment has created an increased likelihood for reporting entities to move to a negative IMR position. This agenda item intends to provide information on the background of IMR, current accounting guidance, recent discussions of the Life Actuarial (A) Task Force and some broad financial results from year-end 2021 and interim 2022 financial statements. The intent is to provide this information to facilitate Working Group discussion.

The following provides a high-level overview of the use of the terms positive IMR and negative IMR for entities filing the Life, Accident & Health / Fraternal annual statement blank:

- A positive IMR means that the net realized interest related gains which are amortized in the IMR calculation are greater than net realized interest related losses which are being amortized in the IMR calculation. A positive IMR is reported as a statutory liability and amortized to income over time.
- A negative IMR means that net realized interest related losses which are amortized in the IMR calculation are greater than net realized interested related gains which are amortized in the IMR calculation. A disallowed negative IMR is reported as a nonadmitted asset and amortized to income as a loss over time.

As IMR occurs in the general and separate account, there are specific guidelines in determining whether the IMR reflects a net disallowed negative or position in the annual statement instructions. These are on page 5.

A letter from the American Council of Life Insurers (ACLI) dated Oct. 31, 2022, raised concerns with existing statutory accounting requirements on the nonadmittance of disallowed negative IMR noting negative ramifications for insurers. Key summarized positions from this ACLI letter include:

- In general, rising interest rates are favorable to the financial health of the insurance industry and policyholders. However, with negative IMR, there is an inappropriate perception of decreased financial strength through lower surplus and risk-based capital.
- Negative IMR could impact the rating agency view of the industry or incentivize companies to avoid prudent investment transactions that are necessary to avoid mismatches between assets and liabilities. In either scenario, negative IMR encourages short-term non-economic activity that is not in the best long-term interest of a reporting entity's financial health or its policyholders.

Background of IMR

The IMR was first effective in statutory accounting in 1992 and requires that a realized fixed income gains or losses attributable to changes in interest rates (excluding gains/losses that are credit related), be amortized into income over the remaining term to maturity of the fixed-income investments (and related hedging programs) sold rather than being reflected in income immediately.

Minutes, including adopted materials – in the Blue Book (Life Statement), from the 2002 4th Quarter NAIC Proceedings discussing IMR are provided below. Please note the last section that includes “Future Directions” which identifies recognition of negative IMR as a major area of effort.

Description and other components of IMR from the Blue Book, captured in the 2002 4th Quarter NAIC Proceedings, provides the following definition and other details: (*Only key excerpts included.*)

The Interest Maintenance Reserve (IMR): captures for all types of fixed income investments, all of the realized capital gains and losses which result from changes in the overall level of interest rates as they occur. Once captured, these capital gains or losses are amortized into income over the remaining life (period to maturity) of the investments sold. Realized gains and losses on derivative investments, which alter the interest rate characteristics of assets/liabilities, also are allocated to the IMR and are to be amortized into income over the life of the associated assets/liabilities. Note: certain significant unusual transactions may require immediate recognition of any realized capital gains or losses, as described in a later section. This reserve is not subject to any maximum.

VII. IMR MINIMUMS/MAXIMUMS: A. Minimums: **The IMR can be negative for any line of business as long as the aggregate IMR for the Company is not less than zero. Any otherwise negative IMR value is carried over to subsequent years.** B. Maximums: There is no maximum of the IMR

VIII. BACKGROUND/PERSPECTIVE: To insure solvency of a company, its assets should be invested so that the company has a very high probability of paying its contractual liabilities when they become due. In order to assess whether a company is able to fulfill its obligations, it must present its liabilities and assets on a financially integrated basis. Since the accounting practices prescribed for the life insurance annual statement are an important element in this discipline, it is imperative that the accounting practices be consistent for assets and liabilities. If they are inconsistent, then the annual statement will not reveal whether assets exceed liabilities; more importantly, neither regulators nor management can determine the risk of insolvency for the company.

The Valuation Actuary’s Opinion includes a statement that the assets backing the liabilities make adequate provision for the company’s liabilities. That is, the Actuary must look beyond the statutory valuation formulas and satisfy himself that the cash flows generated by the assets will probably be sufficient to discharge the liabilities. Prior to the AVR and IMR, there were many circumstances under which the statutory formula valuation methods gave rise to inappropriate results. Some examples were:

- Changes in values due to interest rate swings were recognized inconsistently on the asset and liability sides of the balance sheet. Liabilities are valued using interest rates fixed at issue while some assets may be valued using current interest rates through trading activity.
- When the assets are poorly matched to the liabilities, a significant adverse swing in the interest rates will reduce financial strength and could lead to insolvency even though the balance sheet value of the assets exceeds the balance sheet value of the liabilities. Using long term assets to back demand liabilities is dangerous if there is a significant upswing in interest rates. In addition, individual insurance premiums are received and invested for many years after the issue date on which the reserve interest rate is determined, creating a potential for inadequate yields that is not reflected in standard accounting procedures.
- The potential for future asset losses was not well reflected in the balance sheet or earnings statement.

It is desirable that the valuation of the assets and liabilities be made as consistent as possible to 1) minimize the instances where, in order to render a clean opinion, the actuary must establish extra reserves due to interest rate gains or potential for defaults and 2) increase the likelihood that assets supporting liabilities are sufficient even in the absence of an Actuarial Opinion. The development of an AVR and IMR will correct many of these deficiencies in consistency.

XII. AVR AND IMR BUILT ON AND COMPLEMENT EXISTING VALUATION PRACTICES: The existing framework of asset and liability valuation practices, as augmented by the NAIC Model Standard Valuation Law, played a key role in designing the AVR and IMR, including:

A. Reserve valuation standards should contain a provision for future losses. Although it is well understood that in cash flow testing provision must be made for future asset losses, it may not be as well understood that historically the minimum valuation standards implicitly contained such a provision.

B. Interest assumptions in reserve valuation generally recognize the potential for mismatch. Dynamic valuation rates are lower for ordinary life than for guaranteed investment contracts, for example, because the mismatch is almost inevitable on the former. In addition, it is required in other regulations, and in the NAIC Model Standard Valuation Law, that cash flow testing should be used and may result in the adoption of lower than the dynamic valuation rates if mismatch exists. Hence, with the one exception noted in section (c), there is no need for the IMR reserves to make provision for the risk of mismatch.

C. Asset valuations for fixed interest securities usually reflect the outlook at the time of purchase of an asset. In particular, bond amortization tends to reflect the yields available at time of purchase and the expected cash flow. Liabilities are established at the same time, and the interest rate assumptions on them are those appropriate to the outlook at that time. **But if securities are traded, a new amortization schedule is established that may be based on an entirely different yield environment, which may not be consistent with the liabilities that have been established. Using the IMR to absorb trading gains is desirable and appropriate to eliminate this subsequently created mismatch.**

D. Equities present special valuation problems. Common stocks are valued at market rather than amortized value; hence they require different treatment. Real estate and similar investments, although usually valued at depreciated value, require special consideration because of the great likelihood of major changes in yield and yield expectation after purchase.

XXII. RESERVE MAXIMUM AND MINIMUM LEVELS: No maximum is placed on the Interest Maintenance Reserve. The aggregate minimum value for the IMR for the Company is zero. The IMR may be negative for any Line of Business as long as the aggregate for all lines equals zero. Provision is made in the accounting rules that if an aggregate negative IMR is developed in the absence of the zero minimum, that negative value is carried over to subsequent years.

The basic rationale for the IMR would conclude that neither a maximum nor a minimum is appropriate. If the liability values are based on the assumption that the assets were purchased at about the same time as the liabilities were established, then there should be no bounds to the reserve which corrects for departures from that assumption; if a company has to set up a large reserve because of trading gains, it is in no worse position than if it had held the original assets. As for negative values of the IMR, the same rationale applies. However, the concept of a negative reserve in the aggregate has not been adopted.

XXVIII. EXCESSIVE WITHDRAWALS:

A. Background: Major book-value withdrawals or increases in policy loans can occur at a time of elevated interest rates. If these withdrawals or increases are far in excess of the withdrawals provided for in the company's reserving and cash flow testing, and **if asset sales at this point are, in effect, forced**

sales to fund liabilities that are no longer on the books, the allocation of a negative amount to the IMR is not correct.

A company may also experience a “run on the bank” due to adverse publicity. This could occur even during a period of low interest rates, and the sale of assets to meet a run would conceivably produce gains. It is appropriate to register the gains immediately.

If the withdrawals were scheduled payments under a GIC, then there is a presumption that any gains or losses that might occur at the time of withdrawal should be added to the IMR since the gains or losses would be spurious if the company has followed a policy of matching its assets to its liabilities. Note that many of the situations where an upsurge in withdrawal activity generates real losses arise when a company has a severe mismatch between its assets and its liabilities. Such losses can be present even in the absence of any realized gains or losses. The primary protection as to the adequacy of reserves in these circumstances is the requirement for an actuary’s opinion.

- B. IMR Exclusions: All realized interest-related gains or losses which arise from the sale of investments required to meet “Excess Withdrawal Activity” as defined below will be excluded from the IMR and will be reflected in net income.

STANDARDS FOR ACTUARIAL RESERVES WITH AN IMR AND AN AVR

LXX. IMR RESERVE STANDARD The Interest Maintenance Reserve is a true actuarial reserve, and actuaries should use the assets supporting the Interest Maintenance Reserve when opining that the assets supporting the company’s reserves make adequate provision for the company’s obligations. **In the case of a negative IMR, the actuarial opinion should include an explicit statement that the impact of the negative IMR on reserve adequacy has been considered and that the reserves after deduction of the negative IMR still make adequate provision for the liabilities.**

LXXI. GENERAL EXPLANATION The IMR is designed to work with minimum statutory reserves based on formulas contained in laws or regulations. Where, for example, the valuation rate is based on the interest rate conditions prevailing in the year of deposit, the assets supporting the liabilities will be consistent with the liability assumptions. Disposal of the assets during a period of declining interest rates will produce interest-related gains, but these gains will be needed to support the liabilities that are still valued at the interest rate levels prevailing at time of deposit. Thus, it is appropriate in the case of positive IMR to treat the IMR as an additional reserve requirement above and beyond formula minimums.

In cash-flow-testing actuaries take future cash flows into account from existing assets. In an example such as described above, existing assets may well have been purchased at rates below those prevailing at the time reserves were established. The positive IMR that has been built up has captured the gains and not allowed them to be available for distribution. The IMR is recognized as part of the reserves available to meet future obligation cash flows.

Thus from either point of view a positive IMR is treated as a true actuarial reserve. The same arguments should apply equally well in the case of a negative IMR, but some concern has been expressed that in this case the net reserves are in effect lower than statutory formulas minimums, and therefore special considerations are required.

FUTURE DIRECTIONS

In late 2002, the interested persons (as its name had become) considered refinements of the AVR/IMR for the next several years, from that vantage point, some of the major areas of effort appear to be as follows:

1. **There should be recognition of negative values of the IMR. The group had long recognized that the philosophical basis for the IMR supports negative values of the reserve as well as positive.**

There is a need to have investment return match the liabilities associated with the investment; and a need to remove the incentive for a company to make investment decisions based on the shortterm balance sheet effect; and these needs exist also on the negative side of the IMR.

No doubt there are concerns that a negative reserve of this type could somehow lead to an unsound condition, so there has been appended to this report a discussion entitled “Why Are Negative Values For the IMR Necessary?” It also seems as though there should be additional safeguards in the case of a negative IMR. Rather than put arbitrary limits on the amount of the negative reserve, however, consideration is being given to an actuary’s statement that an asset adequacy analysis has been carried out that demonstrates the soundness of the reserves.

(Staff Note: The NAIC library does not have a record of the report noted in the above paragraph.)

Current Accounting Guidance

The statutory accounting guidance for IMR (and the Asset Valuation Reserve – AVR) is within *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*, but the guidance within that SSAP is very limited. It provides a general description, identifies that IMR/AVR shall be calculated and reported per the guidance in the applicable SSAP, and if not explicit in the SSAP, in accordance with the Annual Statement Instructions. The SSAPs most often simply direct allocation to (or between) IMR and AVR, with the bulk of the guidance within the Annual Statement Instructions.

The guidance in the Annual Statement instructions provides information on the net IMR balance, which takes into consideration both the positive and negative balances in the general and separate accounts. As detailed, disallowed negative IMR is reported so that it is a direct reduction to surplus on the Summary of Operations, page 4, line 41 change in nonadmitted assets:

Line 6 – Reserve as of December 31, Current Year

Record any positive or allowable negative balance in the liability line captioned “Interest Maintenance Reserve” on Page 3, Line 9.4 of the General Account Statement and Line 3 of the Separate Accounts Statement. A negative IMR balance may be recorded as a negative liability in either the General Account or the Separate Accounts Statement of a company only to the extent that it is covered or offset by a positive IMR liability in the other statement.

If there is any disallowed negative IMR balance in the General Account Statement, include the change in the disallowed portion in Page 4, Line 41 so that the change will be appropriately charged or credited to the Capital and Surplus Account on Page 4. If there is any disallowed negative IMR balance in the Separate Accounts Statement, determine the change in the disallowed portion (prior year less current year disallowed portions), and make a direct charge or credit to the surplus account for the “Change in Disallowed Interest Maintenance Reserve” in the write-in line, in the Surplus Account on Page 4 of the Separate Accounts Statement.

The following information is presented to assist in determining the proper accounting:

| General Account IMR Balance | Separate Account IMR Balance | Net IMR Balance |
|--------------------------------|---------------------------------|-----------------------|
| Positive | Positive | Positive (See rule a) |
| Negative | Negative | Negative (See rule b) |

| | | |
|----------|----------|-----------------------|
| Positive | Negative | Positive (See rule c) |
| Positive | Negative | Negative (See rule d) |
| Negative | Positive | Positive (See rule e) |
| Negative | Positive | Negative (See rule f) |

Rules:

- a. If both balances are positive, then report each as a liability in its respective statement.
- b. If both balances are negative, then no portion of the negative balances is allowable as a negative liability in either statement. Report a zero for the IMR liability in each statement and follow the above instructions for handling disallowed negative IMR balances in each statement.
- c. If the general account balance is positive, the separate accounts balance is negative and the combined net balance is positive, then all of the negative IMR balance is allowable as a negative liability in the Separate Accounts Statement.
- d. If the general account balance is positive, the separate account balance is negative, and the combined net balance is negative, then the negative amount not covered by the positive amount is not allowable. Report only the allowable portion as a negative liability in the Separate Accounts Statement and follow the above instructions for handling the disallowed portion of negative IMR balances in the Separate Accounts Statement.
- e. If the general account balance is negative, the separate account balance is positive, and the combined net balance is positive, then all of the negative IMR balance is allowable as a negative liability in the General Account Statement.
- f. If the general account balance is negative, the separate account balance is positive, and the combined net balance is negative, then the negative amount not covered by the positive amount is not allowable. Report only the allowable portion as a negative liability in the General Account Statement and follow the above instructions for handling the disallowed portion of negative IMR balances in the General Account Statement.

The Statutory Accounting Statement of Concepts in the Preamble to the AP&P provides the following on Recognition:

Recognition

35. The principal focus of solvency measurement is determination of financial condition through analysis of the balance sheet. However, protection of the policyholders can only be maintained through continued monitoring of the financial condition of the insurance enterprise. Operating performance is another indicator of an enterprise's ability to maintain itself as a going concern. Accordingly, the income statement is a secondary focus of statutory accounting and should not be diminished in importance to the extent contemplated by a liquidation basis of accounting.

36. 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 but rather should be charged against surplus when acquired or when availability otherwise becomes questionable.

37. Liabilities require recognition as they are incurred. Certain statutorily mandated liabilities may also be required to arrive at conservative estimates of liabilities and probable loss contingencies (e.g., interest maintenance reserves, asset valuation reserves, and others).

Life Actuarial (A) Task Force 2022 Guidance

The Life Actuarial (A) Task Force considered comments from the ACLI that the inclusion of a negative IMR balance in asset adequacy testing, the disallowance of a negative IMR could result in double counting of losses (i.e., through the disallowance on the balance sheet and the potential AAT-related reserve deficiency). The Task Force identified that VM-20 Section 7.D.7.b notes that "...the company shall use a reasonable approach to allocate any portion of the total company balance that is disallowable under statutory accounting procedures (i.e., when the total company balance is an asset rather than a liability)." Question 22 of the AAA's Asset Adequacy Practice Note (Attachment 2) states that "... a negative IMR is not an admitted asset in the annual statement. So, some actuaries do not reflect a negative value of IMR in the liabilities used for asset adequacy analysis." However, Question 22 also notes a 2012 survey data that showed varying practices across companies, including some companies that allocated negative IMR.

On Nov. 17, 2022, in order to assist state regulators in achieving uniform outcomes for year-end 2022, the Task Force exposed guidance until November 30, 2022:

Recommendation In order to assist state regulators in achieving uniform outcomes for year-end 2022, we have the following recommendation: the allocation of IMR in VM-20, VM-21, and VM-30 should be principle-based, "appropriate", and "reasonable". Companies are not required to allocate any non-admitted portion of IMR (or PIMR, as applicable) for purposes of VM-20, VM-21, and VM-30, as being consistent with the asset handling for the nonadmitted portion of IMR would be part of a principle-based, reasonable and appropriate allocation. However, if a company was granted a permitted practice to admit negative IMR as an asset, the company should allocate the formerly non-admitted portion of negative IMR, as again a principle-based, reasonable and appropriate IMR allocation would be consistent with the handling of the IMR asset. This recommended guidance is for year-end 2022, to address the current uncertainty and concerns with the "double-counting" of losses. This recommended guidance will help ensure consistency between states and between life insurers in this volatile rate environment. Refinement of this guidance may be considered beyond year-end 2022.

The Oct. 31, 2022 ACLI Letter also identified the following references to IMR in the valuation manual and Risk-Based Capital Calculations:

| Regulation | Use | IMR references |
|---|--|--|
| Actuarial Opinion and Memorandum Regulation (VM-30) | Asset adequacy analysis for annual reserve opinion | An appropriate allocation of assets in the amount of the IMR, whether positive or negative, shall be used in any asset adequacy analysis. |
| Life principle-based reserves (VM-20) | Calculation of deterministic reserve | Calculate the deterministic reserve equal to the actuarial present value of benefits, expenses, and related amounts less the actuarial present value of premiums and related amounts, less the positive or negative pre-tax IMR balance at the valuation date allocated to the |

| | | |
|---|---|--|
| | | group of one or more policies being modeled |
| Life principle-based reserves (VM-20) | Calculation of stochastic reserve | Add the CTE amount (D) plus any additional amount (E) less the positive or negative pre-tax IMR balance allocated to the group of one or more policies being modeled |
| Variable annuities principle-based reserves (VM-21) | Reserving for variable annuities | The IMR shall be handled consistently with the treatment in the company's cash-flow testing, and the amounts should be adjusted to a pre-tax basis. |
| C3 Phase 1 (Interest rate risk capital) | RBC for fixed annuities and single premium life | IMR assets should be used for C3 modeling. |

Assessment of 2020-2022 IMR Balances:

Note – The following amounts reflect the general account IMR Reserve balance. (This is the amount shown as a liability and shows the decrease in the positive IMR reported since 2020.) This detail does not show the disallowed negative IMR reported as an asset and nonadmitted. Also, information on the separate account IMR, which is a factor in determining in disallowed negative IMR, will not be known until the year-end financial statements are filed (March 1, 2023).

| | GA 2022 – Q3 | GA 2022 – Q2 | GA 2022 – Q1 | GA YE – 2021 | GA YE – 2020 |
|-------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Aggregate IMR | 27,601,001,445 | 31,859,274,989 | 37,697,176,149 | 40,598,068,038 | 35,229,578,726 |
| Change from Prior | (4,258,273,544) | (5,837,901,160) | (2,900,891,889) | 5,368,489,312 | |
| % Change | (13.4%) | (21.5%) | (7.1%) | 15.2% | |

Review of GA IMR Reserve Decrease:

- From the first quarter (Q1) to second quarter (Q2), 25 companies had decreases in the IMR reserve balance over \$50M totaling \$4,717,657,986, representing 80% of the overall change. 13 of these companies had decreases of IMR over \$100M, totaling \$3,959,569,339, representing 68% of the change. Four of these companies had decreases of IMR over \$400M. One of these companies reported a zero IMR liability and reported a disallowed IMR on the asset page of approx. \$570M.
- From the first quarter (Q1) to second quarter (Q2), 49 companies increased their prior reported positive IMR by \$61,390,564. From the second quarter (Q2) to third quarter (Q3), 56 companies increase their prior reported positive IMR by \$60,316,403
- From the second quarter (Q2) to third quarter (Q3), 16 companies had decreases in the IMR reserve balance over \$50M totaling \$3,161,570,362, representing 74% of the change. 8 of these companies had decreases of IMR over \$100M, totaling \$2,580,832,015, representing 60% of the change. All of these companies were still in a net positive IMR position.
- For the 30 companies that reflected the largest decline in reported IMR between the first to second quarter and then the second to third quarter, the following key details are noted.
 - From the first (Q1) to second quarter (Q2), the top 30 companies reflected a decrease in \$4,923,166,733, which is 84% of the total decrease.
 - From the second (Q2) to third quarter (Q3), the top 30 companies reflected a decrease in \$3,642,088,165, which is 85.5% of the total decrease.
 - 19 companies were noted as being in the population for both periods. 29 of the 30 companies reported a net positive IMR in the third quarter. One company reported a zero IMR in Q3.
- For the 15 companies that had the largest declines between the first quarter (Q1) to second quarter (Q2), eight of those companies also had the largest declines from second quarter (Q2) to third quarter (Q3).
- A limited number of companies are reporting a negative IMR on the liabilities side. Seven companies reported a net negative IMR balance in the third quarter (Q3) for a total of 11,031,998. One company made up \$10.5M of the aggregate balance and this company initially went negative in the second quarter (Q2).

Six companies reported a net negative IMR balance for Q2 for a total of \$9,815,594. (The other companies with negative IMR were immaterial amounts.) *(Under the guidance in the A/S instructions, these companies should stop at zero and report the negative as disallowed nonadmitted asset.)*

Review of Disallowed IMR:

Although the assessment of the liability balance shows the decrease in positive IMR, it no longer tracks the decline for companies that go negative, as the reserve balance on the liability page should stop at zero. (This info may be identifiable from the IMR schedule, but not within the quarterly financials from a review of the IMR reported on the liability page.) As such, NAIC staff completed a review of the data to identify the companies that moved to a zero balance (from a prior positive balance) at year-end 2021 or in the 2022 quarters:

Companies that moved from a positive IMR (liability) to a zero balance:

- Initially went to zero in 2022 – Q3: 20 companies
- Initially went to zero in 2022 – Q2: 20 companies
- Initially went to zero in 2022 – Q1: 11 companies
- Initially went to zero YE 2021 – 20 companies (This is a comparison to YE 2020.)

For these 71 companies, NAIC staff has completed a manual review to the 2022 third quarter financial statements to determine if a disallowed IMR was reported as an aggregate write-in on the asset page. For these companies, 60 were identified with a disallowed IMR for a total of \$1 Billion as of the third quarter 2022.

Existing Authoritative Literature:

SSAP Authoritative Guidance:

- *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*
- Life Annual Statement Instructions

(Guidance included as part of discussion.)

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):

- Nov. 17, 2022, Discussion by Life Actuarial (A) Task Force as discussed above.

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

Convergence with International Financial Reporting Standards (IFRS): NA

Recommendation:

NAIC staff recommend that the Working Group include this item on their maintenance agenda as a New SAP Concept for discussion to assess the current guidance for disallowed negative IMR. NAIC staff recommend that at the Working Group's conclusion, documentation of the discussion, and resulting decisions, be captured for historical purposes in an Issue Paper.

Staff Review Completed by: Julie Gann - NAIC Staff, November 2022

Status:

On December 13, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a New SAP Concept and exposed the agenda item with a request for comments by industry on potential guardrails and details on unique considerations. The Working Group directed NAIC staff to coordinate with the Life Actuarial (A) Task Force and request regulator-only sessions with industry to receive specific company information.

On March 22, 2023, the Statutory Accounting Principles (E) Working Group directed NAIC staff regarding the consideration of negative interest maintenance reserve (IMR) with an intent to work on both a 2023 solution and a long-term solution as follows:

- a. Draft a referral to the Life Actuarial (A) Task Force on further consideration of the asset adequacy implications of negative IMR. Items to include: 1) developing a template for reporting within asset adequacy testing (AAT); 2) considering the actual amount of negative IMR that is admitted to be used in the AAT; 3) better consideration of cash flows within AAT (and documentation), as well as any liquidity stress test (LST) considerations; 4) ensuring that excessive withdrawal considerations are consistent with actual data (sales of bonds because of excess withdrawals should not use the IMR process); and 5) ensuring that any guardrails for assumptions in the AAT are reasonable and consistent with other aspects.
- b. Draft a referral to the Capital Adequacy (E) Task Force for the consideration of eliminating any admitted net negative IMR from total adjusted capital (TAC) and the consideration of sensitivity testing with and without negative IMR.
- c. Develop guidance for future Working Group consideration that would allow the admission of negative IMR up to 5% of surplus using the type of limitation calculation similar to that used for goodwill admittance. The guidance should also provide for a downward adjustment if RBC ratio is less than 300.
- d. Review and provide updates on any annual statement instructions for excess withdraws, related bond gains/losses and non-effective hedge gains/losses to clarify that those related gains/losses are through asset valuation reserve (AVR), not IMR.
- e. Develop accounting and reporting guidance to require the use of a special surplus (account or line) for net negative IMR.
- f. Develop governance related documentation to ensure sales of bonds are reinvested in other bonds.
- g. Develop a footnote disclosure for quarterly and annual reporting.

On April 10, 2023, the Working Group exposed a limited-time, optional INT to allow admittance of net negative (disallowed) IMR in the general account up to 5% of adjusted capital and surplus. The exposed INT proposed restrictions on what is permitted to be captured in the net negative IMR balance eligible for admittance as well as reporting and disclosure requirements.

MEMORANDUM

TO: Dale Bruggeman, Chair of the Statutory Accounting Principles (E) Working Group
Kevin Clark, Vice-Chair of the Statutory Accounting Principles (E) Working Group

FROM: Rachel Hemphill, Chair, Life Actuarial (A) Task Force
Craig Chupp, Vice-Chair, Life Actuarial (A) Task Force

RE: Life Actuarial (A) Task Force Response on Negative IMR

DATE: June 15, 2023

Background

On March 27, 2023 a memorandum from the Statutory Accounting Principles (E) Working Group (SAPWG) was received by the Life Actuarial (A) Task Force (LATF) with a referral for consideration of the Asset Adequacy Testing (AAT) implications of negative IMR. Specifically, the Working Group recommended a referral to the Task Force to consider the following:

1. Development of a template summarizing how IMR (positive and negative) is reflected within AAT.
2. Consideration of the actual amount of negative IMR that is to be used in AAT, noting that as negative IMR is included, there is a greater potential for an AAT liability.
3. Better consideration and documentation of cash flows within AAT, as well as any liquidity stress test considerations.
4. Ensuring that excessive withdrawal considerations are consistent with actual data. (Insurers selling bonds because of excess withdrawals should not use the IMR process.)
5. Ensuring that any guardrails for assumptions in AAT are reasonable and consistent with other financial statement / reserving assumptions.

Recommendation

On its April 27th call, LATF discussed the referral from SAPWG. LATF agreed on the following actions:

Develop IMR Template

LATF is drafting a template with additional disclosures on the reflection of IMR in Principle-Based Reserving (PBR) and AAT. We have requested input from the American Academy of Actuaries and the American Council of Life

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|--|------------------|------------------|
| Washington, DC 444 North Capitol Street NW, Suite 700, Washington, DC 20001-1509 | p 202 471 3990 | f 816 460 7493 |
| Kansas City 1100 Walnut Street NW, Suite 1500, Kansas City, MO 64106-2197 | p 816 842 3600 | f 816 783 8175 |
| New York One New York Plaza, Suite 4210, New York, NY 20004 | p 212 398 9000 | f 212 382 4207 |

Insurers on a potential template. The template's disclosures would aim to support verification of the requirements SAPWG is considering for potential admittance of negative IMR, including confirming:

1. That IMR is appropriately allocated for PBR and AAT,
2. That any negative IMR amounts reflected in starting assets do not generate income and so increase reserves in PBR and/or decrease reserve sufficiency in AAT,
3. That admitted negative IMR does not reflect bonds sold due to historical or anticipated future excess withdrawals, and
4. That admitted negative IMR only reflects bonds sold and replaced with similar bonds.

For items three and four above, we note that while LATF can request verification and justification from companies, this may be difficult for companies to demonstrate. For item three, we can require additional disclosures including actual to expected experience for withdrawals. For item four, it is not yet clear what verification companies could provide.

This template would be optional but recommended starting with 2023 reporting and could be required starting in 2025. Individual regulators could request this information during reviews if warranted before 2025.

Issue Guidance on Consistency

LATF is drafting guidance for year-end 2023 and 2024, consistent with the guidance LATF issued for year-end 2022 but updated for SAPWG's potential admittance of some portion of aggregate negative IMR. That is, LATF continues to affirm that a principle-based, reasonable, and appropriate allocation of IMR for PBR and AAT would be consistent with handling of the IMR asset for statutory reporting. LATF will also consider an Amendment Proposal Form to make changes directly in the Valuation Manual to clarify the treatment of negative IMR starting with the 2025 Valuation Manual. This work continues to address the concern raised that there would be a "double hit" if negative IMR were not admitted while being required to be reflected in PBR and/or AAT.

Recommendation to SAPWG Regarding AAT

LATF recommends to SAPWG that any decision to admit or not admit aggregate negative IMR should not rely on AAT at this time. We wish to clarify that AAT is not formulaic, is heavily judgment-based, and generally does not contain prescriptive guardrails on that judgment, such as the reinvestment guardrail and other guardrails that apply in PBR. In response to specific concerns around a lack of consistency in AAT asset assumptions, Actuarial Guideline (AG) 53 was developed to provide regulators with additional disclosures, but again does not contain guardrails. AG 53 review work is currently under way. Moreover, this is not the only area where concerns could arise regarding the reliability of specific AAT results. We do not believe it would be appropriate to admit negative IMR if doing so was depending on AAT as the sole or primary safeguard for any related solvency concerns.

[https://naiconline.sharepoint.com/sites/naicsupportstaffhub/member meetings/e cmte/apptf/2023-2 summer/summary and minutes/sapwg/attachments/att1b3-latf to sapwg referral.docx](https://naiconline.sharepoint.com/sites/naicsupportstaffhub/member%20meetings/e%20cmte/apptf/2023-2%20summer/summary%20and%20minutes/sapwg/attachments/att1b3-latf%20to%20sapwg%20referral.docx)

TO: Thomas Botsko, Chair, Capital Adequacy (E) Task Force
Philip Barlow, Chair, Risk-Based Capital Investment Risk and Evaluation (E) Working Group
Dale Bruggeman, Chair, Statutory Accounting Principles (E) Working Group

FROM: Carrie Mears, Chair, Valuation of Securities (E) Task Force

CC: Charles A. Therriault, Director, NAIC Securities Valuation Office (SVO)
Marc Perlman, Managing Investment Counsel, NAIC Securities Valuation Office (SVO)
Eric Kolchinsky, Director, NAIC Structured Securities Group (SSG) and Capital Markets Bureau
Julie Gann, Assistant Director, NAIC Solvency Policy
Dave Fleming, Sr. Life RBC Analyst, NAIC Financial Regulatory Affairs
Eva Yeung, Sr. P/C RBC Analyst/Technical Lead, NAIC Financial Regulatory Affairs

RE: Referral regarding a Proposed Amendment to Update the Definition of an NAIC Designation in the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual)

DATE: June 1, 2023

Summary – The Valuation of Securities (E) Task Force (VOSTF) requested that the Securities Valuation Office (SVO) staff make a comprehensive review of the definition of an NAIC Designation in the P&P Manual. The SVO identified that there are portions of the definition in both Parts One and Two some of which are redundant. In addition to the redundancy, this splitting of the definition has led to some users to the interpretation that there are two meanings of an NAIC Designation: one meaning, found in Part One, applicable to all securities, whether assigned NAIC Designations pursuant to the Filing Exemption process or by the SVO and a second meaning, found in Part Two, applicable only to securities assigned NAIC Designations by the SVO. It is the SVO staff’s belief that there is only one definition of an NAIC Designation and that it is applicable however the NAIC Designation is assigned. The revisions proposed in the amendment, which is included with this referral, reflect a consolidation of the instructions that define an NAIC Designation to make a single uniform definition. It also includes updates to the definition to address questions and concerns raised about the purpose of NAIC Designations versus credit rating provider ratings. Additionally, the SVO is recommending consolidating the current “NAIC Designation Subscript S” section in Part Two into the revised NAIC Designation section in Part One because the application of a Subscript S to an NAIC Designation for other non-payment risks signifies a change in the meaning of the NAIC Designation and is a policy of the Task Force.

The majority of this proposed amendment involves moving text from Part Two, the “*Operational and Administrative Instructions Applicable to the SVO*”, into Part One, the “*Policies of the NAIC Valuation of Securities (E) Task Force*”. A clean version of the amendment was included to simplify the review, with the new text also clearly highlighted.

Referral Request – Given the importance of NAIC Designations in quantifying investment risk for various NAIC regulatory purposes and guidance, the Task Force is sending this referral with a request that your groups consider the revised definition and assess whether or not it meets your needs. If the definition meets your needs, please informally let the SVO staff know that no response will be submitted. If the definition does not meet your needs, please notify the SVO staff by June 29th that you will be proposing modification to the definition and we request that you submit those modification or a request for

additional time by July 31st so that the revisions or matter can be considered and discussed at the NAIC's Summer National Meeting. Thank you for your consideration of this request.

Please contact Charles Therriault or Marc Perlman with any questions.

<https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2023/Referrals/To CATF and SAPWG/VOSTF Referral to SAPWG CATF RBCIRE - NAIC Designation Def 2023-06-01.docx>

Draft: 5/25/23

Statutory Accounting Principles (E) Working Group
Virtual Meeting
May 16, 2023

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met May 16, 2023. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Sheila Travis (AL); Kim Hudson (CA); William Arfanis and Michael Estabrook (CT); Rylynn Brown (DE); Stewart Guerin and Melissa Gibson (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Diana Sherman and Matt Milford (PA); Jamie Walker (TX); and Doug Stolte and David Smith (VA).

1. Reviewed Comments on Exposed Items

a. INT 22-02

Bruggeman directed the Working Group to *Interpretation (INT) 22-02: Extension of INT 22-02 Through Second Quarter 2023*. Robin Marcotte (NAIC) stated that on April 12, the Working Group conducted an e-vote to expose *INT 22-02: Third Quarter 2022 through Second Quarter 2023 Reporting of the Inflation Reduction Act - Corporate Alternative Minimum Tax*. The exposure proposed to extend INT 22-02 from June 15 to July 1 to allow it to be applied to the second quarter of 2023 financial statements. Disclosures continue to be required. Marcotte stated that interested parties support the extension of INT 22-02, but they recommend that it be extended to Aug. 16, the day after the quarterly statements are due to be filed. She stated that NAIC staff recommend that the Working Group adopt the exposed INT 22-02 with a minor modification to incorporate the Aug. 16 extension date suggested by interested parties.

Hudson made a motion, seconded by Walker, to adopt INT 22-02 (Attachment One-C1) and its proposed extension from June 15 to Aug. 16. The motion passed unanimously.

b. Agenda Item 2023-03

Bruggeman directed the Working Group to agenda item 2023-03: C-2 Mortality Risk Note. Marcotte stated that the exposure proposes the addition of new financial statement notes that calculate the net amount at risk, which is used in the C-2 mortality risk charge calculation. She stated that the Blanks (E) Working Group proposal 2023-09BWG is being simultaneously exposed, and the Life Risk-Based Capital (E) Working Group is working on a project to modify its C-2 mortality risk charges. She stated that the purpose of the note was to provide the development of the net amount at risk and have financial statement links to the elements used in the risk-based capital (RBC) charge. She stated that comments from Connie Jasper Woodroof (CJW Associates) focused on possible redundancy issues in the proposed note because some items in the disclosure could currently be directly referenced from Exhibit 5 – Aggregate Reserve for Life Contracts or the similar Exhibit 3 – Aggregate Reserve of Life, Annuity and Accident and Health Contracts in the separate account statement. She stated that Woodroof recommended removing these elements from the proposal and noted that some of the elements in the exposure were not needed for the C-2 mortality risk charge. She stated that the interested parties' comments were focused on moving the proposed information out of the footnotes and to another location. She stated that NAIC staff reached out to the Life Risk-Based Capital (E) Working Group chair and its NAIC support staff, who confirmed that the annual statement notes for the 2023 year-end would be helpful, but they were not strictly necessary for the planned update to the C-2 mortality risk charges. She stated that NAIC staff recommend that the Statutory Accounting Principles (E) Working Group defer action on this agenda item and refer the comments received to the Life Risk-Based Capital (E) Working Group.

Rose Albrizio (Equitable) stated that interested parties believe this is something that should not be in Statements of Statutory Accounting Principles (SSAPs) or the annual statement footnotes because it is a data capture for the net amount of risk needed for the C-2 mortality risk. She stated that maybe it should be in the interrogatories if it is not currently available. She stated that interested parties reached the same conclusion that this would not impede their ability to do the C-2 mortality this year because the current format can be used to deliver the data.

Bruggeman stated that he does not have an issue with deferring this agenda item. In response to his inquiry, no other Statutory Accounting Principles (E) Working Group members noted a concern with deferral.

c. Agenda Item 2023-11EP

Bruggeman directed the Working Group to agenda item 2023-11-EP: AP&P Manual Editorial Updates. Julie Gann (NAIC) stated that at its March 23 meeting, the Working Group voted to expose various maintenance updates providing revisions to the *Accounting Practices and Procedures Manual* (AP&P Manual), such as editorial corrections, reference changes, and formatting. She stated that the primary revision to note was to *SSAP No. 86—Derivatives*. She stated that the change in the disclosure category from intrinsic value to volatility value was done because of a corresponding comment made to the Blanks (E) Working Group to improve that disclosure category. She stated that other editorial changes are to streamline references to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual), as well as to address inconsistencies with how percentages are referenced—using a symbol (%) versus spelling out “percent.” She stated that interested parties support the changes. She stated that NAIC staff recommend that the Statutory Accounting Principles (E) Working Group adopt the exposed maintenance updates providing revisions to the AP&P Manual.

Weaver made a motion, seconded by Hudson, to adopt agenda item 2023-11EP (Attachment One-C2). The motion passed unanimously.

2. Exposed its Maintenance Agenda

Clark made a motion, seconded by Arfanis, to expose the following agenda items for a public comment period ending June 30. The motion passed unanimously.

a. Agenda Item 2023-12

Bruggeman directed the Working Group to agenda item 2023-12: Residuals in SSAP No. 48 Investments. Gann stated that this agenda item proposes revisions to clarify the scope and reporting for investments that represent residual interests that are not captured in the scope of *SSAP No. 43R—Loan-Backed and Structured Securities*. She stated that at the Spring National Meeting, there was a lot of discussion on how residual interests can exist in other investment structures and that previously adopted guidance only captured those that were in the scope of SSAP No. 43R, which requires those to be reported on Schedule BA – Other Long-Term Invested Assets on a dedicated reporting line for year-end 2022. She stated that the Working Group received a referral from the Valuation of Securities (E) Task Force. She stated that this agenda item is in response to that referral, as well as other discussions on this topic at the Spring National Meeting. She stated that the current population of residuals on the dedicated reporting line on Schedule BA may not reflect the entire population of residuals that are captured in other investment structures. She stated that this agenda item proposes to capture guidance in *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, so those investment structures would be separately reported on the residual line. The agenda item also has conforming edits to SSAP No. 43R and the *Annual Statement Instructions*. She stated that for those items that are not reported as residuals now because they are in the scope of SSAP No. 48, it is strictly a Schedule BA reporting line change because those items would currently

be under the joint venture, limited liability, or partnership line. Therefore, those investments that represent residuals will move to the Schedule BA residual line.

b. Agenda Item 2023-13

Bruggeman directed the Working Group to agenda item 2023-13: PIK Interest Disclosure Clarification. Gann stated that this agenda item was developed to further clarify and incorporate a practical expedient to the paid-in-kind (PIK) interest aggregate disclosure adopted in *SSAP No. 34—Investment Income Due and Accrued* for year-end 2023 that identifies the amount of PIK interest as a cumulative balance on an aggregate basis. She stated that since adoption, NAIC staff have received questions on how that should be calculated, whether it be on a first in, first out (FIFO) basis or a weighted average basis. She stated that this agenda item proposes clarifying revisions to ensure consistency in identifying the amount of PIK interest included in the cumulative principal par balance. She stated that it does not change accounting or any ultimate amounts reported as assets on the balance sheet or income statement. She stated that this identifies the amount of PIK interest that is still being reported as an asset. She stated that the recommendation is to identify that any paydowns that occur would first be applied to reported PIK interest. She stated that there is also a practical expedient that says one can identify the PIK interest from the original par through to the current par, not to go less than zero. She stated that this is to provide clarification to the investment software vendors who are asking if they had to do a retroactive analysis to identify all the PIK interest received and the paydowns. She responded that the answer is no, and the resulting calculation should be the same. She stated that NAIC staff proposed revisions in a footnote to *SSAP No. 34*; however, most of the edits are proposed for inclusion in the *Annual Statement Instructions*, are editorial only, and can be provided by the Working Group in a memorandum to the Blanks (E) Working Group if they are adopted after the deadline to include them in the *Annual Statement Instructions* for year-end 2023.

c. Agenda Item 2022-14

Bruggeman directed the Statutory Accounting Principles (E) Working Group to agenda item 2022-14: New Market Tax Credit Projects. Wil Oden (NAIC) stated that this agenda item was drafted in response to the federal Inflation Reduction Act and the subsequent issuance of *Accounting Standards Update (ASU) 2023-02—Investments—Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method (A Consensus of the Emerging Issues Task Force)*, which amends U.S. generally accepted accounting principles (GAAP) guidance on the application of the proportional amortization method (PAM) for income tax equity investments. He stated that based on direction from the Working Group and feedback received from interested parties, this agenda item now includes *SSAP No. 94R—Transferable and Non-Transferable State Tax Credits*, and it has expanded the scope of *SSAP No. 93—Low-Income Housing Tax Credit Property Investments*.

Oden stated that *SSAP No. 93* is proposed to include all qualifying tax credit investments, irrespective of the structure or tax credit program. He stated that this represents a departure from U.S. GAAP, as *ASU 2023-02* only applies to income tax equity investments that elect to use PAM. He stated that as part of the proposed revisions, both *SSAPs* are intended to work together. *SSAP No. 93* provides guidance on the tax investment itself, whereas *SSAP No. 94R* provides guidance on tax credits allocated from the investments and purchase tax credits.

Oden stated that the proposed scope of *SSAP No. 94R* has been expanded to include all state and federal tax credits, whether allocated or purchased. Additionally, the revised version proposes to amend the requirement to report tax credits at cost, which effectively results in an off-balance sheet asset for tax credits purchased at a discount. Oden stated that tax credits would now be recorded at face value upon receipt; acquisitions at a premium would immediately realize the loss; and acquisitions at a discount would defer the gain as an Other liability until the reporting entity has utilized tax credits in excess of those acquisition costs. He stated that NAIC

staff recommend that the Working Group expose the draft revisions to SSAP No. 93 and SSAP No. 94R as new SSAP concepts with a public comment period ending June 30.

3. Discussed Other Matters

a. Valuation of Securities (E) Task Force Referral Response

Gann stated that the Working Group reviewed the Valuation of Securities (E) Task Force referral on the acquisition of commercially available data and deemed that a response was not necessary.

b. Update on the Referral to the Life Actuarial (A) Task Force on Negative IMR

Hemphill stated that there are a few action items that the Life Actuarial (A) Task Force would take in response to this referral.

First, the Task Force is working on a template that will have additional disclosures on the reflection of interest maintenance reserve (IMR) in principle-based reserving (PBR) and asset adequacy testing (AAT). Those disclosures would support the verification of the requirements that the Working Group is considering for admittance of negative IMR, including: 1) the admitted IMR is appropriately allocated for PBR and AAT; 2) negative IMR is reflected in starting assets and would not generate subsequent income; and 3) that would increase reserves in PBR or decrease reserve sufficiency for AAT. Hemphill noted that the template would include verifications for the company that any admitted negative IMR not reflecting bonds sold due to historical or anticipated future excess withdrawals and bonds generating admitted negative IMR would only be those sold and replaced with similar bonds. She stated that the Task Force was outlining a potential template that is consistent with the current Working Group exposure. She stated that if there were changes by the Working Group, the template would be modified accordingly. She stated that due to the *Valuation Manual* timing constraints, this template would be optional but could be recommended starting with year-end 2023 reporting. The earliest it could be required would be 2025; although, individual state insurance regulators could request or require the information earlier. She stated that the Task Force was working on a draft and had requested input from the American Academy of Actuaries (Academy) and the American Council of Life Insurers (ACLI) on the template.

Second, Hemphill stated that the Task Force was drafting guidance for companies for year-end 2023 and 2024, consistent with what was put out for 2022, to address the potential double-counting issue. She stated that the Task Force was continuing to affirm that a principle-based, reasonable, and appropriate allocation of IMR for PBR and AAT would be consistent with the handling of the IMR asset for statutory reporting. She stated that the Task Force does not believe any double counting is required because the language currently in the *Valuation Manual* endorses a principle-based, appropriate allocation and so would not imply a double hit. This guidance would be for 2023 and 2024, as any change in the *Valuation Manual* at this time would be applicable for 2025. Hemphill stated that the Task Force would work on an amendment proposal form to make clarifying changes directly to the *Valuation Manual* so the Task Force does not have to keep producing guidance each year-end, noting that a principle-based, appropriate allocation does not require such double counting.

Finally, Hemphill stated that the Task Force recommends to the Working Group that any decision to admit or not admit aggregate negative IMR would not rely on AAT as a guardrail at this time. The Task Force wants to clarify that national AAT is not formulaic and is heavily judgment-based, without prescriptive guardrails on that judgment, such as with the reinvestment guardrail or other guardrails that apply in PBR. She stated that in response to the specific concerns around the lack of consistency in AAT asset assumptions, *Actuarial Guideline LIII—Application of the Valuation Manual for Testing the Adequacy of Life Insurer Reserves* (AG 53) was developed. She stated that AG 53 has additional disclosures but no prescriptive guardrails. She stated that the actuaries and

others are now working on reviewing initial AG 53 disclosures, but that it is not the only area where concerns could arise regarding the reliability of specific AAT assumptions or results. She stated that, in summary, the Task Force does not believe it would be appropriate to admit negative IMR if doing so depends on AAT as the sole or primary safeguard for any related solvency concerns. She stated that the Task Force has a few workstreams to work on over the upcoming months and would update the Working Group as it has additional work products.

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

[https://naiconline.sharepoint.com/sites/naicsupportstaffhub/member meetings/e cmte/apptf/2023-2 summer/sapwg/attachments/att1c-sapwg 5.16.23 minutes.docx](https://naiconline.sharepoint.com/sites/naicsupportstaffhub/member%20meetings/e%20cmte/apptf/2023-2%20summer/sapwg/attachments/att1c-sapwg%205.16.23%20minutes.docx)

Interpretation of the Statutory Accounting Principles (E) Working Group

INT 22-02: Third Quarter 2022 through ~~First~~ Second Quarter 2023 Reporting of the Inflation Reduction Act - Corporate Alternative Minimum Tax

INT 22-02 Dates Discussed

October 6, 2022; October 24, 2022, November 16, 2022; December 13, 2022; [April 12, 2023](#)

INT 22-02 References

Current:

SSAP No. 9—Subsequent Events

SSAP No. 101—Income Taxes

INT 22-02 Issue

Key Provisions of the Inflation Reduction Act

1. The Inflation Reduction Act (Act) was enacted on August 16, 2022, and included a new corporate alternative minimum tax (CAMT). The Act and the CAMT go into effect for tax years beginning after 2022. Reporting entities shall refer to the Act and the resulting regulations and other tax guidance to determine application, but a non-authoritative high-level summary based on information at the time of initial INT discussion regarding the CAMT is as follows:

- a. The CAMT is 15% of the corporation’s “adjusted financial statement income” for the tax year, reduced by corporate alternative minimum foreign tax credit.
- b. The CAMT will only apply to “applicable corporations” (determined on an affiliated group basis) with average adjusted financial statement income in excess of \$1 billion for the three prior tax years. This threshold is reduced to \$100 million in the case of certain foreign-parented corporations. When a corporation becomes subject to the CAMT, it remains an applicable corporation for purposes of the CAMT, even if its average adjusted financial statement income is less than \$1 billion, unless an exception applies.
- c. A corporation's adjusted financial statement income is the amount of net income or loss the corporation reports on its applicable financial statement. The income is adjusted for various purposes including certain adjustments in the case of consolidated returns or for foreign income.
- d. The Act includes references to the tax codes which provides a hierarchy for determining the “applicable financial statement.” At a high level, the first choice is U.S. generally accepted accounting principles (GAAP) financial statements; the second choice is international financial reporting standards (IFRS) financial statements. If GAAP and IFRS financial statements are not available, the financial statements filed by the taxpayer with any other regulatory or government body is acceptable. If the taxpayer is part of an affiliated group of corporations filing a consolidated return, the adjustable financial statement income for the group considers the group's applicable financial statement.

- e. To determine its U.S. federal income tax liability, an applicable corporation will need to compute taxes under both systems—the regular tax system and the CAMT system. The CAMT is payable to the extent the tentative CAMT exceeds the regular corporate income tax. Any CAMT paid is available indefinitely as a credit carryover that could reduce future regular tax in future years if the regular tax liability is in excess of CAMT tax liability.
- f. The Act directs the Treasury to issue regulations and other guidance relate to implementing the CAMT, so several issues are pending detailed clarifications including clarifying the definition of an applicable corporation, and providing guidance on the starting point for, and adjustments to, adjusted financial statement income, as well as the handling of separate company tax returns when required under current tax law that are unique to the insurance industry.

Interpretation Issues

2. This interpretation is focused on addressing third quarter 2022 transition accounting and reporting aspects of the new CAMT. While most insurers will not be subject to the CAMT, for those that know that they are subject, and those that could be subject to the CAMT, there are a variety of reporting uncertainties, particularly regarding reporting for third quarter 2022.

3. The CAMT is effective for the tax years on or after 2023.

4. Both statutory accounting principles and U.S. GAAP require the effects of tax changes on deferred taxes, including the valuation allowance (future realizability of existing DTAs) in the period in which the legislation is enacted (third quarter 2022). *SSAP No. 101—Income Taxes*, paragraph 7.e. requires the statutory valuation allowance adjustment as a direct reduction in the gross DTA if, based on the weight of available evidence, it is more likely than not that some or all of the gross DTAs will not be realized. Gross DTA less the statutory valuation allowance results in adjusted gross DTAs. The statutory valuation allowance adjustment is not reported as a separate line in the statutory financial statements (it is an off-balance sheet item that reduces the gross DTAs). The statutory valuation allowance is disclosed.

5. The statutory accounting calculation for admissible DTAs is determined using adjusted gross DTAs (gross DTAs reduced by the valuation allowance). For statutory accounting, admittance of adjusted gross DTAs in *SSAP No. 101* depends on a three-component calculation, for which the second step limits admittance of adjusted gross DTAs to those that are expected to be realized in a timeframe that does not exceed three years. The actual number of years permitted depends on specifics for each reporting entity (type and other information about the reporting entity), but the maximum timeframe is three years. The last step admits DTAs which can be offset by DTLs.

6. Guidance in *SSAP No. 9—Subsequent Events* requires consideration of Type I and Type II¹ subsequent events through the date of the statutory financial statements and the date of issuance of the audited financial statements, or the date in which audited financial statements are available to be issued. For subsequent events identified after the statutory financial statements are filed (example, March 1), but before the audited financial statements are issued (example, June 1), reporting entities are generally required by their domestic state to amend their filed statutory financial statements to ensure that the statutory

¹ A Type I subsequent event relates to an event or transaction that provides additional evidence with respect to conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Under *SSAP No. 9*, entities shall recognize in the financial statements the effects of all material Type I subsequent events. A Type II subsequent event pertains to events or transactions that provide evidence to conditions that did not exist at the balance sheet date but arose after that date. Type II events are disclosed in the financial statements.

financial statements and the audited financial statements are consistent. Under this guidance, as additional information is made available on the impact of the Act, or information becomes available to update estimates and assessments, under existing statutory accounting guidance in SSAP No. 9, reporting entities would need to identify updated estimates as a Type I subsequent event in the audited financial statements.

Issue 1 – Consideration of the Act for Third Quarter 2022 Financial Statements

7. During the period of enactment (third quarter 2022) reporting entities filing statutory financial statements would normally have to consider the applicability of the CAMT and if applicable, determine the impact on the statutory valuation allowance as well as assess DTAs for admissibility (e.g., realization timeframe). These elements will be collectively referred to as “calculations impacted by the Act” or “calculations impacted by the CAMT.”

8. This interpretation will address the issue for what reporting entities are required to report or disclose regarding the calculations impacted by the CAMT for September 30, 2022, financial statements.

Issue 2 – Consideration of Subsequent Events for Third Quarter 2022 Financial Statements

9. SSAP No. 9 requires consideration of subsequent events through the date of the statutory financial statements and the date of issuance of the audited financial statements, or the date in which audited financial statements are available to be issued.

10. For reporting entities that materially revise or establish calculations impacted by the CAMT subsequent to September 30, 2022 (including the statutory valuation allowance, the timing of determination of net admitted DTAs, and the determination of the applicability of the CAMT), this interpretation will address the extent a Type I or Type II subsequent event assessment is required for third quarter 2022 financial reporting.

INT 22-02 Discussion

11. The Statutory Accounting Principles (E) Working Group consensuses to the noted issues are included below.

Response: Issue 1 – Consideration of the Act for Third Quarter 2022 Financial Statements

12. Reporting entities that are aware they will be subject to the CAMT would normally reflect the effects of the Act on the calculations impacted by the CAMT if reasonably estimable for third quarter 2022. Because of the timing of the adoption of the Act and the considerable number of unknown variables for September 30, 2022, reporting, the Working Group has determined that a reasonable estimate is not determinable for third quarter 2022 interim financial statements for the calculations impacted by the CAMT.

13. Because reasonable estimates of calculations impacted by the CAMT are not determinable, reporting entities shall not recognize impacts related to CAMT for third quarter 2022 financial statements, but shall make the following disclosures regarding the CAMT and the Act:

- a. The Act was enacted during the reporting period on August 16, 2022.
- b. A statement regarding whether the reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined if it expects to be liable for CAMT in 2023. For example:

- i. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined that it does not expect to be liable for CAMT in 2023.
- ii. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has not determined as of the reporting date if it will be liable for CAMT in 2023. The third quarter 2022 financial statements do not include an estimated impact of the CAMT because a reasonable estimate cannot be made.
- iii. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined that it expects to be liable for CAMT in 2023. The third quarter 2022 financial statements do not include an estimated impact of the CAMT, because a reasonable estimate cannot be made.

Response: Issue 2 – Consideration of Subsequent Events for Third Quarter 2022 Financial Statements

14. For third quarter 2022 reporting, CAMT updated estimates or other calculations affected by the Act determined subsequent to third quarter statutory financial statement or filing date shall not be recognized as Type I subsequent events. Meaning, amended financial statements are not required to reflect updated estimates subsequent to the third quarter filing date and prior to the filing the third quarter financial statements. With the disclosure required under Issue 1, additional subsequent event disclosure (such as what would be required for Type II event) is not required.

15. Reporting entities shall be working in good faith to complete the accounting for the changes adopted under the Act.

INT 22-02 Status

16. The consensuses in this interpretation were adopted on October 24, 2022, to provide reporting guidance regarding the calculations impacted by the CAMT and provide limited-scope, limited-time exceptions to the valuation allowance and DTA calculations in response to legislation under SSAP No. 101 as well as Type I subsequent event requirements in SSAP No. 9 for September 30, 2022, statutory reporting. As detailed, the exceptions to SSAP No. 101 and SSAP No. 9 are effective for third quarter 2022.

17. On December 13, 2022, the Working Group adopted a consensus to extend this interpretation for December 31, 2022, and first quarter 2023 statutory financial statements. For application as of year-end 2022 and first quarter 2023:

- a. Consistent with paragraphs 12 and 13, the Working Group has concluded that a reasonable estimate is not determinable for December 31, 2022, and March 31, 2023, therefore impacts related to the CAMT in the year-end 2022 and March 31, 2023, financial statements are not required.
- ~~b. The reporting entity shall include disclosures in paragraph 13 in the year end 2022 and March 31, 2023, financial statements. In addition, the reporting entity shall disclose the following:~~
 - ~~i. If, based on information regarding the projected adjusted financial statement income for 2023, the entity or the controlled group of corporations of which the reporting entity is a member has determined if it is an “applicable corporation” to determine if CAMT exceeds the regular federal income tax payable. That is,~~

~~disclose if the reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined if average “adjusted financial statement income” is above the thresholds for 2023 tax year that they expect to be required to perform the CAMT calculations. This disclosure is about being applicable corporation, not if the entity is required to pay.~~

~~e.b.~~ Consistent with paragraph 14, CAMT updated estimates or other calculations affected by the Act determined subsequent to filing the December 31, 2022, and March 31, 2023, financial statements shall not be recognized as Type I subsequent events.

~~d.c.~~ For year-end 2022 financial statements, the subsequent event exception is expanded to encompass events that occur prior to the issuance of statutory financial statements as well as events that occur before the date the audited financial statements are issued, or available to be issued. This provision intends to prevent reporting entities from having to amend statutory financial statements from material Type I subsequent events as a result of updated information / estimates received after the reporting date of year-end 2022 statutory financial statements pertaining to the accounting for the enactment of the Act.

18. On April 12, 2023, the Working Group adopted a tentative consensus to extend this interpretation for the second quarter 2023 statutory financial statements. For application to the second quarter 2023 financial statements, reporting entities shall follow the guidance in this interpretation paragraphs 17 a-c.

~~18.~~19. With the extension, this interpretation will be automatically nullified on ~~June 15, 2023~~July 1, 2023.

~~19.~~20. ~~No. f~~ Further discussion is planned.

[https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2023/05-16-23/1int 22-02-april 23 ed.docx](https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national%20meetings/a.%20national%20meeting%20materials/2023/05-16-23/1int%2022-02-april%2023%20ed.docx)

**NAIC Accounting Practices and Procedures Manual
Editorial and Maintenance Update
March 22, 2023**

Maintenance updates provide revisions to the *Accounting Practices and Procedures Manual*, such as editorial corrections, reference changes and formatting.

| SSAP/Appendix | Description/Revision |
|-----------------------|--|
| SSAP No. 86 | Paragraph 43.g.ii.: Revise “Intrinsic Value” to reflect “Volatility Value” |
| P&P Manual References | All citations to the <i>Purposes and Procedures Manual of the NAIC Investment Analysis Office</i> are proposed to be reviewed and streamlined so they do not reflect a specific location in the Manual or a webpage. These references will be eliminated to prevent inappropriate citations. |
| Percent References | Instances in which ‘percent’ is spelled out in combination with a number will be eliminated with retention of the % sign. This is a consistency change as the usage is currently inconsistent within the Manual. |

Recommendation:

NAIC staff recommend that the Statutory Accounting Principles (E) Working Group move this agenda item to the active listing, categorize as a SAP Clarification, and expose editorial revisions as illustrated within.

SSAP No. 86R—Derivatives

Revise the reference to “Intrinsic Value” to reflect “Volatility Value.” This change was proposed by industry to clarify the disclosure category for the excluded component to the Blanks (E) Working Group and a corresponding revision is needed in SSAP No. 86R.

- 43.a. For hedging instruments with excluded components for determining hedge effectiveness:
- i. In the investment schedule, identify hedging instruments with excluded components and report the current fair value of the excluded component, the fair value of the excluded component that is reflected in the reported BACV for the hedging instrument (this item would not be applicable for foreign-currency forwards and currency swaps where the forward points or cross-currency basis, respectively, are the excluded component), and the change in fair value reported as an unrealized gain/loss.
 - ii. In the notes to the financial statements, provide information on the aggregate excluded components by category: Time Value, ~~Intrinsic~~ Volatility Value, Forward Points and Cross Currency Basis Spread. The aggregate amounts reported should include the following (as applicable): current fair value, recognized unrealized gain/loss, the fair value reflected in BACV, and for the excluded forward points (e.g., forward spot rates), the aggregate amount owed at maturity, along with current year and remaining amortization.

Purposes and Procedure Manual References

The following SSAPs will be revised to update references to the P&P Manual.

SSAP No. 25—Affiliates and Other Related Parties

- 21.h. The amount deducted from the value of an upstream intermediate entity or ultimate parent owned, either directly or indirectly, via a downstream subsidiary, controlled, or affiliated entity, in accordance with [SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities](#). ~~the Purposes and Procedure Manual of the NAIC Investment Analysis Office, “Procedures for Valuing Common Stocks and Stock Warrants.”~~

SSAP No. 26R—Bonds

- 4.a. Exchange traded funds (ETFs), which qualify for bond treatment, as identified in ~~Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office~~ and published on the SVO web page ~~at <https://content.naic.org/industry/securitiesvaluation-office>~~. (SVO-identified ETFs are reported on Schedule D – Part 1.)

SSAP No. 30R—Unaffiliated Common Stock

- 4.c. Shares of SEC registered Investment Companies³ captured under the Investment Company Act of 1940 (open-end investment companies (mutual funds), closed-end funds and unit investment trusts), regardless of the types or mix of securities owned by the fund (e.g., bonds or stocks), including shares of funds referenced in the “NAIC Fixed Income-Like SEC Registered Funds List” as identified in ~~Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office~~ [and published on the SVO web page](#).;
- 4.d. Exchange Traded Funds, except for those identified for bond or preferred stock treatment, as identified in ~~Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office~~ and published on the SVO web page ~~at <https://content.naic.org/industry/securitiesvaluation-office>~~;

SSAP No. 32R—Preferred Stock

- 4.a. Exchange Traded Funds, which qualify for preferred stock treatment, as identified in ~~Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office~~ and published on the SVO web page ~~at <https://content.naic.org/industry/securitiesvaluationoffice>~~. SVO-identified preferred stock ETFs shall follow the accounting provisions for perpetual preferred stock.

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

64. By August 31 or one month after the audit report date of each year, the NAIC shall initiate a review of all SCA investments for which new Sub 2 form filings have been received as well as an annual update review of Sub 2 SCA investments already logged in the VISION database. The NAIC review shall encompass a review of the most recent annual statutory reporting by the parent insurance company's Schedule Y (to ascertain the identity of the members of the holding company system and to ensure that information for all SCA companies has been submitted), a review of the parent's financial statement blank to review the last reported value for the SCA investments and a review of the VISION database to determine whether SCA debt and SCA preferred securities have been assigned NAIC designations. As part of its analysis, the NAIC shall review the portion of the bond investments carried by the parent or a subsidiary insurer with a **Z** notation. If the NAIC determines that the portion of the **Z** bonds shown on the documentation is significant, the NAIC shall not process the Sub 2 filing until the insurance company reports the bonds to permit removal of the **Z** notation. Beginning with year-end 2019, two new suffixes will apply: **YE** and **IF**. **YE** means that the security is a properly filed annual update that the SVO has determined will not be assigned an NAIC

designation by the close of the year-end reporting cycle. The symbol YE is assigned by the SVO pursuant to the carryover administrative procedure described in ~~Part One, Section 3 f) (iii) of the Purposes and Procedures Manual of the NAIC Investment Analysis Office~~. When the SVO assigns the symbol YE it also assigns the NAIC designation in effect for the previous reporting year. IF means that the security is an initial filing that has been properly filed with the SVO but which the SVO has determined will not be assigned an NAIC designation by the close of the year-end reporting cycle. The symbol IF is assigned by the SVO and communicates that the insurer should self-designate the security for year-end and identify it with the symbol IF. IF, therefore, also communicates to the regulator that the NAIC designation reported by the insurance company was not derived by or obtained from the SVO, but has been determined analytically by a reporting insurance company.

Percent References

The following SSAPs will be revised to update the percent reference.

SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets:

13. As directed by *SSAP No. 101—Income Taxes*, tax loss contingencies (including related interest and penalties) for current and all prior years, shall be computed in accordance with this SSAP, with the following modifications:
 - a. The term “probable” as used in this standard 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.
 - b. 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.
 - c. If the estimated tax loss contingency is greater than ~~50% percent~~ of the tax benefit originally recognized, the tax loss contingency recorded shall be equal to ~~100% percent~~ of the original tax benefit recognized.

As noted in *SSAP No. 101*, state taxes (including premium, income and franchise taxes) shall also be computed in accordance with this SSAP. These items (as detailed in *SSAP No. 101*) are not impacted by the modifications detailed in paragraphs 13.a.-13.c.

SSAP No. 16R—Electronic Data Processing Equipment and Software

4. The aggregate amount of admitted EDP equipment and operating system software (net of accumulated depreciation) shall be limited to ~~3% three percent~~ of the reporting 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 EDP equipment and operating system software, net deferred tax assets and net positive goodwill.^(INT 01-18)

SSAP No. 43R—Loan-Backed and Structured Securities

FN 10: Changes in the interest rate of a “plain-vanilla,” variable-rate beneficial interest (a plain-vanilla, variable-rate beneficial interest does not include those variable-rate beneficial interests with interest rate reset formulas that involve either leverage or an inverse floater) generally should not result in the recognition of an other-than-temporary impairment. For plain-vanilla, variable-rate beneficial interests, the yield is changed to reflect the revised interest rate based on the contractual interest rate reset formula. For example, if a beneficial interest pays interest quarterly at a rate equal to LIBOR plus ~~2% percent~~, the yield of that beneficial interest is changed prospectively to reflect changes in LIBOR. However, changes in the

fair value of a plain-vanilla, variable-rate beneficial interest due to credit events should be considered when evaluating whether there has been an other-than-temporary impairment.

SSAP No. 57—Title Insurance

- 19.g. An investment in a title plant or plants in an amount equal to the actual cost shall be allowed as an admitted asset for title insurers. The aggregate carrying value of an investment in a title plant or plants shall not exceed the lesser of 20% of admitted assets or ~~forty percent (40%)~~ of surplus to policyholders, both as required to be shown on the statutory balance sheet of the insurer for its most recently filed statement with the domiciliary state commissioner; if the amount of the investment exceeds the above limits, the excess amount shall be recorded as a nonadmitted asset.

SSAP No. 60—Financial Guarantee Insurance

10. The contingency reserve shall be the greater of ~~50% fifty percent~~ of premiums written for each category or the amount provided by applying the following percentages to the principal guaranteed in each calendar year. The premiums written shall be net of reinsurance if the reinsurer has established a contingency reserve.
- | | |
|---|--------------------------|
| a. Municipal obligation bonds | 0.55% percent |
| b. Special revenue bonds | 0.85% percent |
| c. Investment grade Industrial Development Bonds (IDBs) secured by collateral or having a term of seven years or less, and utility first mortgage obligations | 1.00% percent |
| d. Other investment grade IDBs | 1.50% percent |
| e. Other IDBs | 2.50% percent |
| f. Investment grade obligations, secured by collateral or having a term of seven years or less | 1.00% percent |
| g. Other investment grade obligations not secured | 1.50% percent |
| h. Non-investment grade consumer debt obligations | 2.00% percent |
| i. Non-investment grade asset backed securities | 2.00% percent |
| j. All other non-investment grade obligations | 2.50% percent |

SSAP No. 62R—Property and Casualty Reinsurance

- 116.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
- 116.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.

Exhibit C – Assumptions

Premium = \$1,000 (assumes no commissions or allowances)
Coverage Period = 1 year
Initial expected recoveries = \$225 per year (at end of year) for five years
Initial Implicit rate = 4% ~~percent~~*

*present value of \$225 per year for five years at 4% ~~percent~~ = \$1,000

At the end of Year 2, the timing of anticipated recoveries under the reinsurance contract changes. A reevaluation of the implicit interest rate produces a rate of 3.63% ~~percent~~ and an asset of \$640 at the end of the year.

SSAP No. 65—Property and Casualty Contracts

37. If the reporting entity does not hold specific collateral for the policy, amounts accrued for reimbursement of the deductible shall be billed in accordance with the provisions of the policy or the contractual agreement and shall be aged according to the contractual due date. In the absence of a contractual due date, billing date shall be utilized for the aging requirement. Deductible recoverables that are greater than ninety days old shall be nonadmitted. However, if the reporting entity holds specific collateral for the high deductible policy, 10% ~~ten percent~~ of deductible recoverable in excess of collateral specifically held and identifiable on a per policy basis, shall be reported as a nonadmitted asset in lieu of applying the aging requirement; however, to the extent that amounts in excess of the 10% are not anticipated to be collected they shall also be nonadmitted. The collateral requirements of this paragraph may be satisfied when an insured provides one collateral instrument to secure amounts owed under multiple policies, provided that the reporting entity has the contractual right to apply the collateral to the high deductible policy. Collateral obtained at a group level that is not supported by an existing pooling agreement requires a written allocation agreement among all collateral beneficiaries. The terms of such agreement must be fair and equitable. Documentation supporting any allocation of collateral among reporting entities must be maintained to allow proper calculation of the nonadmitted amounts and prohibit double counting of collateral.

SSAP No. 78—Multiple Peril Crop Insurance

3. Catastrophic insurance is designed to provide farmers with protection against extreme crop losses for a small processing fee. Buy-up insurance provides protection against more typical and smaller crop losses in exchange for a policyholder-paid premium. The government subsidizes the total premium for catastrophic insurance and a portion of the premium for buy-up insurance. Farmers who purchase buy-up crop insurance must choose both the coverage level (the proportion of the crop to be insured) and the unit price (such as, per bushel) at which any loss is calculated. With respect to the coverage level of production, farmers can choose to insure as much as 85% ~~percent~~ of normal production or as little as 50% ~~percent~~ of normal production at different price levels. With respect to the unit price, farmers choose whether to value their insured production at FCICs full estimated market price or at a percentage of the full price.
5. Companies participate in the MPCl program with FCIC through the Standard Reinsurance Agreement (SRA) per the terms of which the insurance companies share in the underwriting results of each policy. The SRA reinsurance terms provide a company the flexibility to limit its exposure on a state by state basis. MPCl premium is not expense loaded, therefore FCIC pays the insurance companies, on behalf of the policyholder, a ~~percent~~ of premium for administrative expenses associated with selling and servicing crop insurance policies, including the expenses associated with adjusting claims.

15. FCIC pays the insurance companies a percent of premium for administrative expenses associated with selling and servicing crop insurance policies, including the expenses associated with adjusting claims. The expense payment associated with the catastrophic coverage shall be recorded as a reduction of loss expenses whereas the expense payment for the buy-up coverage shall be recorded as a reduction of other underwriting expenses. The company shall disclose the total amounts received for each type of coverage.

SSAP No. 86—Derivatives

- 26.c. The term highly effective describes a cash flow hedging relationship where the change in fair value of the derivative hedging instrument is within 80 to 125%~~percent~~ of the opposite change in the fair value of the hedged item attributable to the hedged risk. It shall also apply when an R-squared of .80 or higher is achieved when using a regression analysis technique. Further guidance on determining effectiveness can be found within Exhibit A;
- 27.c. The term highly effective describes a cash flow hedging relationship where the change in cash flows or present value of cash flows of the derivative hedging instrument is within 80 to 125%~~percent~~ of the opposite change in the cash flows or present value of the cash flows of the hedged item attributable to the hedged risk. It shall also apply when an R-squared of .80 or higher is achieved when using a regression analysis technique. Further guidance on determining effectiveness can be found within Exhibit A.

Exhibit A, 19.c.ii. The variable-rate asset or liability has a floor or cap and the interest rate swap has a floor or cap on the variable interest rate that is comparable to the floor or cap on the variable-rate asset or liability. For purposes of this paragraph, comparable does not necessarily mean equal. For example, if an interest rate swap's variable rate is based on LIBOR and an asset's variable rate is LIBOR plus 2%~~percent~~, a 10%~~percent~~ cap on the interest rate swap would be comparable to a 12%~~percent~~ cap on the asset.

Exhibit A, 22 The fixed interest rate on a hedged item need not exactly match the fixed interest rate on an interest rate swap designated as a fair value hedge. Nor does the variable interest rate on an interest-bearing asset or liability need to be the same as the variable interest rate on an interest rate swap designated as a cash flow hedge. An interest rate swap's fair value comes from its net settlements. The fixed and variable interest rates on an interest rate swap can be changed without affecting the net settlement if both are changed by the same amount. That is, an interest rate swap with a payment based on LIBOR and a receipt based on a fixed rate of 5%~~percent~~ has the same net settlements and fair value as an interest rate swap with a payment based on LIBOR plus 1%~~percent~~ and a receipt based on a fixed rate of 6%~~percent~~.

SSAP No. 92—Postretirement Benefits Other Than Pensions

49. As a minimum, amortization of a net gain or loss included in unassigned funds (surplus) shall be included as a component of net periodic postretirement benefit cost for a year if, as of the beginning of the year, that net gain or loss exceeds 10%~~percent~~ of the greater of the accumulated postretirement benefit obligation or the fair value of plan assets. If amortization is required, the minimum amortization shall be that excess divided by the average remaining service period of active plan participants. If all or almost all of a plan's participants are inactive, the average remaining life expectancy of the inactive participants shall be used instead of the average remaining service period.
75. An employer shall disclose the amount of contributions to multiemployer plans for each annual period for which a statement of income is presented. An employer may disclose total contributions to multiemployer plans without disaggregating the amounts attributable to pension plans and other postretirement benefit plans. The disclosures shall include a description of the nature and effect of any

changes affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture. This disclosure shall identify whether the contributions represent more than ~~5% percent~~ of total contributions to the plan as indicated in the plan's most recently available annual report.

108.b.i ~~Ten~~10% percent of the calculated surplus impact as of the transition date; and

SSAP No. 93—Low-Income Housing Tax Credit Property Investments

Exhibit A Assumptions

1. All cash flows (except initial investment) occur at the end of each year.
2. Depreciation expense is computed, for book and tax purposes, using the straight-line method with a 27.5 year life (the same method is used for simplicity).
3. The investor made a \$100,000 investment for a ~~5% percent~~ limited partnership interest in the project at the beginning of the first year of eligibility for the tax credit.
4. The partnership finances the project cost of \$4,000,000 with ~~50% percent~~ equity and ~~50% percent~~ debt.
5. The annual tax credit allocation (equal to ~~4% percent~~ of the project's original cost) will be received for a period of 10 years.
6. The investor's tax rate is ~~40% percent~~.

Chart Footnotes:

- (1) End-of-year investment for a ~~5% percent~~ limited liability interest in the project net of amortization in Column (2).
- (3) ~~4%~~Four percent tax credit on \$200,000 tax basis of the underlying assets.

SSAP No. 100R—Fair Value

- 52.g. If a group of investments would otherwise meet the criteria in paragraph 45 but the individual investments to be sold have not been identified (for example, if a reporting entity decides to sell ~~20% percent~~ of its investments in private equity funds but the individual investments to be sold have not been identified), so the investments continue to qualify for the practical expedient in paragraph 39, the reporting entity shall disclose its plans to sell and any remaining actions required to complete the sale(s).

SSAP No. 101—Income Taxes

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.

- 3.a.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.
- 7.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, determined in a manner consistent with paragraphs 20-25 of FAS 109, shall reduce the gross DTAs to the amount that is more likely than not to be realized (the adjusted gross deferred tax assets).
- 1.3 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.
- 1.11 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 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.
- 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). 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.
- 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.

- 5.14 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 consider 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 of SSAP No. 30R—Unaffiliated Common Stock.
- 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 percent~~ tax rate on all its income, it incurred federal income tax expense of \$210,000. In preparing its 20X1 statutory income tax provision, the company estimated that its liability for 20X1 federal income tax would be \$147,000 based on \$600,000 of ordinary income and \$100,000 realized capital gains.
- 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 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.
- 12.20 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 \$200,000.

SSAP No. 102—Pensions

22. As a minimum, amortization of a net gain or loss included in unassigned funds (surplus) shall be included as a component of net pension cost for a year if, as of the beginning of the year, that net gain or loss exceeds ~~10 percent~~ of the greater of the projected benefit obligation or the fair value of plan assets. If amortization is required, the minimum amortization shall be that excess divided by the average remaining service period of active employees expected to receive benefits under the plan. If all or almost all of a plan's participants are inactive, the average remaining life expectancy of the inactive participants shall be used instead of average remaining service.
79. A reporting entity shall disclose the amount of contributions to multiemployer plans for each annual period for which a statement of income is presented. A reporting entity may disclose total contributions to multiemployer plans without disaggregating the amounts attributable to pension plans and other postretirement benefit plans. The disclosures shall include a description of the nature and effect of any changes affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture. This disclosure shall identify whether the contributions represent more than ~~5 percent~~ of total contributions to the plan as indicated in the plan's most recently available annual report.
- 93.b.i. ~~Ten~~~~10 percent~~ of the calculated surplus impact as of the transition date;

SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

22. An exchange of debt instruments with substantially different terms is also considered a debt extinguishment and shall be accounted for in accordance with paragraph 21. A debtor's exchange of debt instruments (in a nontroubled debt situation) is accomplished with debt instruments that are substantially different if the present value of the cash flows under the terms of the new debt instrument is at least ~~10% percent~~ different from the present value of the remaining cash flows under the terms of the original instrument. If the difference between the present value of the cash flows under the terms of the new debt instrument and the present value of the remaining cash flows under the terms of the original debt instrument is less than ~~10% percent~~, a creditor should evaluate whether the modification is more than minor based on the specific facts and circumstances (and other relevant considerations) surrounding the modification.
91. The reporting entity shall receive collateral having a fair value as of the transaction date at least equal to ~~102% percent~~ of the fair value of the loaned securities at that date. If at any time the fair value of the collateral received from the counterparty is less than ~~100% percent~~ of the fair value of the loaned securities, the counterparty shall be obligated to deliver additional collateral by the end of the next business day, the fair value of which, together with the fair value of all collateral then held in connection with the transaction at least equals ~~102% percent~~ of the fair value of the loaned securities. If the collateral received from the counterparty is less than ~~100% percent~~ at the reporting date, the difference between the actual collateral and ~~100% percent~~ will be nonadmitted. Collateral value is measured and compared to the loaned securities in aggregate by counterparty.
92. In the event that foreign securities are loaned and the denomination of the currency of the collateral is other than the denomination of the currency of the loaned foreign securities, the amount of collateral shall be at least equal to ~~105% percent~~ of the fair value of the loaned securities at that date. If at any time the fair value of the collateral received from the counterparty is less than ~~102% percent~~ of the fair value of the loaned securities, the reporting entity must obtain additional collateral by the end of the next business day, the fair value of which together with the fair value of all collateral then held in connection with the transaction at least equals ~~105% percent~~ of the fair value of the loaned securities. If the collateral received from the counterparty is less than ~~100% percent~~ at the reporting date, the difference between the actual collateral and ~~100% percent~~ will be nonadmitted. Collateral value is measured and compared to the loaned securities in aggregate by counterparty.
113. The collateral requirements for repurchase and reverse repurchase agreements are as follows:

Repurchase Transaction

- a. The reporting entity shall receive collateral having a fair value as of the transaction date at least equal to ~~95% percent~~ of the fair value of the securities transferred by the reporting entity in the transaction as of that date. If at any time the fair value of the collateral received from the counterparty is less than ~~95% percent~~ of the fair value of the securities so transferred, the counterparty shall be obligated to deliver additional collateral by the end of the next business day the fair value of which, together with the fair value of all collateral then held in connection with the transaction, at least equals ~~95% percent~~ of the fair value of the transferred securities. If the collateral is less than ~~95% percent~~ at the reporting date, the difference between the actual collateral and ~~95% percent~~ will be nonadmitted.

Reverse Repurchase Transaction

- b. The reporting entity shall receive as collateral transferred securities having a fair value at least equal to ~~102% percent~~ of the purchase price paid by the reporting entity for the securities. If at any time the fair value of the collateral is less than ~~100% percent~~ of the purchase price paid by

the reporting entity, the counterparty shall be obligated to provide additional collateral, the fair value of which, together with fair value of all collateral then held in connection with the transaction, at least equals 102%~~percent~~ of the purchase price.

130. Exchanges of debt instruments or debt instrument modifications are considered extinguishments if the exchange or modification results with substantially different terms or is considered more than minor. If the cash flows under the terms of the new debt instrument are at least 10%~~percent~~ different from the present value of the remaining cash flows under the terms of the original instrument, then the exchange of, or modification to, debt instruments is consider substantially different and/or more than minor.

Illustration 3 Company C originates \$1,000 of loans that yield 10%~~percent~~ interest income for their estimated lives of 9 years. Company C transfers the entire loans to an entity and the transfer is accounted for as a sale. Company C receives as proceeds \$1,000 cash, a beneficial interest to receive 1%~~percent~~ on the contractual interest on the loans (an interest-only strip receivable), and an additional 1%~~percent~~ of the contractual interest as compensation for servicing the loans. The fair values of the servicing asset and the interest-only strip receivable are \$40 and \$60, respectively.

Illustration 4 – Facts

| | |
|---|---------|
| Transferor’s carrying amount and fair value of security loaned | \$1,000 |
| Cash “collateral” | 1,020 |
| Transferor’s return from investing cash collateral at a 5% percent annual rate | 5 |
| Transferor’s rebate to the securities borrower at a 4% percent annual rate | 4 |

SSAP No. 104R—Share-Based Payments

- 117.a.ii. Any purchase discount from the market price does not exceed the per-share amount of share issuance costs that would have been incurred to raise a significant amount of capital by a public offering. A purchase discount of 5%~~percent~~ or less from the market price shall be considered to comply with this condition without further justification. A purchase discount greater than 5%~~percent~~ that cannot be justified under this condition results in compensation cost for the entire amount of the discount. Note that an entity that justifies a purchase discount in excess of 5%~~percent~~ shall reassess at least annually, and no later than the first share purchase offer during the fiscal year, whether it can continue to justify that discount pursuant to this paragraph.
122. Changes in total employee withholdings during a purchase period that occur solely as a result of salary increases, commissions, or bonus payments are not plan modifications if they do not represent changes to the terms of the award that was offered by the employer and initially agreed to by the employee at the grant (or measurement) date. Under those circumstances, the only incremental compensation cost is that which results from the additional shares that may be purchased with the additional amounts withheld (using the fair value calculated at the grant date). For example, an employee may elect to participate in the plan on the grant date by requesting that 5%~~percent~~ of the employee’s annual salary be withheld for future purchases of stock. If the employee receives an increase in salary during the term of the award, the base salary on which the 5%~~percent~~ withholding amount is applied will increase, thus increasing the total amount withheld for future share purchases. That increase in withholdings as a result of the salary increase is not considered a plan modification and thus only increases the total compensation cost associated with the award by the grant date fair value associated with the incremental number of shares that may be purchased with the additional withholdings during the period. The incremental number of shares that may be purchased is calculated by dividing the incremental amount withheld by the exercise price as of the grant date (for example, 85%~~percent~~ of the grant date stock price).

SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees

11. The term “highly effective” describes a fair value hedging relationship where the change in fair value of the derivative instrument is within 80 to 125% ~~percent~~ of the opposite change in fair value of the hedged item attributed to the hedged risk. It shall also apply when an R-squared of .80 or higher is achieved when using a regression analysis technique.

Status:

On March 22, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed editorial revisions as illustrated within the agenda item.

[https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/APPTF/2023-2 Summer/SAPWG/Attachments/Att1C2-2023-11EP.docx](https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member%20Meetings/E%20CMTE/APPTF/2023-2%20Summer/SAPWG/Attachments/Att1C2-2023-11EP.docx)

Draft: 4/25/23

Statutory Accounting Principles (E) Working Group
E-Vote
April 12, 2023

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded April 12, 2023. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Sheila Travis (AL); Kim Hudson (CA); William Arfanis (CT); Rylynn Brown (DE); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Doug Stolte and David Smith (VA); and Amy Malm (WI).

1. Exposed INT 22-02

The Working Group considered exposure of *Interpretation (INT) 22-02: Third Quarter 2022 through Second Quarter 2023 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax*. This proposes to extend the existing INT 22-02 from June 15 to July 1 so that the Interpretation can be used through the second quarter of 2023.

Key elements of INT 22-02 are that it does not require accrual of the Corporate Alternative Minimum Tax (CAMT), it requires disclosures. INT 22-02 provides overrides to existing guidance in *Statement of Statutory Accounting Principles (SSAP) No. 9—Subsequent Events* and *SSAP No. 101—Income Taxes*. The Working Group anticipates having calls this quarter to address accounting for the CAMT.

Arfanis made a motion, seconded by Clark, to expose INT 22-02 with a comment deadline of May 5. The motion passed unanimously. This meets the NAIC Policy Statement on Statutory Accounting Principles Maintenance Agenda Process requirement for a 2/3 vote of the membership for INTs that conflict with existing statutory accounting.

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

<https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/MemberSummer/SAPWG/Attachments/Att1D-SAPWG 4.12.23 evote.docx>

Meetings/E

CMTE/APPTF/2023-2

Draft: 4/25/23

Statutory Accounting Principles (E) Working Group
E-Vote
April 10, 2023

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded April 10, 2023. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Sheila Travis (AL); Kim Hudson (CA); Rylynn Brown (DE); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Jamie Walker (TX); David Smith (VA); and Amy Malm (WI).

1. Exposed INT 23-01

The Working Group considered an e-vote exposure of *Interpretation (INT) 23-01: Net Negative (Disallowed) Interest Maintenance Reserve*. This INT proposes a limited-time, optional exception to statutory accounting to admit net negative (disallowed) interest maintenance reserve (IMR) in the general account up to 5% of adjusted capital and surplus. The tentative INT includes limitations on the negative IMR permitted to be admitted, with an explicit exclusion for losses captured in the IMR from derivatives that were reported at fair value prior to termination/settlement. It also specifically excludes separate account negative (disallowed) IMR from the admittance provisions. The INT details reporting requirements, which include an allocation to special surplus for the admitted net negative (disallowed) IMR, as well as disclosures on the derivative losses removed from IMR in determining the amount that could be admitted and disclosures on the overall IMR admittance calculation and the percentage of adjusted capital and surplus.

Hudson made a motion, seconded by Walker, to expose INT 23-01 for a public comment period ending May 5. The motion passed with 11 Working Group members responding with affirmative votes, meeting the NAIC Policy Statement on Statutory Accounting Principles Maintenance Agenda Process requirement for a 2/3 vote of the membership for INTs that conflict with existing statutory accounting.

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

Subsequent to the e-vote, the comment period for this exposure was extended to June 9.

<https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/APPTF/2023-2 Summer/SAPWG/Attachments/Att1E-SAPWG 4.10.23 evote.docx>

**Statutory Accounting Principles (E) Working Group
Summer National Meeting
Comment Letters Received**

TABLE OF CONTENTS

| COMMENTS / DOCUMENT | PAGE REFERENCE |
|---|-------------------|
| Comment Letters Received for Items Exposed for the Summer National Meeting | |
| Interested Parties – May 31, 2023 <ul style="list-style-type: none"> ○ Corporate Alternative Minimum Tax (CAMT) | 2-14 |
| Interested Parties – June 9, 2023 <ul style="list-style-type: none"> ○ Principles-Based Bond Definition ○ Ref #2022-01: Conceptual Framework – Updates ○ Ref #2022-11: Collateral for Loans ○ Ref #2022-12: Review of INT 03-02: Modification to an Existing Intercompany Pooling Arrangement ○ Ref #2022-19: Negative IMR ○ Ref #2023-01: Review Annual Statement Instructions for Accounting Guidance ○ Ref #2023-02: SSAP No. 43R – CLO Financial Modeling ○ Ref #2023-05: <i>ASU 2022-06, Reference Rate Reform (Topic 848), Deferral of the Sunset Date of Topic 848</i> ○ Ref #2023-06: Additional Updates on ASU 2021-10, Government Assistance ○ Ref #2023-07: ASU 2019-08, Codification Improvements to Topic 718 and Topic 606 ○ Ref #2023-08: ASU 2019-07, Codification Updates to SEC Sections ○ Ref #2023-09: <i>ASU 2020-09—Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)</i> ○ Ref #2023-10: ASU 2022-05, Long-Durations Contracts | 15-32 |
| Security Benefit Life Insurance Company – June 9 and August 7, 2023 <ul style="list-style-type: none"> ○ Ref #2022-11: Collateral for Loans | 33-36 |
| Interested Parties – June 30, 2023 <ul style="list-style-type: none"> ○ Ref #2022-14: New Market Tax Credits ○ Ref #2019-21e - Principles-Based Bond Definition: Schedule BA ○ Ref #2023-13: PIK Interest Disclosure Clarification ○ Ref #2023-12: Residuals in SSAP No. 48 Investments | 37-53 |
| Interested Parties – July 14, 2023 <ul style="list-style-type: none"> ○ Ref #2023-12: Residuals in SSAP No. 48 Investments | 54-55 |

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May 31, 2023

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' Proposal for Statutory Accounting for CAMT

Dear Mr. Bruggeman:

Interested parties would like to thank you for the continued meetings with the Statutory Accounting Principles Working Group (SAPWG) staff to discuss the interested parties' proposal for accounting for the Corporate Alternative Minimum Tax (CAMT). Over the past five months, interested parties has provided materials illustrating its proposal.

Interested parties is now providing a draft of suggested language for a recommended Interpretation addressing the statutory accounting for the CAMT. This draft is intended to aid the SAPWG staff by providing the interested parties' proposal in direct language suitable for an Interpretation. The draft Interpretation is more detailed than the previously provided material and also includes transitional guidance, as well as suggested disclosures. We believe this detailed language should help prevent different interpretations among the industry and the accounting firms.

In drafting this proposal, interested parties followed the guiding principles that you previously communicated. First, given that CAMT only applies to a limited number of large and profitable companies, *SSAP No. 101 – Income Taxes* does not need to, and should not, be opened and rewritten. Although guidance is necessary to address how the consolidated tax should be accounted for under statutory accounting, revising *SAAP No. 101* is not necessary as this draft clarifies the existing guidance in *SSAP No. 101*. Following this guiding principle, interested parties drafted guidance through an Interpretation, leaving *SSAP No. 101* intact. Next, given that the CAMT is calculated based on consolidated book income and not taxable income, you suggested the use of the tax sharing agreement to bridge the CAMT calculation to the separate company statutory statements. As such, the proposed Interpretation relies on tax sharing

agreements to allocate the consolidated CAMT for purposes of the admittance calculation. In addition, all insurance companies will have different organizational structures, various book income starting points (U.S. GAAP, STAT or IFRS), and other facts and circumstances that will lead to unique situations under the CAMT. To avoid situational guidance, you indicated the solution should be principles-based and cover all insurance companies. By using a hierarchy of filers, the proposal covers all insurance companies without the need to address company specific issues. Finally, you suggested the solution should be developed between the working group and the industry, not external audit firms. Utilizing industry and working group representatives to develop the guidance prevents external audit firms from deviating in how they require insurance companies to account for the CAMT.

Thank you for the attention you have given to the impact that CAMT will have on statutory accounting and for considering the interested parties' proposed treatment.

Please feel free to contact either one of us with any questions you may have.

Sincerely,

D. Keith Bell

Rose Albrizio

cc: Interested parties
NAIC staff

Interpretation of the Statutory Accounting Principles (E) Working Group

INT 23-XX: Inflation Reduction Act – Corporate Alternative Minimum Tax

INT 23-XX References

Current:

SSAP No. 3 – Accounting Changes and Corrections of Errors

SSAP No. 9 – Subsequent Events

SSAP No. 101 – Income Taxes

INT 23-XX Issue

Key Provisions of the Inflation Reduction Act

1. The Inflation Reduction Act (Act) was enacted on August 16, 2022 and included a new corporate alternative minimum tax (CAMT). The CAMT is effective for tax years beginning after December 31, 2022. Reporting entities shall refer to the Act and the related regulations and other tax guidance to determine application, but a non-authoritative high-level summary regarding the CAMT is as follows:
 - a. The tentative CAMT is 15% of the corporation’s “adjusted financial statement income” for the taxable year, reduced by the CAMT foreign tax credit for the taxable year.
 - b. The CAMT applies only to corporations (determined on a controlled group basis as defined for Federal income tax purposes) with average annual adjusted financial statement income in excess of \$1 billion for three prior taxable years. The threshold is reduced to \$100 million in the case of certain foreign-owned corporations. A corporation that meets the applicable threshold is an “applicable corporation.” Applicable corporations generally remain applicable corporations for subsequent taxable years, unless certain limited exceptions apply.
 - c. A corporation’s adjusted financial statement income is the amount of net income or loss the corporation reports on its applicable financial statement, adjusted by various enumerated adjustments.
 - d. The Act provides a hierarchy for determining the applicable financial statement. At a high level, the first choice is U.S. generally accepted accounting principles (GAAP) financial statements; the second choice is international financial reporting standards (IFRS) financial statements. If GAAP and IFRS financial statements are not available, the financial statements filed by the taxpayer with any other regulatory or governmental body is acceptable. If the taxpayer is part of a tax-controlled group of corporations, the group’s applicable financial statement is the applicable financial statement for each member of the group.

- e. To determine its U.S. federal income tax liability, a corporation will need to compute taxes under both systems – the regular tax system and the CAMT system. The CAMT is payable to the extent the tentative CAMT exceeds the sum of the regular corporate income tax plus the base erosion anti-abuse tax (BEAT). Any CAMT paid is available indefinitely as a credit carryover that would reduce regular tax in future years when the regular tax liability is in excess of CAMT tax liability.
- f. The Act directs the Treasury to issue regulations and other guidance relating to implementing the CAMT, and many issues are pending detailed clarification, including issues that are unique to the insurance industry.

Interpretation Issues

2. This interpretation addresses statutory accounting and reporting aspects of the CAMT for year-end 2023 and subsequent reporting periods. While most insurers will not be applicable corporations, this interpretation provides comprehensive statutory accounting guidance for all reporting entities with respect to the CAMT. This interpretation incorporates a principles-based approach which progressively categorizes reporting entities for purposes of statutory accounting for the CAMT so that each step in the interpretation is dependent on the prior steps.
3. Although it is likely that most insurers that are applicable corporations will be members of a tax-controlled group of corporations and included in a consolidated Federal income tax return with other members of the group, this interpretation applies to all reporting entities, whether an unaffiliated corporation¹ that files a separate tax return, a member of a tax-controlled group not included in the common parent company's consolidated tax return that files a separate company tax return or a separate consolidated tax return with other members of the group, or as a member of the common parent's consolidated return group. For reporting entities that are included in a consolidated tax return, the fundamental statutory tax accounting issue for the CAMT is how to reflect in the reporting entity's separate company financial statements a portion of what is essentially an add-on tax for a consolidated tax return group that is based on the group's financial statement income. Unlike the alternative minimum tax (AMT) that applied under pre-2018 tax law, the new CAMT does not apply to every corporation and is not based on the corporation's regular taxable income with adjustments for minimum tax purposes. Instead, the determination of whether the CAMT applies is made on a tax-controlled group basis (scope determination), the tentative CAMT is based on the group's adjusted financial statement income (not adjusted regular taxable income), and any tax actually due (liability determination) is based on a comparison of consolidated tentative CAMT to consolidated regular tax. Even if a member of a tax-controlled group of corporations files its own separate Federal income tax return, the tax law does not provide for a separate company scope determination, but rather looks to the tax-controlled group for applicable corporation status and determination of the applicable financial statement.

¹ As used herein, an "unaffiliated" corporation is one that is not a member of a tax-controlled group.

4. As described in the rules below, this interpretation is based on the principle that the statutory tax accounting for the CAMT for reporting entities included in a consolidated tax return should be matched to the CAMT charges and credits that actually are expected to be paid by or to the reporting entity. For such reporting entities, this interpretation applies the provisions of the intercompany tax allocation agreement (also referred to as a tax sharing agreement or TSA) that governs allocation of consolidated taxes to individual members of the group.
 - a. Paragraph 16. of *SSAP No. 101* provides that in the case of a reporting entity that files a consolidated income tax return with one or more affiliates, income tax transactions between the affiliated parties shall be recognized if such transactions are economic transactions as defined in *SSAP No. 25*; are pursuant to a written TSA; and income taxes incurred are accounted for in a manner consistent with the principles of FAS 109 (the forerunner of what is now ASC 740), as modified by *SSAP No. 101*.
 - b. This interpretation provides the applicable statutory tax accounting rules for the CAMT for a reporting entity that is included in a consolidated tax return and is subject to a TSA. In such case, the rules are applied consistently with the modifications to ASC 740 pursuant to both *SSAP No. 101* and this interpretation, and CAMT expense or benefit is recognized in accordance with the TSA.
 - c. Consistent with paragraph 4 of *SSAP No. 3 – Accounting Changes and Corrections of Errors*, application of this interpretation shall not be considered a change in accounting principle.

INT 23-XX Discussion

5. A reporting entity is an “applicable corporation” for purposes of this interpretation if, either as an unaffiliated corporation or as a member of a tax-controlled group of corporations, the reporting entity is an “applicable corporation” as defined for CAMT purposes in the tax code or guidance thereunder. With limited exceptions, once a corporation is an applicable corporation under the tax law, it remains an applicable corporation for subsequent taxable years and for purposes of this interpretation. Applicable corporation status means that CAMT must be tentatively determined and compared to regular tax liability. However, no CAMT is actually payable unless tentative CAMT exceeds regular tax liability. CAMT in excess of regular tax liability gives rise to a credit that is carried forward indefinitely for use when regular tax liability exceeds CAMT.

Categories of Reporting Entities

6. In an annual determination, all reporting entities are separated into one of four categories – the first three of which are not required to account for CAMT in determining current or deferred income taxes under *SSAP No. 101*.
 - a. Category a. consists of unaffiliated reporting entities that do not reasonably expect to be an applicable corporation for the taxable year that includes the reporting period. A reporting entity that was an applicable corporation for the preceding taxable year is deemed to reasonably expect to be an applicable corporation for

- the current taxable year, unless one of the tax law exceptions to continued applicable corporation status applies. Category a. reporting entities are not required to recognize CAMT in any current or deferred tax computations under *SSAP No. 101*. Accordingly, non-applicable corporation status for the current reporting period applies both for purposes of determination of current taxes and determination of the amount “expected to be realized within the applicable period” in the admitted DTA calculation in paragraph 11.b.i. of *SSAP No. 101*.
- b. Category b. includes a reporting entity that is a member of a tax-controlled group of corporations, and the tax-controlled group does not reasonably expect to be an applicable corporation for the taxable year that includes the reporting period. As with category a. reporting entities, a category b. reporting entity that is a member of a tax-controlled group of corporations that was an applicable corporation for the preceding taxable year is deemed to reasonably expect to be an applicable corporation for the current taxable year, unless one of the tax law exceptions to continued applicable corporation status applies. On the other hand, because the tax law does not provide for a separate company scope determination for members of a tax-controlled group, but instead determines applicable corporation status on a tax-controlled group basis, a category b. reporting entity is not required to make a separate company scope determination as if it was an unaffiliated corporation. Like category a. reporting entities, category b. reporting entities are not required to recognize CAMT in any current or deferred tax computations under *SSAP No. 101*, and non-applicable corporation status for the current reporting period applies both for purposes of determination of current taxes and determination of the amount “expected to be realized within the applicable period” in the admitted DTA calculation in paragraph 11.b.i. of *SSAP No. 101*.
 - c. Category c. includes a reporting entity that is a member of a tax-controlled group of corporations, and the tax-controlled group reasonably expects to be an applicable corporation for the taxable year that includes the reporting period. However, the reporting entity is included in a consolidated Federal income tax return with other members of the tax-controlled group and is a party to a TSA that is in effect for the reporting period and pursuant to the terms of which the category c. reporting entity i) is excluded from charges for any portion of the group’s CAMT, and ii) is not allocated any portion of the group’s utilization of CAMT credit carryover. Paragraph 8.3 of *SSAP No. 101 Exhibit A – Implementation Questions and Answers (Q&A)* is not applicable to Category c. reporting entities with respect to the CAMT. Like category a. and b. reporting entities, category c. reporting entities are not required to recognize CAMT in any current or deferred tax computations under *SSAP No. 101*, and this accounting treatment for the current reporting period applies both for purposes of determination of current taxes and determination of the amount “expected to be realized within the applicable period” in the admitted DTA calculation in paragraph 11.b.i. of *SSAP No. 101*. See *Example 1d* in paragraph 10.b. of this interpretation for an illustration.
 - d. Category d. includes all other reporting entities. Accordingly, category d. includes a reporting entity that reasonably expects to be an applicable corporation for the

taxable year that includes the reporting period, either as an unaffiliated corporation or as a member of a tax-controlled group of corporations if, in the latter case, the reporting entity is not included in category c. A category d. reporting entity may be the common parent company of a consolidated return group. It may also be a member of an affiliated group of corporations (as defined for Federal income tax purposes) but excluded from the consolidated tax return and filing its own separate return (if, for example, the reporting entity is a life insurance company and i) the group has not made a “life-nonlife” consolidated return election, or ii) the reporting entity has been recently-acquired and is excluded from the life-nonlife consolidated return for a period of 5 years). Category d. reporting entities are required to consider CAMT in *SSAP No. 101* current and deferred tax computations in the manner set forth in the following paragraphs. Because CAMT is not payable by an applicable corporation unless it is in excess of regular tax liability, the calculations under category d. may or may not result in different current and deferred income taxes than if the CAMT was not taken into account.

Operational Rules for Category d. Reporting Entities

7. Category d. reporting entities are required to take CAMT into account under *SSAP No. 101* to the extent it is reasonably expected that the tax actually is (for the current period) or could be (for future years in the *SSAP No. 101* paragraph 11.b. applicable period) incurred a) by the reporting entity (if unaffiliated or affiliated but excluded from a consolidated tax return) or b) by the consolidated tax return group of which the reporting entity is a member and the consolidated CAMT is allocable in some part to the reporting entity pursuant to the group’s intercompany income tax allocation agreement. Such reporting entities recognize CAMT, if any, as a current tax expense for the taxable year that includes the reporting period and recognize CAMT credit utilization as a current tax benefit for such period. If the reporting entity is a party to a TSA, CAMT expense or CAMT credit utilization is based on the amount determined under the TSA. If the reporting entity pays CAMT or utilizes the CAMT credit to offset regular tax liability, its CAMT expense or CAMT credit utilization is based on the amount of such payments or receipts less allocations to other members of the consolidated tax group pursuant to the TSA.
8. A reporting entity is allowed an accounting policy election to either consider or disregard CAMT when evaluating the need for a valuation allowance for its regular tax DTAs.² The accounting policy election applies for valuation allowance purposes only - that is, in the determination of adjusted gross DTAs other than CAMT-related DTAs. This accounting policy election cannot be used to avoid a valuation allowance analysis for CAMT credit carryforward DTAs. The accounting policy election must be disclosed in the notes to the financial statements and applied consistently in subsequent reporting periods.

² ASC 740 does not specifically address whether future years’ CAMT should be anticipated in a valuation allowance assessment for regular tax DTAs. Accordingly, an accounting policy election is allowed for GAAP purposes as to whether to consider or disregard CAMT when evaluating the need for a valuation allowance for regular tax DTAs.

9. An adjusted gross deferred tax asset (DTA) is recognized for any CAMT credit carryforward that is more likely than not to be recognized (that is, after reduction of the gross DTA by any required valuation allowance) and is admissible under the conditions described in paragraph 10 of this interpretation. The valuation allowance analysis should include, for example, the risk that the reporting entity, or the tax-controlled group of corporations of which the reporting entity is a member, more likely than not may be unable to realize the CAMT credit carryforward. Because the CAMT credit utilization is determined at the consolidated group level for reporting entities that are part of a consolidated group, the reporting entity valuation allowance determination shall be consistent with the consolidated group determination. A valuation allowance analysis for a CAMT credit carryforward is required regardless of the accounting policy election described in paragraph 8.
10. The admissible amount of adjusted gross DTAs for a category d. reporting entity is determined under paragraph 11 of *SSAP No. 101* with the modifications set forth below.
 - a. An RBC-reporting entity with an ExDTA Authorized Control Level Risk Based Capital (RBC) percentage – calculated as described in footnote 3 of paragraph 11.b. of *SSAP No. 101* - of greater than [450]% if a life insurance company and [400]% in all other cases is not required to take the CAMT into account in calculating the “with and without” tax liability for purposes of determining the amount expected to be realized under paragraph 11.b.i. of *SSAP No. 101* within the 3-year applicable period determined under paragraph 11.b. **[NOTE TO DRAFT:** An RBC ratio is being proposed for this financial strength test in part because *SSAP No. 101* already includes an RBC threshold in paragraph 11.b. An alternative financial strength test might incorporate an approach similar to that of Section 8.B.(3)(c) of the Credit for Reinsurance Model Regulation relating to certified reinsurers, wherein an assuming insurer must maintain financial strength ratings from two or more rating agencies deemed acceptable by the commissioner. For this purpose, acceptable rating agencies include Standard & Poor’s, Moody’s Investor Service, Fitch Ratings, A. M. Best Company, or any other nationally recognized statistical rating organization.] The post-valuation allowance adjusted gross DTA for any CAMT credit carryforward is admitted by such entities without regard to paragraph 11.b.i. The 15% limitation of capital and surplus limitation of paragraph 11.b.ii. of *SSAP No. 101* continues to apply to admitted adjusted gross DTAs, including the adjusted gross DTA for any CAMT credit carryforward. See *Example 1c* below. A category d. reporting entity that accounts for CAMT pursuant to this paragraph 10.a. shall disclose that fact in the notes to the financial statements.
 - b. If this financial strength threshold is not met, the amount expected to be realized under paragraph 11.b.i. of *SSAP No. 101* within the applicable period determined under paragraph 11.b. is based on the reporting entity’s “with and without” regular tax liability reduced by CAMT, if any, reasonably expected to be incurred during the paragraph 11.b. applicable period. In the case of a reporting entity included in a consolidated Federal income tax return, the amount expected to be realized is reduced

by the portion of the consolidated CAMT, if any, reasonably expected to be allocable to the reporting entity pursuant to the group’s TSA. CAMT credit utilization during the applicable period is recognized based on the same principles, with the opposite effect – that is, as an admitted DTA. The purpose of these computations is to account for CAMT in deferred taxes in the same manner as CAMT would be reflected in current taxes. The DTA for any CAMT credit carryforward not admitted under paragraph 11b. of SSAP No. 101 is available to offset liabilities under paragraph 11c. of SSAP No. 101 without any other considerations.

c. Paragraph 8.3 of the SSAP No. 101 Q&A is not applicable to Category d. reporting entities with respect to the CAMT.

d. Examples

Example 1a: Insurance company IC is a member of a tax-affiliated group of corporations that files consolidated Federal income tax return and that reasonably expects to be an applicable corporation for 20X3. For 20X3, IC falls below the financial strength threshold applicable for category d. but exceeds the RBC threshold in paragraph 11.b. of SSAP No. 101 for use of a 3-year applicable period. At the end of 20X3, IC has a \$50x CAMT credit carryover DTA (pursuant to the consolidated group's TSA, IC was allocated a portion of the group's expected 20X3 current CAMT expense, which IC included in its 20X3 current tax expense). IC also has \$200x of regular tax adjusted gross DTAs (i.e., as already reduced by any required valuation allowance), of which \$150x reverses over the 3-year applicable period 20X4-20X6 and is expected to be realized in IC's with and without calculation under paragraph 11.b.i. of SSAP No. 101. The consolidated group expects to absorb its entire CAMT credit carryover, including the \$50x allocated to IC, in 20X4, and expects to incur CAMT in each of 20X5 and 20X6, of which \$5x each year is expected to be allocated under the TSA to IC. IC’s 15% of surplus limitation under paragraph 11.b.ii. of SSAP No. 101 is \$225x.

Ignoring for purposes of this example any DTA admittance under paragraphs 11.a. and 11.c. of SSAP No. 101, IC admits the \$50x adjusted gross DTA for the CAMT credit carryover expected to be utilized in 20X4 and reduces its \$150x of regular tax admitted DTAs by the \$10x CAMT expected to be incurred in 20X5 and 20X6, resulting in \$190x of DTA admitted under paragraph 11.b.i., which is less than the \$225x paragraph 11.b.ii. limitation. However, if the 15% of capital and surplus limitation was \$175x instead of \$225x, the \$190x would be limited to \$175x.

| | DTAs | Regular DTAs Admitted Standalone | Impact of Consolidated CAMT | Admitted DTAs under 11.b.i | 15% Surplus limitation under 11.b.ii | Non Admitted DTAs |
|--|------------|----------------------------------|-----------------------------|----------------------------|--------------------------------------|-------------------|
| Adjusted gross DTAs reversing in 3 years | 200 | 150 | (10) | 140 | | 60 |
| CAMT Credit DTA | 50 | | 50 | 50 | | - |
| | 250 | 150 | 40 | 190 | 225 | 60 |

Example 1b. The facts are the same as in *Example 1a* except that the consolidated group of which IC is a member expects to absorb in 20X4 only a portion of its CAMT credit carryover, of which \$30x would be allocated to IC, and expects to incur CAMT in each of 20X5 and 20X6, of which \$5x each year is expected to be allocated under the TSA to IC. The consolidated group also concludes that its remaining consolidated CAMT credit carryforward, of which \$20x would be allocated to IC, is not more likely than not to be realized.

In accordance with paragraph 9 of this interpretation, IC establishes a \$20x valuation allowance against its \$50x AMT credit carryforward DTA, resulting in an adjusted gross DTA of \$30x. Under paragraph 8 of this interpretation, IC makes an accounting policy election to disregard CAMT when evaluating the need for a valuation allowance for its regular tax DTAs. IC admits \$150x of regular tax adjusted gross DTAs and the \$30x adjusted gross DTA for its allocated portion of the CAMT credit carryforward. IC reduces its admitted adjusted gross DTAs by its \$10x share of the consolidated CAMT expected to be incurred in 20X5 and 20X6. The result is an admitted DTA of \$170x, \$20x less than an *Example 1a*, attributable to the \$20x valuation allowance against the CAMT credit carryforward.

Example 1c. The facts are the same as in *Example 1a* except that IC exceeds the financial strength threshold applicable for category d. Accordingly, IC would not reduce its admitted regular tax DTA by any CAMT for years after 20X3. However, IC would still have to perform a valuation allowance analysis on its \$50x CAMT credit carryforward at the end of 20X3 and reduce the adjusted gross DTA for such credit to the amount more likely than not to be realized. Assume the valuation allowance is \$20x and the adjusted gross DTA for the CAMT credit carryover is reduced to \$30x. IC's admitted DTA would be \$180x. Additionally, if IC's 15% of surplus limitation under paragraph 11.b.ii. was \$175x, IC's admitted adjusted gross DTA would be further reduced to \$175x.

Example 1d. If, in *Example 1a*, the TSA to which IC is a party excluded IC from any allocation of CAMT or CAMT credit utilization, IC would be a category c. reporting entity for 20X3, CAMT would be excluded from the calculations, and IC's admitted adjusted gross DTA would be \$150x.

- e. Also recognized are CAMT credit carryovers arising during the applicable period that become utilizable within the applicable period.

Example 2: The facts are the same as *Example 1a* except that the consolidated group (and IC) have no CAMT credit carryovers at the end of 20X3. Furthermore, the consolidated group reasonably expects to incur CAMT liability in each of 20X4 and 20X5 (instead of 20X5 and 20X6) and to utilize in 20X6 a portion of the CAMT credit carryovers generated in 20X4 and 20X5. Of these amounts, IC is expected to be allocated under the TSA \$5x of CAMT in each of 20X4 and 20X5, and \$6x of

CAMT credit utilization in 20X6. In determining admitted adjusted gross DTAs for the 20X3 reporting period, IC reduces its regular tax admitted adjusted gross DTA by its \$10x TSA-allocated portion of the consolidated group's CAMT for 20X4 and 20X5 but increases such admitted amount by its \$6x TSA-allocated portion of the consolidated group's CAMT credit utilization for 20X6.

- f. Projections of CAMT liability, if any, (and CAMT credit utilization) during the applicable period involve forward-looking data, groupings, estimates and other adjustments for both the reporting entity and the group of which it is a member. The manner in which this is done shall be conducted in a reasonable and consistent manner. A reporting entity shall retain internal documentation to support these computations and the methodologies so employed. Modifications are permitted should events or circumstances change from a previous period – such as a change in materiality or administrative costs associated with the computations, or system changes that affect the level of detail available. Entities that make such modifications should be prepared to rationalize the changes. Disclosure of material modifications, and the general reason for such, should be made in the notes to the financial statements.³
- g. *SSAP No. 101* provides that tax-planning strategies are required to be considered in the valuation allowance analysis and may be considered in determining the admission of DTAs under *SSAP No. 101* paragraph 11. A reporting entity may consider tax-planning strategies in making the determinations required under this interpretation. Because the CAMT scope and liability determinations are made at a group level, tax-planning strategies may be considered both at a group level and at the reporting entity level. However, tax-planning strategies at the group level shall not conflict with tax-planning strategies at the reporting entity level and vice versa.
- h. CAMT arising during the *SSAP No. 101* paragraph 11.b. applicable period that reduces the amount expected to be realized under paragraph 11.b. results in DTAs for CAMT credit carryforwards that may be taken into account in the *SSAP No. 101* paragraph 11.c. calculation.

Example 3: The facts are the same as in Example 2. The remaining \$4x of CAMT credit carryforward arising during the 3-year applicable period is taken into account in IC's 20X3 paragraph 11 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.

Disclosures

- 11. The reporting entity shall disclose whether it is a category a., b., c., or d. reporting entity. Additionally, the following disclosures shall be made in the notes to the financial statements of category d. reporting entities:
 - a. The accounting policy election described in paragraph 8. of this interpretation.
 - b. Application of the RBC reporting threshold described in paragraph 10.a. of this interpretation

³ See paragraph 2.9 of the *SSAP No. 101 Q&A* for similar requirements in the context of grouping of assets and liabilities for measurement.

- c. Any disclosure required by paragraph 10.f. of this interpretation.
- d. In the disclosure required by paragraph 28.b. of *SSAP No. 101*, a statement as to whether the reporting entity may be charged with a portion of CAMT incurred by the consolidated group (or credited with a portion of the consolidated group's CAMT credit utilization).
- e. Inclusion of CAMT credit carryforwards, if any, in the disclosure required by paragraph 26.a. of *SSAP No. 101*.
- f. The impact of CAMT tax-planning strategies, if any, in the disclosure required by paragraph 22.f. of *SSAP No. 101*.

Transition Guidance

12. Even though the CAMT was enacted in 2022 and generally became effective January 1, 2023, the requirements for statutory tax accounting for the CAMT have effectively been deferred by INT 22-02.⁴ It is well understood that reporting entities have been awaiting the guidance provided in this interpretation to file requests for approval of TSA amendments or a new TSA relating to the CAMT. This paragraph 11. provides the applicable transition rules for year-end 2023 statutory accounting for requests for a timely-filed TSA amendment or a new TSA for the 2023 taxable year.

- a. Because the CAMT was newly-enacted effective for 2023, TSAs in effect for periods prior to the 2023 taxable year include no explicit provisions relating to the CAMT.⁵ Thus, category c. and category d. reporting entities may need to amend TSAs to deal with the CAMT effective for the entire 2023 taxable year. A reporting entity would file a request for amendment to a TSA or a new TSA on Form D – Prior Notice of a Transaction with its applicable domiciliary regulator(s) and commercial domiciliary regulator(s).
- b. Time is of the essence in both requesting and approving TSA amendments or a new TSA relating to the CAMT for the 2023 taxable year to be applicable to the 2023 reporting period. Accordingly, if, within [45] days after adoption of this interpretation, a reporting entity files the applicable Form D request(s) for TSA amendment or a new TSA to address the CAMT for 2023 and subsequent taxable years,⁶ such TSA amendment or new TSA shall be accounted for as applicable for the entire 2023 reporting period, regardless of whether the approved TSA allocates consolidated CAMT (or utilization of consolidated AMT credit carryforwards) to the reporting entity.
 - i. If the final approved TSA differs in its treatment of the CAMT allocation from the TSA originally requested on the Form D, the difference shall be recorded as follows:
 - 1. If Form D approval occurs subsequent to the balance sheet date, but before the issuance of the statutory financial statements and before

⁴ INT 22-02: Third Quarter 2022 through Second Quarter 2023 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax (last updated April 12, 2023).

⁵ TSAs may include provisions relating to the pre-2018 AMT if not previously amended to remove such provisions.

⁶ That is, with an effective date of January 1, 2023, or, if not a calendar year taxpayer, the first day of the 2023 taxable year.

the date the audited financial statements are issued, or available to be issued, such approval shall be considered a Type I subsequent event within the meaning of *SSAP No. 9 – Subsequent Events*.

2. In the extraordinary circumstance that a Form D approval occurs after the period which defines a subsequent event in *SSAP No. 9*, the difference created by such approval shall be recognized and disclosed in the period in which the approval is given.
 - ii. The transition guidance in this paragraph 12. does not apply to a reporting entity that does not file a Form D request for a CAMT-related TSA amendment or a new TSA within the time period specified in subparagraph b.

Interested Parties Draft

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June 9, 2023

Mr. Dale Bruggeman, Chairman
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RE: Interested Parties Comments on Exposures with Comments due June 9

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the items exposed for comment by the Statutory Accounting Working Group (the Working Group) during its March 22, 2023, meeting with comments due June 9.

Ref #2022-19: Negative IMR

The Working Group directed NAIC staff regarding the consideration of negative interest maintenance reserve (IMR) with an intent to work on both a 2023 solution and a long-term solution as follows:

- a. Draft a referral to the Life Actuarial (A) Task Force on further consideration of the asset adequacy implications of negative IMR. Items to include: 1) developing a template for reporting within asset adequacy testing (AAT); 2) considering the actual amount of negative IMR that is admitted to be used in the AAT; 3) better consideration of cash flows within AAT (and documentation), as well as any liquidity stress test (LST) considerations; 4) ensuring that excessive withdrawal considerations are consistent with actual data (sales of bonds because of excess withdrawals should not use the IMR process); and 5) ensuring that any guardrails for assumptions in the AAT are reasonable and consistent with other aspects.
- b. Draft a referral to the Capital Adequacy (E) Task Force for the consideration of eliminating any admitted net negative IMR from total adjusted capital (TAC) and the consideration of sensitivity testing with and without negative IMR.

- c. Develop guidance for future Working Group consideration that would allow the admission of negative IMR up to 5% of surplus using the type of limitation calculation similar to that used for goodwill admittance. The guidance should also provide for a downward adjustment if RBC ratio is less than 300.
- d. Review and provide updates on any annual statement instructions for excess withdraws, related bond gains/losses and non-effective hedge gains/losses to clarify that those related gains/losses are through asset valuation reserve (AVR), not IMR.
- e. Develop accounting and reporting guidance to require the use of a special surplus (account or line) for net negative IMR.
- f. Develop governance related documentation to ensure sales of bonds are reinvested in other bonds.
- g. Develop a footnote disclosure for quarterly and annual reporting.

Please see the comments in the letter submitted by ACLI on May 17th.

Principles-Based Bond Definition

The Working Group exposed changes to several SSAP's that propose statutory accounting changes under the principles-based bond project.

The exposure also proposes changes to Schedule BA to encompass debt securities that do not qualify as bonds and consolidate existing reporting lines.

Interested parties' comments are shown below related to each of the five separate documents exposed for comment.

SSAP No. 26R, SSAP No. 43R, and Other SSAPs

Interested parties have no comments on these exposures and are appreciative of the changes made and the responsiveness to interested parties' previous comments.

Schedule BA

Interested parties will respond to this exposure under separate cover as comments are more involved and not due until June 30, 2023.

SSAP No. 21R

Paragraphs 22 and 29

Interested parties understand that proposed paragraph 22 of SSAP No. 21 requires that the underlying collateral in an asset-backed security that fails the bond definition must qualify as admitted assets for the security to be admitted. Paragraph 22 also proposes to report these bonds at a value that does not exceed the fair value of the collateral with any amount above the fair value of the collateral being non-admitted. Interested parties have concerns with the proposal as this would be operationally very difficult to do since some asset-backed securities can have a

large number of assets and the fair value of the underlying collateral in the asset-backed security may not be readily available. This is very different from collateral loans in SSAP No. 21 where there are generally fewer assets that compose the underlying collateral. In addition, this would be costly as currently the servicer/trustee reports do not usually include fair value of the collateral so this would be a new service for which we would have to pay. Interested parties believe that accounting for these securities at the lower of cost or market of the security owned by the insurer will consider the performance of the underlying collateral. The unit of account is the security owned by the insurer and not the underlying collateral for the asset-backed security. The fair value of the bond will consider the fair value of the collateral to a great extent, but it will also take into account other key characteristics of the bond itself that impact the bond's fair value and will better reflect the consideration expected to be received upon maturity or sale of the security. If the collateral is an admitted asset, the entire carrying balance of the security should be admitted without having to quantify collateral fair value given the cost and complexity in doing so. Interested parties propose changes to paragraph 22 as a result of the comments above.

Interested parties also have comments regarding the new paragraph 29 that was added to clarify the accounting for residual tranches. We believe that the intent of paragraph 29 is to require non-admission of a residual tranche only if another tranche from the same securitization owned by the insurer fails the bond definition and the collateral is not an admitted investment. Interested parties propose changes to paragraph 29 to further clarify what we believe to be the intent of the paragraph.

We proposed the following changes to paragraphs 22 and 29 to address the aforementioned comments:

22. Debt securities in scope of this standard that do not qualify as bonds under SSAP No. 26R and for which the primary source of repayment is derived through rights to underlying collateral, qualify as admitted assets ~~only to the extent they are secured~~ if the underlying collateral primarily qualify as admitted invested assets. Any residual tranches or first loss positions held from the same securitization that did not qualify as a bond under SSAP No. 26R also only qualify as admitted assets to the extent the underlying collateral primarily qualify as admitted invested assets. Any amounts in excess of the fair value of the underlying admitted invested assets shall be non-admitted.

29. As stated in paragraph 22, Residuals are permitted to be admitted if debt securities from the same securitization qualify as bonds under SSAP No. 26R as an issuer credit obligation or an asset backed security. For example, if a debt security from a securitization does not qualify as a bond, and the source of repayment is derived through rights to the underlying collateral, the debt security is only permitted to be admitted if the underlying assets qualify as admitted assets. If the debt security from a securitization is nonadmitted due to the requirements under paragraph 22, then any residual interests or first loss positions held from the same securitization also do not qualify as admitted assets and would be reported as nonadmitted assets.

Paragraph 25

Interested parties also note that the way paragraph 25 below was written implies that the only securities that can fail the definition are asset-backed securities. Since an issuer credit obligation could also fail the bond definition (i.e., does not reflect a creditor relationship in substance), we believe the changes recommended below are needed to reference the appropriate accounting guidance under either SSAP No. 26 for issuer credit obligations or SSAP No. 43R for asset-backed securities.

25. Debt securities that do not qualify as bonds ~~are captured~~included in the scope of this statement. Debt securities included in the scope of this statement shall follow the guidance in SSAP No. 43R—Asset-Backed Securities or SSAP No. 26R Bonds, depending on whether they would have been classified as asset-backed securities or issuer credit obligations, respectively, should they have qualified as bonds. This includes the guidance, for calculating amortized cost, for determining and recognizing other-than-temporary impairments and for allocating unrealized and realized gains and losses between the asset valuation reserve (AVR) and interest maintenance reserve (IMR).

Paragraphs 30 and 31

In paragraph 31 of the exposure, NAIC asks the following question:

Exposure Question: Industry is requested to provide information on how residual tranches have been amortized and how they have been assessed for OTTI as there are no contractual principal or interest payments.

Regarding the calculation of amortized cost and the assessment of OTTI for residuals, it has generally been industry practice to follow the SSAP No. 43R guidance for beneficial interests (i.e., paragraphs 21-25 of the bond definition proposal titled “Accretible Yield and Changes to Effective Yield for Application of Prospective Method”), which requires estimates of cash flows to be calculated quarterly with prospective yield adjustments. If there is an adverse change in estimated cash flows at the reporting date, an OTTI is recorded. Under those circumstances, the residual is written down to the current estimate of cash flows discounted at a rate equal to the current yield used to accrete the residual with the resulting change being recognized as a realized loss. If the cash flows increase from the prior period, the yield is adjusted upward. To require recognition of a loss for the entire amount of the residual would not be a reasonable accounting result. Also, for insurers who are US GAAP filers, they also apply the prospective method discussed above for their US GAAP financial statements, if they have not elected the fair value option. As a result, interested parties propose the edits below to paragraphs 30 and 31, which also include clarification on AVR treatment of residuals:

30. Residuals shall be initially reported at cost, or allocated cost (using proportional fair values) if acquired along with debt tranches from the securitization. Subsequent to initial acquisition, residuals shall be reported at the lower of amortized cost or fair value, with changes in fair value (or from amortized cost to fair value) reported as unrealized gains or losses. To determine amortized cost, the reporting entity should apply SSAP No. 43R,

paragraphs 21-25 (i.e., prospective method). Unrealized and realized gains and losses on residuals are reported in the AVR.

~~31. Residuals shall be assessed for other-than-temporary impairment (OTTI) on an ongoing basis based on SSAP No. 43R. An OTT shall be considered to have occurred if it is probable that the reporting entity will not receive cash flows distributed to the residual tranche to cover the reported amortized cost basis. Upon identification of a probable OTTI, the reporting entity shall recognize a realized loss equal to the remaining amortized cost basis. Subsequent to the recognition of OTTI, the residual shall be reported with a zero book adjusted carrying value. Any subsequent cash flows received attributed to the residual tranche shall be reported as interest income.~~

Interested parties also note that the recent exposure by the Working Group that intends to expand the scope of what is considered a residual investment may require significant changes to the accounting laid out above. The accounting model for residuals issued in a securitization that we explain above is in line with the accounting for residuals that are more akin to a debt security. If the scope of a residual is expanded to include other types of residuals, this model may not fit those types of investments. Given this linkage, interested parties may have additional recommendations for the accounting discussed above as the residual investment definition is finalized.

Ref #2022-01: Conceptual Framework – Updates

The Working Group exposed additional revisions to *Issue Paper No. 16X—Updates to the Definition of a Liability* related to the definition change of a liability in *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*. The revisions to: 1) add an additional footnote to the definition of a liability in SSAP No. 5R which defers to more topic specific contradictory guidance 2) revise the relevant literature section of SSAP No. 5R to note the modification and 3) note the additional exposure action in the Issue Paper paragraph 18.

These clarifications were because of the authoritative treatment that statutory accounting provides to the definition of an asset and a liability in SSAP No. 4 and SSAP No. 5R. For GAAP, the FASB Conceptual statements definitions are not authoritative, but rather are concepts to consider when developing and applying guidance. The FASB basis for conclusions noted that some existing authoritative FASB literature regarding liabilities is inconsistent with the updates to Concepts Statement No. 8. Therefore, a modification regarding topic specific liabilities guidance was incorporated to address variations from the definition of a liability. Examples of existing SAP variations from the definition of a liability include but are not limited to:

- a. *SSAP No. 7—Asset Valuation Reserves and Interest Maintenance Reserves – AVR* and *IMR* establish liabilities for regulatory objectives.
- b. *SSAP No. 62R—Property and Casualty Reinsurance* – contains the provision for reinsurance liability guidance which results in a liability that is a regulatory valuation allowance for overdue and slow paying reinsurance and also enforces Credit for Reinsurance (Model No. 785) collateral requirements.

- c. *SSAP No. 92—Post Retirement Benefits Other than Pensions*, provides liability recognition, which adopts several GAAP standards with modifications.

The additional exposed revisions to SSAP No. 16X and SSAP No. 5R are reflected in the Issue Paper and also shown below.

- **Exposed revisions – Topic Specific Footnote** - This language is proposed for incorporation as a footnote to the liability definition in SSAP No. 5R and its related and *Issue Paper No. 16X—Updates to the Definition of a Liability*.

New Footnote to paragraph 3 of SSAP No. 5R:

The guidance in this Statement regarding the definition of a liability is applicable unless another authoritative statement of statutory accounting principles provides more topic specific contradictory guidance. In such cases the topic specific guidance shall apply.

- Exposed revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets* and *Issue Paper No. 16X—Updates to the Definition of a Liability* (New language shaded):

Relevant Literature

39. This statement adopts *FASB Statement No. 5, Accounting for Contingencies* (FAS 5), *FASB Statement 114, Accounting by Creditors for Impairment of a Loan* only as it amends in part FAS 5 and paragraphs 35 and 36 of ~~*FASB Statement of Financial Accounting Concepts No. 6—Elements of Financial Statements*~~. *FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss, An Interpretation of FASB Statement No. 5* (FIN No. 14) is adopted with the modification to accrue the loss amount as the midpoint of the range rather than the minimum as discussed in paragraph 3 of FIN No. 14. This statement adopts with modification *ASU 2013-04, Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date* with the same statutory modification adopted for FIN 14. This statement incorporates the definition of a liability from *FASB Statement of Financial Accounting Concepts No. 8, Chapter 4, Elements of Financial Statements*, paragraphs E37 and E38 with modification reflected in this Statement regarding topic specific guidance.

Interested parties believe the proposed changes above are responsive to our previous comments and address the issue of having statutory accounting guidance in other authoritative sources, e.g., the *NAIC Annual Statement Instructions*.

Ref #2022-11: Collateral for Loans

The Working Group exposed revisions to *SSAP No. 21 – Revised—Other Admitted Assets* which clarify that the invested assets pledged as collateral for admitted collateral loans must qualify as admitted invested assets. These revisions clarify that for specific investments, the comparison for admittance is between the net equity audited value of the pledged collateral to the collateral loan

balance. In addition, a consistency revision to *SSAP No. 20—Nonadmitted Assets*, paragraph 4.b. was exposed.

Interested parties support the proposed changes.

Ref #2022-12: Review of INT 03-02: *Modification to an Existing Intercompany Pooling Arrangement*

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

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

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

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

Prospective reinsurance versus retroactive reinsurance

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

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

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

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

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

SSAP No. 62R versus SSAP No. 63

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

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

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

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

Schedule P

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

Additionally, the *NAIC Annual Statement Instructions* for Schedule P require that when changes to pooling agreements impact prior accident years, historical data values in Schedule P must be

restated based on the new pooling percentages. This instruction effectively recognizes that Schedule F only provides useful information related to changes in intercompany pooling agreements if such changes are treated as prospective reinsurance.

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

Other intercompany pooling issues

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

Consistency of accounting

The NAIC has noted concerns that the "guidance in INT 03-02 can result with in essence, unrecognized gains (dividends) or losses through the using the statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements." The NAIC also notes that the "treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions." Interested parties note the following:

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

SSAP No. 63

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

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

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

Ref #2023-01: Review Annual Statement Instructions for Accounting Guidance

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification, with a request for regulator and industry viewpoints on situations in which guidance in the annual statement instructions should be captured within a SSAP.

Interested parties are aware of Annual Statement guidance on IMR /AVR and Schedule F penalties that should be considered for inclusion in SSAP's as well as the guidance related to intercompany pooling arrangements discussed above. If additional items come to our attention, we will inform the Working Group.

Ref #2023-02: SSAP No. 43R – CLO Financial Modeling

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 43R to incorporate changes to add CLOs to the financial modeling guidance and to clarify that CLOs are not captured as legacy securities.

Interested parties have no comments on this item.

Ref #2023-05: *ASU 2022-06, Reference Rate Reform (Topic 848), Deferral of the Sunset Date of Topic 848*

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed temporary (optional) expedient and exception interpretative guidance,

to revise the expiration date of the guidance in *INT 20-01: 2020-04, 2021-01 & 2022-06 - Reference Rate Reform* to be December 31, 2024, as reflected in INT 20-01.

Interested parties support the extension of the expiration date of *INT 20-01* to December 31, 2024.

Ref #2023-06: Additional Updates on ASU 2021-10, Government Assistance

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 24 to specify rejection of *ASU 2021-10, Government Assistance* but that the statutory guidance does incorporate general disclosures regarding government assistance for all entity types.

Interested parties agree with the proposed revisions to SSAP No. 24, as exposed in Ref 2023-06, subject to the following comments.

Interested parties noted that the Working Group's discussion of Ref #2023-06 in the Spring 2023 Working Group meeting agenda, indicated that use of a grant or contribution model was not intended to be permitted when accounting for government assistance under statutory accounting principles. The discussion did not indicate what accounting model should be applied. Interested parties are not aware of specific statutory guidance addressing the accounting for government assistance transactions, and believe, in the absence of specific guidance, companies may look to industry practice and other nonauthoritative GAAP guidance, which supports the use of a grant or contribution model, to determine appropriate statutory accounting treatment. Additionally, interested parties believe the disclosure requirements in SSAP No. 24 provide sufficient detail to allow a user of the financial statements to adequately understand the impact of any government assistance received by an insurer on its results regardless of the accounting model used to recognize and measure the assistance. Given these considerations and the relative infrequent occurrence of such items, interested parties suggest that the Working Group clarify that the intent of the exposed revisions in Ref #2023-06 are to require disclosure of unusual or infrequent government assistance transactions regardless of how such transactions are accounted for, and are not intended to prohibit entities from accounting for government assistance transactions through the use of a grant or contribution model.

Ref #2023-07: ASU 2019-08, Codification Improvements to Topic 718 and Topic 606

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 95, SSAP No. 104R, and SSAP No. 47 to adopt, with modification, *ASU 2019-08 Compensation—Stock Compensation (Topic 718)* and

Revenue from Contracts with Customers (Topic 606): Codification Improvements—Share-Based Consideration Payable to a Customer, as illustrated in the exposure draft.

Interested parties have no comments on this item.

Ref #2023-08: ASU 2019-07, Codification Updates to SEC Sections

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to Appendix D to reject *ASU 2019-07—Codification Updates to SEC Sections: Amendments to SEC Paragraphs Pursuant to SEC Final Rule Releases No. 33-10532, Disclosure Update and Simplification, and Nos. 33-10231 and 33-10442, Investment Company Reporting Modernization, and Miscellaneous Updates* as not applicable to statutory accounting.

Interested parties have no comments on this item.

Ref #2023-09: ASU 2020-09—Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to Appendix D to reject *ASU 2020-09, Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)* as not applicable to statutory accounting.

Interested parties have no comments on this item.

Ref #2023-10: ASU 2022-05, Long-Durations Contracts

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification to reject *ASU 2022-05, Transition for Sold 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*, which is consistent with prior agenda items related to this topic.

Interested parties support the conclusion reached for this guidance

* * * *

Thank you again for your consideration of interested parties' comments regarding the exposures discussed above. Please feel free to contact either one of us with any questions you may have.

Sincerely,

D. Keith Bell

Rose Albrizio

cc: Interested parties
NAIC staff

Statement of Statutory Accounting Principles No. 63

Underwriting Pools

STATUS

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

| | |
|------------------------------------|----------|
| STATUS | 1 |
| SCOPE OF STATEMENT | 1 |
| SUMMARY CONCLUSION | 1 |
| Disclosures | 3 |
| Effective Date and Transition..... | 4 |
| REFERENCES | 4 |
| Relevant Issue Papers | 4 |

SCOPE OF STATEMENT

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

SUMMARY CONCLUSION

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

SSAP No. 63

Statement of Statutory Accounting Principles

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

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

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

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

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

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

Underwriting Pools

SSAP No. 63

~~8.9.~~ Underwriting results relating to voluntary and involuntary pools shall be accounted for on a gross basis whereby the participant's portion of premiums, losses, expenses, and other operations of the pools are recorded separately in the financial statements rather than netted against each other. Premiums and losses shall be recorded as direct, assumed, and/or ceded as applicable. If the reporting entity is a direct writer of the business, premiums shall be recorded as directly written and accounted for in the same manner as other business which is directly written by the entity. To the extent that premium is ceded to a pool, premiums and losses shall be recorded in the same manner as any other reinsurance arrangement. A reporting entity who is a member of a pool shall record its participation in the pool as assumed business as in any other reinsurance arrangement.

~~9.10.~~ Underwriting results relating to intercompany pools shall be accounted for and reported as described in paragraph 8. While it is acceptable that intercompany pooling transactions be settled through intercompany arrangements and accounts, intercompany pooling transactions shall be reported on a gross basis in the appropriate reinsurance accounts consistent with other direct, assumed and ceded business.

~~10.11.~~ Equity interests in, or deposits receivable from, a pool represent cash advances to provide funding for operations of the pool. These are admitted assets and shall be recorded separately from receivables and payables related to a pool's underwriting results. Receivables and payables related to underwriting results shall be accounted for in accordance with the guidance in paragraphs 6-8. If it is probable that these receivables are uncollectible, any uncollectible amounts shall be written off against operations in the period such determination is made. If it is reasonably possible a portion of the balance is uncollectible but is not written off, disclosure requirements outlined in SSAP No. 5R shall be followed.

Disclosures

~~11.12.~~ If a reporting entity is part of a group of affiliated entities which utilizes a pooling arrangement under which the pool participants cede substantially all of their direct and assumed business to the pool, the financial statements shall include:

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

SSAP No. 63

Statement of Statutory Accounting Principles

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

~~12.~~13. Refer to the Preamble for further discussion regarding disclosure requirements.

Effective Date and Transition

~~13.~~14. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

REFERENCES

Relevant Issue Papers

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



June 9, 2023

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Dear Mr. Bruggeman:

Re: Exposure Reference No. 2022-11 – Collateral for Loans

Security Benefit Life Insurance Company would like to thank the Statutory Accounting Principles Working Group (“SAPWG”) for the opportunity to provide comments for consideration on Reference No. 2022-11—Collateral for Loans (the “Exposure”)¹, which proposes revisions to Statements of Statutory Accounting principles (“SSAP”) No. 21R, *Other Admitted Assets* (“SSAP No. 21R”) as follows:

1. A joint venture, partnership, or limited liability company (“JV/LP/LLC”) or a subsidiary controlled or affiliated entity (“SCA”) that is pledged as collateral to support an outstanding collateral loan balance must each be audited annually to qualify as an admitted investment.
2. The audited net equity of a pledged JV/LP/LLC and/or SCA is the basis of measurement for comparison to an outstanding collateral loan balance. Any portion of the outstanding balance of a collateral loan that is greater than the audited net equity of a pledged JV/LP/LLC and/or SCA must be non-admitted.

Firstly, consistent with the separate and broader Interested Party comment letter dated February 10, 2023, we do not believe an audit is necessary. In addition, we believe considering book value as a measure of the adequacy of collateralization, or ability for a borrower to repay a collateral loan is not supportable. Book value of equity is not acknowledged to reflect the value of what an asset would be bought or sold for (*i.e.*, the ultimate source of repayment for the collateral loan). The concept of fair value (*vs.* book value) exists precisely to represent the price that would be received for the sale of an asset in an orderly transaction between market participants at the measurement date. This variance between book value and fair value is observed in markets every day, where trading and transaction prices vary significantly from the proportionate book value of equity (hence the concept of “price-to-book multiples”). Book value can be lower than or higher than fair value. Notably, for example, insurers often trade on public markets for less than one times price-to-book value ratio (*i.e.*, book value is greater than fair value).

Using the book value of equity in lieu of fair value when assessing collateralization for the admissibility of collateral loans will all but guarantee the carrying value of the collateral will differ from what it could ultimately be sold for to repay the collateral loan. This will create volatility for insurance companies and may lead borrowers to begin to manage to a metric in the short term that does not ultimately provide the highest proceeds to repay the collateral loan.

Please consider the following example: a borrower borrows \$100 on a collateral loan to make a \$100 equity investment in an equipment leasing business. The \$100 investment equates to 20% of the company upon investment, which implies that the total business is worth \$500. The total book value of the business is \$250 (equipment leasing businesses, for example, typically trade around 2x price/ book value). This means that, immediately upon making the \$100 investment, the borrower’s stake would be considered to have a collateral value of only \$50 (*i.e.*, 20% of the \$250 book value), resulting in an immediate loss of \$50 of collateral value. Further, this differs from the statutory accounting that would apply if the insurer had made the investment directly on its balance sheet (equity-method accounting). In accordance with SSAP No. 48, the insurer would record the initial investment in an investee at cost plus subsequent capital contributions to the investee. The carrying amount of the investment would then subsequently be adjusted for the amortization difference (difference between the cost and underlying GAAP equity) over a period of time as well as for the insurer’s pro-rata share of GAAP-basis earnings or losses and distributions of the investee. Therefore, under SSAP No. 48, the investment is worth its investment at cost (*i.e.*, \$100) on day one and subsequently amortized to the GAAP equity value of the investee over the period that the investing entity benefits economically rather than at a point in time as would occur under the proposed revisions in SSAP No. 21R.

We request consideration for the likely adverse effects to decision-making this exposed revision may cause, in addition to the operational disruptiveness of immediate adoption, as discussed further in this document.

Secondly, we believe the Exposure proposes substantive changes, not clarifications, and as a result, the process for a substantive change is not being followed. The Exposure will impose undue costs and efforts if adopted, as it substantively causes a change

¹ Dated March 22, 2023.



to the application of SSAP No. 48, *Joint Ventures, Partnerships and Limited Liability Companies* (“SSAP No. 48”) and SSAP No. 97, *Investments in Subsidiary, Controlled and Affiliated Entities* (“SSAP No. 97”). The Accounting Practices and Procedures Manual provides that “[n]onsubstantive revisions are characterized as language clarifications which do not modify the original intent of a SSAP . . .” Utilization of fair value equity of pledged JV/LP/LLC and/or SCA investments has long been utilized as required by SSAP No. 21R and subject to both independent audits and state insurance department examinations, without this practice being raised as an issue nor requiring adjustments to financial statements. Accordingly, the Exposure modifies the original intent of SSAP Nos. 21R, 48 and 97.²

The accelerated approach here is not supported by the analytical rigor that the SAPWG typically applies and denies affected parties the due process otherwise required when substantive changes are made. Should the Exposure be adopted with the proposed revisions to SSAP No. 21R to require audited net equity of pledged JV/LP/LLC and/or SCA investments, it would similarly be a material modification to an acceptable and supportable industry practice. It would also require insurers to disclose a change in accounting policy, which is further evidence that this is a substantive change. Furthermore, we would have to incur considerable cost and effort along with our borrowers (assuming that borrowers are willing to cooperate and, given that loan documentation was drafted prior to the changes being proposed here, there can be no assurance of such cooperation) to accurately determine the collateral value by applying the guidance prescribed in SSAP No. 48 with no assurance that we would be successful given the ability of borrowers to obtain the required information from their investees. Without the additional time typically afforded for a substantive modification, we find ourselves unable to consider effective alternative solutions in a timely manner and unable perform a full risk assessment of adoption impacts for both intended and potentially unintended consequences.

As a standard setting body (not a regulatory body), the NAIC has an obligation to adhere to proper processes and to base decisions on empirical data rather than hypotheses. Providing more process, rather than less, is critically important because decisions that the NAIC make can adversely affect competition in the industry; failing to do so can result in its decisions impermissibly choosing winners and losers in the marketplace. The Company believes that there have been other occasions where a proposed revision has been classified as “non-substantive” or a “SAP clarification,” despite the fact that the revisions have modified the intent of applicable SSAPs and thereby caused material changes in acceptable accounting practices.³

* * * * *

We appreciate your attention to the issues raised in this letter and would be pleased to discuss our questions and comments with the SAPWG or its staff at your convenience.

Kind Regards,

Tai D. Giang
Director, Accounting Policy
Security Benefit Life Insurance Company

² The same can be said of the Exposure’s requirement to perform audits of JV/LP/LLC and/or SCAs pledged in support of collateral loans. For years insurers have secured collateral loans with these types of interests and have been subject to both independent audit and state insurance department examinations without this practice being raised as an issue nor requiring adjustments to financial statements. We therefore believe requiring audits is a substantive change to SSAP No. 21R.

³ See, e.g., Exposure Ref No. 2019-24—Levelized and Persistency Commissions and Exposure Ref Nos. 2021-21—Related Party Reporting and 2022-15—Affiliate Reporting Clarification.



August 7, 2023

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Dear Mr. Bruggeman:

Re: Exposure Reference No. 2022-11 – Collateral for Loans

Security Benefit Life Insurance Company (“Security Benefit”, “our”, “we”) extends its appreciation to the Statutory Accounting Principles Working Group (“SAPWG”) for the opportunity to submit a new comment letter on Exposure Reference No. 2022-11—*Collateral for Loans* (the “Exposure”). After further consideration of the Exposure, we agree that clarification of the guidance in SSAP No. 21R is necessary, and we support the clarification that collateral pledged to secure a collateral loan must qualify as an admitted asset for the collateral loan itself to qualify as an admitted asset. Therefore, we also support the specific clarification that when the collateral pledged to secure a collateral loan would be in the scope of SSAP No. 48 or SSAP No. 97 if held directly by the reporting entity, audited financial statements are required for the collateral (and thus the collateral loan) to qualify as an admitted asset. However, we respectfully request that the SAPWG reconsider the proposed guidance that, if adopted, would require reporting entities to use the proportionate audited equity valuation (“book value”) when testing the sufficiency of the collateral (“collateral test”) for collateral loans secured by collateral that would be in the scope of SSAP No. 48 or SSAP No. 97 if held directly by the reporting entity. More specifically, we ask the SAPWG to revise the Exposure to allow reporting entities to make an accounting policy election, applied consistently and across all applicable collateral loans, to use either fair value or book value when performing the collateral test. Below is Security Benefit’s proposed revision to the Exposure (underlined, italicized and in green font, the underlined red text is the SAPWG’s currently exposed changes).

- b. Nonadmitted Asset – In Accordance with *SSAP No. 20—Nonadmitted Assets*, collateral loans secured by assets that do not qualify as investments which would otherwise be admitted 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. For qualifying investments which are pledged as collateral that would be in the scope of SSAP No. 48 or SSAP No. 97 if held directly by the reporting entity, such as joint ventures, partnerships and limited liability companies and investments that would qualify as SCAs if held directly, reporting entities shall elect to use either fair value or the proportionate audited equity valuation of the pledged investment for the comparison for the adequacy of pledged collateral. This election shall be considered an accounting policy election subject to the guidance in SSAP No. 3—Accounting Changes and Corrections of Errors and is required to be applied consistently to all such pledged investments. If the collateral loan exceeds the elected valuation basis of these pledged investments, then the excess shall be nonadmitted.

Security Benefit understands that SAPWG’s proposed change to the valuation basis used for the collateral test may have emanated from industry concerns over the need to obtain both audited financial statements and fair value measurements of these pledged investments. We believe our proposed revisions to the Exposure would simultaneously address those industry concerns and prevent unintended consequences, namely that reporting entities that have historically relied on the use of fair value as the basis for the collateral test may suddenly be required to nonadmit portions of their collateral loans. Furthermore, we believe that fair value continues to be the most appropriate measure of the sufficiency of collateral as fair value is the most representative measure of the value of assets that would be available to support policyholder liabilities in the event a reporting entity forecloses on the pledged collateral. Finally, allowing reporting entities to elect to continue to use fair value for the collateral test will retain a level of consistency with collateral loans secured by other forms of qualifying investments, and also, across other types of instruments where the sufficiency of collateral is based on fair value (i.e., repurchase agreements, securities lending agreements, derivatives, etc.).

Security Benefit also understands that state regulators may have concerns about the uncertainty inherent in fair value measurements, particularly Level 2 and Level 3 measurements, due to the use of unobservable inputs and/or assumptions, and these concerns may have also contributed to the desire to use the book value of these pledged investments for the collateral test. While we agree that Level 2 and Level 3 fair value measurements may have a greater level of uncertainty, Security Benefit obtains independent valuations, and independent reviews of our internal valuations, from reputable third-party valuation experts for these pledged investments, and in all cases, these valuations are subject to independent audit. It is our understanding that this is common industry practice, which we believe should sufficiently alleviate the regulatory concern. Additionally, we would like to note that the use of book value may not, and in many cases will not, reduce the reliance on Level 2 and Level 3 measurements when reporting entities perform the collateral test. Specifically, we expect that most of these pledged investments are considered



investment companies that recognize and measure all assets at fair value on their financial statements where many, and in some cases all, of those assets are valued using Level 2 and Level 3 fair value measurements.

In summary, Security Benefit supports the proposed clarifications to SSAP No. 21R; however, we believe the proposed change to the valuation basis for the collateral test represents a substantive change that could materially and adversely impact reporting entities that have historically underwritten collateral loans based on the fair value of the pledged collateral. We believe fair value remains the best and most appropriate measure of the sufficiency of collateral pledged to secure collateral loans. As a result, we respectfully request that the SAPWG revise the Exposure to allow reporting entities to continue to use fair value based on an accounting policy election.

* * * * *

We appreciate your attention to and consideration of our comments and would be pleased to discuss our comments with the SAPWG or its staff at your convenience.

Kind Regards,

Caleb Brainerd
SVP, Chief Financial Officer
Security Benefit Life Insurance Company

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June 30, 2023

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 Exposures with Public Comment Period ending June 30

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the items exposed for comment by the Statutory Accounting Working Group (the Working Group) on May 16th with the public comment period ending June 30th.

Ref #2022-14: New Market Tax Credits

Interested Parties appreciate the opportunity to comment on the substantive revisions exposed by the Working Group to SSAP No. 93 - *Low Income Housing Tax Credit Property Investments* and SSAP No. 94 *Transferable and Non-Transferable State Tax Credits*. As stated in our prior comment letter on this topic, interested parties agree with having uniformity in accounting and reporting for equity and debt investments for which the return is earned primarily through tax credits. Interested parties also agree that the proportional amortization method is an appropriate method to use for any type of investment (debt or equity) where the return is primarily earned through tax credits. We have a few comments on the exposure to make sure the guidance is clear and insurers know how to apply it.

SSAP No. 93

- 1) Paragraph 2 and 3– Paragraph 2 includes the criteria for investments in tax credit structures to apply the proportional amortization method. If an investment does not meet the criteria, then paragraph 3 states that the investment should follow the applicable statutory accounting statement. For equity investments, that means that SSAP No. 48 should be followed, which would require the use of equity method of accounting. For bonds in tax credit structures that

do not meet the definition, interested parties believe that the bond needs to be analyzed under the new proposed principles-based bond definition to determine if bond reporting or other-invested asset reporting is required. Interested parties recommend clarifying this in the standard if that is the case.

- 2) Paragraph 14 (a) –This paragraph states that tax credits under the SSAP No. 93 accounting guidance are to be recorded and assessed for admittance in accordance with SSAP No. 94. Interested parties found this confusing and subject to many different interpretations. There is a key difference between SSAP No. 93 and SSAP No. 94 tax credits in that SSAP No. 93 tax credits are only earned as part of the return on the investment so the only asset recorded on the insurer’s books is related to the investment itself. The tax credits are only recorded upon becoming available for use on a reporting entity’s tax return. Therefore, there is no tax credit to non-admit per se. In the rare case that the tax credit cannot be utilized in the year that it is allowed to be utilized due to the insurer not having enough income from operations in the case of federal tax credits or premium income in the case of state programs, the insurer would record a Deferred Tax Asset (DTA). Any DTA set up would be subject to the admissibility requirements under SSAP No. 101 - *Income Taxes*. For these reasons, interested parties recommend that paragraph 14 (a) be removed.
- 3) Paragraph 18 (a) and (b) and (c) - These paragraphs are intended to address admissibility considerations. Paragraph (c) states that if the tax credits cannot be utilized in the next three years, they will be non-admitted, while paragraphs (a) and (b) are intended to address instances when the credits cannot be utilized by the insurer, but the insurer has the ability to sell them to third parties or get a refund for the credits. We understand from discussions with the Working Group that the intent of this guidance is for an insurer to first start with the assessment in (c) to determine if it will be able to utilize the tax credits in the next three years. If not, then the insurer can consider whether the tax credits can be sold or whether the insurer can be reimbursed for the credits if unable to utilize them. Under the former, the insurer can admit the credits up to their fair value as the insurer would recover the fair value in a sale. Under the latter, the insurer can admit up to the amount of the expected refund.

Similar to our comments under #1 above, it is not clear to us what exactly we are non-admitting. As explained above, the only item that gets recorded on the balance sheet as an actual asset is the investment itself. The cost of the investment is amortized in proportion to the tax credits earned every year regardless of whether the credits are utilized or not. Admissibility requirements are already addressed for the investment itself in the proposal (i.e., the tax opinion and audited financial statements). As the tax credits are allocated to the insurer, they either reduce federal income taxes, or state/premium taxes. If the tax credits cannot be utilized in a given year, a DTA would be established. Any admissibility rules on the DTA itself are already addressed in SSAP No. 101 - *Income Taxes*.

If the DTA admissibility is what is being addressed in paragraph 18, interested parties recommend that be clarified. We understand that this may have been one of the reasons why the SSAP No. 93 proposal references SSAP No. 94. As stated above, to avoid any confusion regarding the accounting for the tax credits earned in a SSAP No. 93 investment, we suggest including all guidance in SSAP 93 (i.e., no reference to SSAP 94) regarding the credits

earned in a SSAP No. 93 investment. Interested parties also have the following suggested edits to make the admissibility rules on the tax credits themselves clear.

~~Paragraph 18 – If tax credits allocated to the reporting entity cannot be utilized in the year they have been allocated to the entity, a deferred tax asset (DTA) would be established. Under those circumstances, the reporting entity would follow the requirements under SSAP No. 101 *Income Taxes* regarding admissibility rules on DTAs. A reporting entity is required to assess the realization of tax credits against tax liability for both the tax year in which the credit can be initially utilized as well as in accordance with carry-forward and/or carryback periods to determine the extent the investments can be admitted:~~

- ~~a. Tax credit investments which allocate tax credits which are transferable in accordance with permitted IRS or state tax provisions are admitted up to the lesser of the proportional amortized cost, or fair value of the tax credits.~~
- ~~b. Tax credit investments which allocate tax credits eligible for direct payment are admitted up to the lesser of the proportional amortized cost, or the estimated proceeds.~~
- ~~e. For all other tax credits, if a reporting entity does not expect to fully utilize investment tax credits in the upcoming tax year or for a carryback year, the reporting entity shall perform an assessment to determine the extent it will be able to utilize the tax credits over the life of the investment. If assessment projections identify that the tax credits from investments in tax credit programs will exceed what can be utilized under IRS or state tax provisions (current and other applicable tax periods), the reporting entity shall nonadmit investments as necessary so that investments in scope of this statement (in aggregate) are only admitted to the extent tax credits are expected to be utilized. Additionally]. In making this assessment, the reporting entity is not permitted to assume increased operations (e.g., expanded product sales) beyond actual experience to conclude that additional federal or state tax liability will exist that would allow additional utilization of tax credits. A reporting entity can subsequently admit a previously nonadmitted tax credit investment, based on subsequent assessments in which the reporting entity determines that they will be able to utilize the tax credits.~~

- 4) Paragraph 34 - The SSAP No. 93 exposure states that reporting entities shall prospectively modify the recognition, accounting and reporting of tax credit investment structures to follow the guidance under SSAP No. 3. We believe this means that on day of adoption, the SSAP No. 93 investment's book value is the starting value of the investment and the prospective method will be applied using that book value and amortizing the book value at the date of adoption based on the future tax credits to be earned. If that is the case, some clarification on the application of the prospective method would be helpful. Those companies that are US GAAP reporters are to apply the FASB ASU on a retrospective basis and thus there will continue to be differences between US GAAP and Statutory proportional method results for already existing tax credit investments. We believe further clarification of how the prospective method is to be applied for Statutory reporting should be clarified to avoid inconsistent interpretation of the intent.

SSAP No. 94

- 1) Paragraph 1 – This paragraph explains the scope of the types of tax credits that fall within the SSAP No. 94 guidance. Interested parties believe that the key difference between SSAP No. 93 and SSAP No. 94 is that SSAP No. 93 relates to tax credits that are earned as a result of being an investor (i.e., an equity investor) in the entity earning the credits and SSAP No. 94 relates to tax credit certificates that are purchased outright without being an investor in the entity. To make sure that is clear, interested parties propose the following changes to paragraph 1

Paragraph 1 – This statement establishes statutory accounting principles for state and federal tax credits certificates that are purchased by the reporting entity without being an investor in the entity from which the tax credit certificates were purchased. ~~that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts)~~

- 2) Paragraph 2 - The last sentence in this paragraph states that the tax credits received from SSAP No. 93 tax credit investments are within the scope of SSAP No. 94. For the reasons stated above in the SSAP No. 93 section of this comment letter, we do not think that SSAP No. 94 and SSAP No. 93 should be linked. As stated above, there are two very different assets that are recorded upon purchasing an investment under SSAP No. 93 versus SSAP No. 94. The only similarity in accounting for the tax credits relates to instances when the credits earned under a SSAP No. 93 investment cannot be utilized in the current year. Under that scenario, a DTA would be recorded, which would be subject to the admissibility rules under SSAP No. 101. For that reason, interested parties recommend removing the last sentence in paragraph 2 as suggested below.

Paragraph 2 - Investments in tax credits as discussed in SSAP No. 93R - *Investments in Tax Credit Structures*, which involve investments in projects or programs that generate general business federal tax credits or state tax credits, are not within the scope of this statement. ~~However, the tax credits received from tax credit investments are within the scope of this statement.~~

- 3) Paragraph 9 - This paragraph states that federal and state tax credits that can be utilized in the year allocated or purchased shall be reported in the income statement as an offset to federal taxes in accordance with SSAP No. 101 or state premium tax, respectively. Interested parties note that most tax certificates reduce a reporting entity's tax liability and do not directly impact the income statement at the time they are used. In addition, interested parties believe that upon purchase, the tax credits should be reported as an other-than-invested asset since the asset represents a right to receive future benefits. As the tax credits become available for use, a reduction to the insurer's income tax payable or premium/state taxes payable should take place. Based on that, we propose the following changes:

Paragraph 9 – Tax credits shall be recognized in the period that they are purchased or allocated to the reporting entity for tax purposes:

- a. ~~Federal and state tax credits are recorded as other-than-invested assets upon purchase. As the tax credits are redeemed, the carrying value of the tax credits is reduced dollar for dollar by the amount of tax credits applied toward the reporting entity's federal or state/premium tax liability, as applicable. that can be utilized in the year allocated or purchased shall be reported in the income statement as an offset to federal taxes in accordance with SSAP No. 101 *Income Taxes*. Federal tax credits that cannot be utilized in the year allocated or purchased and are carried forward to a future tax year shall be reported net of deferred tax asset (DTA) in accordance with SSAP No. 101.~~
- b. ~~Federal and State tax credits that can be utilized in the year allocated or purchased shall be reported in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax reporting year in which the credit is utilized. State tax credits that cannot be utilized in the year they are available for use allocated or purchased and are carried forward to a future tax year shall be reported as a deferred tax asset (DTA). gross of any related state tax liabilities and reported in the category of other than invested assets (not reported net).~~

We have updated the illustration that was included in Exhibit B below to reflect this as well.

- 7) Paragraph 7 - The accounting for purchased tax credits under the SSAP No. 94 exposure is different from the current guidance in that the credits will be recorded at face value instead of at cost. Interested parties do not have an issue with this accounting treatment per se, but we would like to point out that this is not consistent with the accounting treatment for other types of assets that are purchased at a premium or discount such as bonds and mortgage loans.
- 8) Exhibit B – Accounting for Non-Transferable Tax Credits

Interested parties recommend some edits to the illustration under Exhibit B to reflect the changes described in item 2) above. In addition, the edits below include other edits that we believe are necessary to show the appropriate flow of transactions and to add clarity to the accounting for federal tax credit certificates. These are our suggestions:

On 7/1/X1 LJW Insurance Company purchased non-transferable federal tax credits for a cost of \$100,000. The federal tax credits are redeemable for \$110,000 and expire on, April 1, 20x2. LJW expects to utilize the tax credits before expiration in the amount of \$110,000. The credits are earned pro-rata every quarter from acquisition date to expiration date. Therefore, the credits earned quarterly are about \$36,666. The illustration below assumes that LJW Insurance Company's quarterly income tax liability equals the amount of credits that were purchased.

| | | | |
|--------|--|---------|---------|
| 7/1/x1 | Federal tax credits | 110,000 | |
| | Deferred gains on acquired tax credits | | 10,000 |
| | Cash | | 100,000 |
| | <i>To record the purchase of the tax credits</i> | | |

| | | | |
|----------|---|--------|--------|
| 9/30/x1 | Income Premium tax expense | 36,666 | |
| | Income Premium taxes payable | | 36,666 |
| | <i>To record quarterly income tax liability.</i> | | |
| 10/1/x1 | Income taxes payable | 36,666 | |
| | Federal tax credits | | 36,666 |
| | <i>To record the use of tax credits in the quarter</i> | | |
| 12/31/x1 | Income tax expense | 36,666 | |
| | Income taxes payable | | 36,666 |
| | <i>To record quarterly income tax liability</i> | | |
| 1/1/x2 | Income taxes payable | 36,666 | |
| | Federal tax credits | | 36,666 |
| | <i>To record the use of tax credits in the quarter</i> | | |
| 3/31/x2 | Income tax expense | 36,666 | |
| | Income taxes payable | | 36,666 |
| | <i>To record quarterly income tax liability</i> | | |
| 4/1/x2 | Income taxes payable | 36,666 | |
| | Deferred gains on acquired tax credits | 10,000 | |
| | Other Income | | 10,000 |
| | Federal tax credits | | 36,666 |
| | <i>To record the use of income tax credits in excess of cost and recognize a gain on premium tax credits in other income.</i> | | |

4/1/x2

Ref #2019-21e - Principles-Based Bond Definition: Schedule BA

Interested parties have the following observations and suggestions to the proposed changes to the categories within Schedule BA (*Other Invested Assets*):

- Ensure that all reporting categories reflect the related SSAP within the instructions.
- Recommend exposing changes to the columns.

- For investments tagged as ‘Debt Securities That Do Not Quality as Bonds’ that are transferred from Schedule D, interested parties recommend that the investment will retain its’ NAIC Designation and its’ FE/ PLR status at the time of transfer.
- We believe the instructions for Tax Credit Investments (e.g., Guaranteed Low Income Housing Tax Credit Investments) are stale as the sentence ‘*There must be an all-inclusive guarantee from a CRP-rated entity that guarantees the yield on the investment*’ is no longer valid.
- The various types of Tax Credit Investments (e.g., Low Income Housing; New Market; Renewable Energy) have different risks and should be evaluated accordingly and be reported according to their risks. Recommend a referral to the RBC Investment Risk & Evaluation Working Group to evaluate the various risk categories such that changes could be implemented for Annual 2025 reporting.
- Based on Ref #2022-14 (*Tax Credits*), interested parties will provide additional comments when this item is adopted by the Statutory Accounting Principles Working Group (SAPWG).
- Based on Ref #2023-12 (*SSAP No. 48 - Residuals*), interested parties will provide comments when this item is adopted by SAPWG.
- Please refer to the attached markup version of the exposure as there are several editorial revisions that we are suggesting that clarify the descriptions within the categories and language within the instructions.

Interested parties have attached a markup version of the exposure with our detailed suggested changes.

Ref #2023-13: PIK Interest Disclosure Clarification

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 34 and the Annual Statement Instructions to clarify and incorporate a practical expedient to the paid-in-kind (PIK) interest aggregate disclosure. These SSAP No. 34 revisions, when adopted, will also result in editorial changes to the annual statement instructions.

Interested parties have no comment on this item.

Ref #2023-12: Residuals in SSAP No. 48 Investments

The Working Group moved this agenda item to the active listing, categorized as an SAP clarification, and exposed revisions to SSAP No. 48 which clarify that investments structures captured in scope of SSAP No. 48 that represent residual interests or that predominantly hold residual interests, shall be reported on the dedicated residual reporting line on Schedule BA. Corresponding edits to ensure consistent language in SSAP No. 43R and revisions to the Schedule BA Annual Statement Instructions were also exposed.

Interested parties have received comments from NAIC staff that we are currently reviewing and will submit a separate comment letter at a later date.

* * * *

Please feel free to contact either one of us with any questions you may have.

Sincerely,

D. Keith Bell

Rose Albrizio

cc: Interested parties
NAIC staff

**Bond Definition
Proposed Reporting Lines – Schedule BA
2023 Spring NM Exposure**

This document proposes annual statement reporting line and descriptions for suggested reporting lines for investments reported as other invested assets on Schedule BA. The main focus is to categorize debt securities that do not qualify as bonds under SSAP No. 26—Bonds or SSAP No. 43R—Asset-Backed Securities and are captured in scope of SSAP No. 21R—Other *Invested Admitted Assets*. As detailed within, other revisions have also been proposed to update the schedule.

Comments are requested on all aspects of this document – including whether reporting lines should be added or deleted as well as the suggested instructions to clarify what should be captured in each location.

SCHEDULE BA – PARTS 1, 2 AND 3

OTHER LONG-TERM INVESTED ASSETS – GENERAL INSTRUCTIONS

Include only those classes of invested assets not clearly or normally includable in any other invested asset schedule, or that have been specifically identified for reporting on Schedule BA: Other Invested Assets. ~~Such assets should include any assets previously written off for book purposes, but which still have a market or investment value. Give a detailed description of each investment and the underlying security. If an asset is to be recorded in Schedule BA that is normally reported in one of the other invested asset schedules, make full disclosure in the Name or Description column of the reason for recording such an asset in Schedule BA.~~

For accounting guidance related to foreign currency transactions and translations, refer to SSAP No. 23—Foreign Currency Transactions and Translations.

If a reporting entity has any detail lines reported for any of the following required groups, categories, or subcategories, it shall report the subtotal amount of the corresponding group, category, or subcategory, with the specified subtotal line number appearing in the same manner and location as the pre-printed total or grand total line and number:

| <u>Group or Category</u> | <u>Line Number</u> |
|--------------------------|--------------------|
|--------------------------|--------------------|

Debt Securities That Do Not Qualify as Bonds

Debt Securities That Do Not Reflect a Creditor Relationship in Substance

NAIC Designation Assigned by the Securities Valuation Office (SVO)

Unaffiliated

Affiliated

NAIC Designation Not Assigned by the Securities Valuation Office (SVO)

Unaffiliated

Affiliated

Debt Securities That Lack Substantive Credit Enhancement

NAIC Designation Assigned by the Securities Valuation Office (SVO)

Unaffiliated

Affiliated

NAIC Designation Not Assigned by the Securities Valuation Office (SVO)

Unaffiliated

Affiliated

Debt Securities That Do Not Qualify as Bonds Solely to a Lack Of Meaningful Cash Flows

NAIC Designation Assigned by the Securities Valuation Office (SVO)

| | |
|---|--|
| <u>Unaffiliated</u> | |
| <u>Affiliated</u> | |
| <u>NAIC Designation Not Assigned by the Securities Valuation Office (SVO)</u> | |
| <u>Unaffiliated</u> | |
| <u>Affiliated</u> | |

~~Non-Registered Private Funds with Underlying Assets Having Characteristics of:~~

~~Bonds~~

| | |
|---|--------------------|
| NAIC Designation Assigned by the Securities Valuation Office (SVO) | |
| Unaffiliated | 0799999 |
| Affiliated | 0899999 |
| NAIC Designation Not Assigned by the Securities Valuation Office (SVO) | |
| Unaffiliated | 0999999 |
| Affiliated | 1099999 |

~~Mortgage Loans~~

| | |
|-------------------------------|--------------------|
| Unaffiliated | 1199999 |
| Affiliated | 1299999 |

~~Other Fixed Income Instruments~~

| | |
|-------------------------------|--------------------|
| Unaffiliated | 1399999 |
| Affiliated | 1499999 |

Equity Interests in Joint Ventures (Including Non-Registered Private Funds), Partnerships, or Limited Liability Companies
~~Interests or Non-Registered Private Funds~~ with Underlying Assets Having the Characteristics of:

~~Fixed Income Instruments~~

| | |
|---|--------------------|
| NAIC Designation Assigned by the Securities Valuation Office (SVO) | |
| Unaffiliated | 1599999 |
| Affiliated | 1699999 |
| NAIC Designation Not Assigned by the Securities Valuation Office (SVO) | |
| Unaffiliated | 1799999 |
| Affiliated | 1899999 |

~~Common Stocks~~

| | |
|-------------------------------|--------------------|
| Unaffiliated | 1999999 |
| Affiliated | 2099999 |

~~Real Estate~~

| | |
|-------------------------------|--------------------|
| Unaffiliated | 2199999 |
| Affiliated | 2299999 |

~~Mortgage Loans~~

| | |
|-------------------------------|--------------------|
| Unaffiliated | 2399999 |
| Affiliated | 2499999 |

~~Other~~

| | |
|-------------------------------|--------------------|
| Unaffiliated | 2599999 |
| Affiliated | 2699999 |

~~Surplus Debentures, etc. Notes~~

| | |
|-------------------------------|--------------------|
| Unaffiliated | 2799999 |
| Affiliated | 2899999 |

Capital Notes

| | |
|---------------------------|--|
| <u>Unaffiliated</u> | |
| <u>Affiliated</u> | |

| | |
|---|---------|
| Collateral Loans | |
| Unaffiliated..... | 2999999 |
| Affiliated | 3099999 |
| Non-collateral Loans | |
| Unaffiliated..... | 3199999 |
| Affiliated | 3299999 |
| Capital Notes | |
| Unaffiliated..... | 3399999 |
| Affiliated | 3499999 |
| Guaranteed Federal Low Income Housing Tax Credit | |
| Unaffiliated..... | 3599999 |
| Affiliated | 3699999 |
| Non-Guaranteed Federal Low Income Housing Tax Credit | |
| Unaffiliated..... | 3799999 |
| Affiliated | 3899999 |
| Guaranteed State Low Income Housing Tax Credit | |
| Unaffiliated..... | 3999999 |
| Affiliated | 4099999 |
| Non-Guaranteed State Low Income Housing Tax Credit | |
| Unaffiliated..... | 4199999 |
| Affiliated | 4299999 |
| All Other Low Income Housing Tax Credit | |
| Unaffiliated..... | 4399999 |
| Affiliated | 4499999 |

NAIC Staff Note: The reporting lines for Low Income Housing Tax Credits are anticipated to be updated as part of the current tax credit investment statutory accounting review.

| | |
|--|---------|
| Working Capital Finance Investment | |
| Unaffiliated..... | 4599999 |
| Residual Tranches or Interests with Underlying Assets Having Characteristics of: | |
| Fixed Income Instruments | |
| Unaffiliated..... | 4699999 |
| Affiliated..... | 4799999 |
| Common Stock | |
| Unaffiliated..... | 4899999 |
| Affiliated..... | 4999999 |
| Preferred Stock | |
| Unaffiliated..... | 5099999 |
| Affiliated..... | 5199999 |
| Real Estate | |
| Unaffiliated..... | 5299999 |
| Affiliated..... | 5399999 |
| Mortgage Loans | |
| Unaffiliated..... | 5499999 |
| Affiliated..... | 5599999 |

| | | |
|---------------------------|--------------------|---------|
| Other | Unaffiliated | 5699999 |
| | Affiliated | 5799999 |
| Any Other Class of Assets | | |
| | Unaffiliated | 5899999 |
| | Affiliated | 5999999 |
| Subtotals | | |
| | Unaffiliated | 6099999 |
| | Affiliated | 6199999 |
| TOTALS | | 6299999 |

The following listing is intended to give examples of investments to be included in each category; however, the list should not be considered all-inclusive, ~~and it should not be implied that any invested asset currently being reported in Schedules A, B or D is to be reclassified to Schedule BA:~~

Oil and Gas Production

~~Include: Offshore oil and gas leases.~~

Transportation Equipment

~~Include: Aircraft owned under leveraged lease agreements.
Motor Vehicle Trust Certificates.~~

Mineral Rights

~~Include: Investments in extractive materials.

Timber Deeds.~~

Debt Securities That Do Not Qualify as Bonds

Include: Debt securities captured in SSAP No. 21R—Other Admitted Assets. This is specific to securities, as that term is defined in SSAP No. 26—Bonds, whereby there is a fixed schedule for one or more future payments (referred to as debt securities), but for which the security does not qualify for bond reporting under SSAP No. 26R as an issuer credit obligation or an asset-backed security.

Investments that have been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the Purposes and Procedures Manual of the NAIC Investment Analysis Office shall be reported on Lines ~~0799999~~TBD and ~~0899999~~TBD.

Investments that have not been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the Purposes and Procedures Manual of the NAIC Investment Analysis Office for this category. Designations received from an SEC NRSRO are permitted to be reported but are not required. Report these investments on Lines ~~0999999~~ TBD, ~~1099999~~ TBD, ~~1199999~~ TBD, ~~1299999~~ TBD, ~~1399999~~ TBD and ~~1499999~~ TBD.

Exclude: Any investment that does not qualify as a security. This term is defined in SSAP No. 26R – Bonds.

Any investment that is not captured as a debt security that does not qualify as a bond pursuant to SSAP No. 21R—Other Admitted Assets.

Non-Registered Private Funds with Underlying Assets Having Characteristics of a Bond, Mortgage Loan or Other Fixed Income Instrument

Include: ~~Fixed income instruments that are not corporate or governmental unit obligations (Schedule D) or secured by real property (Schedule B).~~

~~Any investments deemed by the reporting entity to possess the underlying characteristics of a bond or other fixed income instrument that has been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on ~~Lines 0799999 and 0899999.~~~~

~~Any investments deemed by the reporting entity to possess the underlying characteristics of a bond or other fixed income investment that has not been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on ~~Lines 0999999, 1099999, 1199999, 1299999, 1399999 and 1499999.~~~~

Equity interests in Joint Ventures (Including Non-Registered Private Funds), Partnerships or Limited Liability Company Companies or Non-Registered Private Funds ~~Interests with Underlying Assets Having the Characteristics:~~

Fixed Income Instruments

Include: Equity interests in Joint joint ventures (including non-registered private funds), partnerships, or limited liability companies or non-registered private funds investments that are engaged in bond or preferred stock fixed income strategies. Leveraged Buy-out Fund.

~~A fund investing in the “Z” strip of Collateralized Mortgage Obligations.~~

Investments on the NAIC List of Schedule BA Non-Registered Private Funds with Underlying Assets Having Characteristics of Bonds or Preferred Stock ~~Any investments deemed by the reporting entity to possess the underlying characteristics of fixed income instruments that has been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines ~~TBD 1599999 and TBD 1699999.~~~~

~~Any investments deemed by the reporting entity to possess the underlying characteristics of fixed income instruments~~ Investments that have ~~s~~ not been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* ~~for this category.~~ Designations received from an SEC NRSRO are permitted to be reported but are not required. Report these investments on Lines ~~1799999-TBD and TBD 1899999.~~

Common Stocks

Include: Venture Capital Funds or other underlying equity investments.

Real Estate

Include: Real estate development interest. Reporting should be consistent with the detailed property analysis appropriate for the corresponding risk-based capital factor for this investment category. If the requisite details are not available for reporting, report under “Other” subcategory.

Mortgage Loans

Include: Mortgage obligations. Reporting should be consistent with the detailed property analysis appropriate for the corresponding risk-based capital factor for this

investment category. If the requisite details are not available for reporting, report under “Other” subcategory.

Other

Include: Limited partnership interests in oil and gas production.

Forest product partnerships.

Investments within the Joint Venture and Partnership Interests category that do not qualify for inclusion in the “Fixed Income Instruments,” “Common Stocks,” “Real Estate” or “Mortgage Loans” subcategories.

~~Reporting should be consistent with the corresponding risk-based capital factor for this investment category (i.e., Other Long-Term Assets).~~

Surplus Debentures, etc. Notes

Include: That portion of any subordinated indebtedness, surplus debenture, surplus note, debenture note, premium income note, bond, or other contingent evidence of indebtedness that is reported in the surplus of the issuer.

Capital Notes

Include: The portion of any capital note that is reported on the line for capital notes of the issuing insurance reporting entity.

Collateral Loans

Include: ~~Refer to SSAP No. 21R—Other Admitted Assets for a definition of collateral loans. Loans meeting the SSAP No. 21R—Other Admitted Assets definition of collateral loans that are backed by any form of collateral, regardless of if the collateral is sufficient to fully cover the loan, shall be captured in this category. Guidance in SSAP No. 21R shall be followed to determine nonadmittance.~~
Refer to SSAP No. 21R—Other Admitted Assets for a definition of collateral loans.

In the description column, the name of the actual borrower and state if the borrower is a parent, subsidiary, affiliate, officer or director. Also include the type of collateral held.

Non-collateral Loans

Include: ~~For purposes of this section, n~~Non-collateral loans are considered the unpaid portion of loans previously made to another organization or individual in which the reporting entity has a right to receive money for the loan, but for which the reporting entity has not obtained collateral to secure the loan.

Non-collateral loans shall not include those instruments that meet the definition of a bond, per SSAP No. 26R—Bonds, a mortgage loan per SSAP No. 37—Mortgage Loans, ~~loan-backed or structured~~asset-backed securities per SSAP No. 43R—Loan-Backed and Structured Securities, or a policy or contract loan per SSAP No. 49—Policy Loans, or a collateral loan in SSAP No. 21, Other Admitted Assets.

Non-collateral loans are nonadmitted unless they are to related parties and meet the criteria in SSAP No. 25—Affiliates and Other Related Parties. SSAP No. 20

[Nonadmitted Assets and SSAP No. 25 should be referred to for accounting guidance for Non-collateral loans](#)

In the description column, provide the name of the actual borrower. For affiliated entities, state if the borrower is a parent, subsidiary, affiliate, officer or director. ~~Refer to SSAP No. 20 Nonadmitted Assets and SSAP No. 25 Affiliates and Other Related Parties for accounting guidance.~~

Capital Notes

~~Include: The portion of any capital note that is reported on the line for capital notes of the issuing insurance reporting entity.~~

Low Income Housing Tax Credit

[Note: These instructions will be updated in accordance with the SAPWG tax credit agenda item.](#)

- Include: All Low Income Housing Tax Credit Investments (LIHTC or affordable housing) that are in the form of a Limited Partnership or a Limited Liability Company including those investments that have the following risk mitigation factors:
- A. Guaranteed Low Income Housing Tax Credit Investments. There must be an all-inclusive guarantee from a CRP-rated entity that guarantees the yield on the investment.
 - B. Non-guaranteed Low Income Housing Tax Credit Investments.
 - I. A level of leverage below 50%. For a LIHTC Fund, the level of leverage is measured at the fund level.
 - II. There is a Tax Credit Guarantee Agreement from General Partner or managing member. This agreement requires the General Partner or managing member to reimburse investors for any shortfalls in tax credits due to errors of compliance, for the life of the partnership. For a LIHTC Fund, a Tax Credit Guarantee is required from the developers of the lower tier LIHTC properties to the upper tier partnership and all other LIHTC investments.
 - III. There are sufficient operating reserves, capital replacement reserves and/or operating deficit guarantees present to mitigate foreseeable foreclosure risk at the time of the investment.

Non-qualifying LIHTCs should be reported in the “All Other” category

[\[placeholder for changes resulting from SAPWG 2022-14 \(New Market Tax Credits\)\]](#)

Working Capital Finance Investment

- Include: Investments in an interest in a Confirmed Supplier Receivables (CSR) under a Working Capital Finance Program (WCFP) that is designated by the SVO as meeting the criteria specified in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for an NAIC “1” or “2.”

Working Capital Finance Program (WCFP)

Open account program under which an Investor may purchase interests, or evidence thereof, in commercial non-insurance receivables. A WCFP is created for the benefit of a commercial investment grade obligor and its suppliers of goods or services and facilitated by a financial intermediary.

Confirmed Supplier Receivables (CSR)

A first priority perfected security interest claim or right to payment of a monetary obligation from the Obligor arising from the sale of goods or services from the Supplier to the Obligor the payment of which the Obligor has confirmed by representing and warranting that it will not protest, delay, or deny, nor offer nor assert any defenses against, payment to the supplier or any party taking claim or right to payment from the supplier.

See *SSAP No. 105R—Working Capital Finance Investments* for accounting guidance.

Residual Tranches or Interests with Underlying Assets Having Characteristics of:

Investment in Residual Tranches or Interests should be assigned to the subcategory with the highest underlying asset concentration. There shouldn't be any bifurcation of the underlying assets among the subcategories.

Include: Residual tranches or interests captures securitization tranches and beneficial interests as well as other structures captured in scope of *SSAP No. 43R – ~~Loan-Backed and Structured Securities~~ Asset-Backed Securities*, that reflect loss layers without any contractual payments, whether interest or principal, or both. Payments to holders of these investments occur after contractual interest and principal payments have been made to other tranches or interests and are based on the remaining available funds. See *SSAP No. 43R* for accounting guidance.

[\[placeholder for changes resulting from SAPWG 2023-12 \(SSAP No. 48 – Residuals\)\]](#)

Fixed Income Instruments

Include: -Investments with underlying collateral which, if held individually, would be reported on *Schedule D – Part 1 – Long-Term Bonds*

Common Stocks

Include: Investments with underlying collateral which, if held individually, would be reported on *Schedule D – Part 2 – Section 2 – Common Stocks*

Preferred Stocks

Include: Investments with underlying collateral which, if held individually, would be reported on *Schedule D – Part 2 – Section 1 – Preferred Stocks*

Real Estate

Include: Investments with underlying collateral which, if held individually, would be reported on *Schedule A – Real Estate Owned*

Mortgage Loans

Include: Investments with underlying collateral which, if held individually, would be reported on *Schedule B – Mortgage Loans*

Other

Include: Items that do not qualify for inclusion in the above subcategories.

Any Other Class of Assets

Include: Investments that do not fit into one of the other categories. An example of items that may be included are reverse mortgages.

All structured settlement income streams acquired as investments where the reporting entity acquires the legal right to receive payments. (Valuation and admittance provisions are detailed in *SSAP No. 21R—Other Admitted Assets*.)

[This category shall also include oil and gas leases, aircraft owned under leveraged lease arrangements, investments in extractive materials and timber deeds that are not owned within a partnership, LLC or joint venture structure.](#)

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July 14, 2023

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 Ref #2023-12, Residuals in SSAP No. 48 Investments

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the following item that was exposed for comment by the Statutory Accounting Working Group (the Working Group).

Ref # 2023-12: Residuals in SSAP No. 48 Investments

This agenda item proposes revisions to clarify the scope and reporting for investment structures that represent residual interests or a residual security tranche (collectively referred to as residuals) within statutory accounting principles regardless of the legal form of the residual (e.g., debt, stock, LP/LLC equity ownership, etc.) It proposes guidance to clarify the reporting of in-substance residuals regardless of the structure of the investment vehicle.

Interested parties has been working with NAIC staff to clarify the definition in order to facilitate consistent interpretation by the industry and auditors, to avoid unintended consequences of certain equity investments being scoped into the definition of a residual when they were not intended to be in scope. We appreciate NAIC staff working with us on these clarifications and look forward to reviewing the next exposure. In addition to the redrafted exposure draft, we offer the following comments.

In reviewing the exposure, we understand that the residual definition is related to investment structures that issue debt securities created for the primary purpose of raising debt capital backed by collateral assets (ABS issuers as defined in paragraph 8 of the current bond exposure in SSAP Nos. 26R). As a result, interested parties do not believe the intent was to include the following types of investment structures:

- Private Funds (e.g., equity, debt, hedge)- that issued debt for liquidity / operating purposes rather than to raise capital backed by a discrete pool of collateral assets.
- Real Estate Funds (including REITs and JVs) (i.e., considered Issuer Credit Obligations, or “ICOs”, in the proposed bond standard)
- Non-US registered Funds (i.e., considered ICOs in the proposed bond standard)
- Other ICOs in the proposed bond definition, such as 40 Act Funds, Business Development Company, Operating Entities, and Holding Companies supported by operating companies.

The exposure currently addresses changes to SSAP No. 48 - Joint Ventures, Partnerships and Limited liability Companies, but we also believe the definition is relevant to SSAP Nos. 26R, 43R, and 21R and should be included in those other SSAPs. Also, consideration should be given to whether the definition should also be added to SSAPs where residuals may currently be in scope, such as SSAP No. 30R (e.g., from securitizations in legal form of a corporation).

Upon adoption of the Form A, interested parties believe the guidance would be effective immediately. Interested parties will need time to consider the guidance, develop accounting policies, and identify the residuals under the new definition. As a result, we recommend an effective date of six months after the adoption by Executive (Ex) Committee.

* * * *

Please feel free to contact either one of us with any questions you may have.

Sincerely,

D. Keith Bell

Rose Albrizio

cc: Interested parties
NAIC staff

<https://naiconline.sharepoint.com/:b:/r/sites/NAICSupportStaffHub/Member%20Meetings/E%20CMTE/APPTF/2023-2%20Summer/Summary%20and%20Minutes/SAPWG/Attachments/Att1F-Comment%20Letters.pdf?csf=1&web=1&e=803UKA>

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

Issue: SSAP No. 43R – CLO Financial Modeling

Check (applicable entity):

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

Description of Issue: This agenda item proposes revisions to *SSAP No. 43R—Loan-Backed and Structured Securities* to incorporate edits to reflect changes adopted by the Valuation of Securities (E) Task Force on Feb. 21, 2023, to include collateralized loan obligations (CLOs) in the SVO financial modeling process.

This agenda item has been drafted to ensure the financial modeling guidance summarized in *SSAP No. 43R—Loan-Backed and Structured Securities* reflects the practices as directed by the *Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual)*. (Note, while the *Accounting Practices and Procedures Manual* is higher than the P&P manual in the statutory hierarchy, the primary source of authoritative guidance for financial modeling is the P&P manual. Only a general description of the modeling process is included in SSAP No. 43R). The methodology to model CLOs is still being developed, but guidance that permits the SVO to model CLOs has been adopted and should be followed once CLOs begin to be financially modeled.

Existing Authoritative Literature:

SSAP No. 43R—Loan-Backed and Structured Securities

Designation Guidance

27. For RMBS/CMBS securities within the scope of this statement, the initial NAIC designation used to determine the carrying value method and the final NAIC designation for reporting purposes is determined using a multi-step process or the NAIC designation assigned by the NAIC Securities Valuation Office. The P&P Manual provides detailed guidance. A general description of the processes is as follows:

- a. Financial Modeling: Pursuant to the P&P Manual, the NAIC identifies select securities where financial modeling must be used to determine the NAIC designation. For a modeled legacy security, meaning one which closed prior to January 1, 2013, the NAIC designation is based on financial modeling incorporating the insurers' carrying value. For a modeled non-legacy security, meaning one which closed after December 31, 2012, the NAIC designation and NAIC designation category assigned by the NAIC Securities Valuation Office must be used. For those legacy securities that are financially modeled, the insurer must use NAIC CUSIP specific modeled breakpoints provided by the modelers in determining initial and final designation for these identified securities. As specified in the P&P Manual, a modeled legacy security RMBS or CMBS tranche that has no expected loss, as compiled and published by the NAIC Securities Valuation Office, under any of the selected modeling scenarios would be assigned an NAIC 1 designation and NAIC 1.A designation category regardless of the insurer's book/adjusted carrying value. The three-step process for modeled legacy securities is as follows:
 - i. Step 1: Determine Initial Designation – The current amortized cost (divided by remaining par amount) of a loan-backed or structured security is compared to the modeled breakpoint values assigned to each NAIC designation and NAIC designation category for each CUSIP to establish the **initial** NAIC designation.

- ii. Step 2: Determine Carrying Value Method – The carrying value method, either the amortized cost method or the lower of amortized cost or fair value method, is then determined as described in paragraph 26 based upon the initial NAIC designation from Step 1.
 - iii. Step 3: Determine Final Designation – The final NAIC designation is determined by comparing the carrying value (divided by remaining par amount) of a security (based on paragraph 27.a.ii.) to the NAIC CUSIP specific modeled breakpoint values assigned to the NAIC designation and NAIC designation category for each CUSIP or is mapped to an NAIC designation category, according to the instructions in the P&P Manual. This final NAIC designation shall be applicable for statutory accounting and reporting purposes and the NAIC designation category will be used for investment schedule reporting and establishing RBC and AVR charges. The final NAIC designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 27.a.ii.).
- b. All Other Loan-Backed and Structured Securities: For securities not subject to paragraph 27.a. (financial modeling) follow the established designation procedures according to the appropriate section of the P&P Manual. The NAIC designation shall be applicable for statutory accounting and reporting purposes (including determining the carrying value method and establishing the AVR charges). The carrying value method is established as described in paragraph 26.

Specific Interim Reporting Guidance Financially Modeled Securities

28. For securities that will be financially modeled under paragraph 27, the guidance in this paragraph shall be applied in determining the reporting method for such securities acquired in the current year for quarterly financial statements. Securities reported as of the prior-year end shall continue to be reported under the prior-year end methodology for the current-year quarterly financial statements. For year-end reporting, securities shall be reported in accordance with paragraph 27, regardless of the quarterly methodology used.

- a. Reporting entities that acquired the entire financial modeling database for the prior-year end are required to follow the financial modeling methodology (paragraph 27.a.) for all securities acquired in the subsequent year that were included in the financial modeling data acquired for the prior year-end.
- b. Reporting entities that acquired identical securities (identical CUSIP) to those held and financially modeled for the prior year-end are required to follow the prior year-end financial modeling methodology (paragraph 27.a.) for these securities acquired subsequent to year-end.
- c. Reporting entities that do not acquire the prior-year financial modeling information for current-year acquired individual CUSIPS, and are not captured within paragraphs 28.a. or 28.b., are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate). Reporting entities that do acquire the individual CUSIP information from the prior-year financial modeling database shall use that information for interim reporting.
- d. Reporting entities that acquire securities not previously modeled at the prior year-end are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate).

SSAP No. 43R - EXHIBIT A – Question and Answer Implementation Guide Index to Questions

| |
|--|
| Questions 8-10 are specific to securities subject to the financial modeling process. (This process is limited to qualifying RMBS/CMBS securities reviewed by the NAIC Structured Securities Group.) The guidance in questions 8-10 shall not be inferred to other securities in scope of SSAP No. 43R. |
|--|

| | |
|----|---|
| 8 | 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? |
| 9 | The NAIC Designation process for LBSS 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? |
| 10 | 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? |

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.)

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.

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 following edits have previously been reflected in the financial modeling guidance:

- Agenda Item 2018-19: To be consistent with the prior SVO P&P Manual revisions, eliminated the multi-step designation guidance for modified filing exempt (MFE) securities. The elimination of MFE was effective March 31, 2019, with early application permitted for year-end 2018. With the elimination of

MFE, for securities that are filing exempt, the NAIC designation reported will correspond to the Credit Rating Provider (CRP) rating without adjustment based on carrying value.

- Agenda Item 2018-03: Clarified that securities acquired in lots shall not be reported with weighted average designations. With the adopted guidance, 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. With the elimination of MFE, the instances of different designations by lot are not expected to be prevalent, but could still occur with the financial modeling process for residential mortgage backed securities (RMBS) and commercial mortgage backed securities (CMBS).
- Agenda Item 2020-21: Edits incorporated adopted guidance to the P&P manual detailing the use and mapping of NAIC designations to NAIC designation categories. Reporting entities were to then utilize the new NAIC designation categories for accounting and reporting purposes.
- Agenda Item 2021-23: Adopted changes to summarize the financial modeling guidance in SSAP No. 43R. This guidance continues to refer users to the detailed financial modeling guidance in the P&P Manual.

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 a SAP clarification, and expose revisions to *SSAP No. 43R—Loan-backed and Structured Securities* to incorporate changes to add CLOs to the financial modeling guidance and to clarify that CLOs are not captured as legacy securities. These revisions reflect the guidance adopted for the P&P Manual in February 2023.**

Proposed Revisions to *SSAP No. 43R—Loan-Backed and Structured Securities*

Designation Guidance

27. For [Residential Mortgage-Backed Securities \(RMBS\)](#), [Commercial Mortgage-Backed Securities \(CMBS\)](#) and [Collateralized Loan Obligations \(CLOs\)](#), ~~RMBS/CMBS~~ securities within the scope of this statement, the initial NAIC designation used to determine the carrying value method and the final NAIC designation for reporting purposes is determined using a multi-step process or the NAIC designation assigned by the NAIC Securities Valuation Office. The P&P Manual provides detailed guidance. A general description of the processes is as follows:
- a. Financial Modeling: Pursuant to the P&P Manual, the NAIC identifies select securities where financial modeling must be used to determine the NAIC designation. For a modeled [RMBS/CMBS](#) legacy security, meaning one which closed prior to January 1, 2013, the NAIC designation is based on financial modeling incorporating the insurers' carrying value. For a modeled [RMBS/CMBS](#) non-legacy security, meaning one which closed after December 31, 2012, [or modeled CLO](#) the NAIC designation and NAIC designation category assigned by the NAIC Securities Valuation Office must be used. For those [RMBS/CMBS](#) legacy securities that are financially modeled, the insurer must use NAIC CUSIP specific modeled breakpoints provided by the modelers in

determining initial and final designation for these identified securities. As specified in the P&P Manual, a modeled legacy security RMBS or CMBS tranche that has no expected loss, as compiled and published by the NAIC Securities Valuation Office, under any of the selected modeling scenarios would be assigned an NAIC 1 designation and NAIC 1.A designation category regardless of the insurer's book/adjusted carrying value. The three-step process for modeled [RMBS/CMBS](#) legacy securities is as follows:

- i. Step 1: Determine Initial Designation – The current amortized cost (divided by remaining par amount) of a loan-backed or structured security is compared to the modeled breakpoint values assigned to each NAIC designation and NAIC designation category for each CUSIP to establish the initial NAIC designation.
 - ii. Step 2: Determine Carrying Value Method – The carrying value method, either the amortized cost method or the lower of amortized cost or fair value method, is then determined as described in paragraph 26 based upon the initial NAIC designation from Step 1.
 - iii. Step 3: Determine Final Designation – The final NAIC designation is determined by comparing the carrying value (divided by remaining par amount) of a security (based on paragraph 27.a.ii.) to the NAIC CUSIP specific modeled breakpoint values assigned to the NAIC designation and NAIC designation category for each CUSIP or is mapped to an NAIC designation category, according to the instructions in the P&P Manual. This final NAIC designation shall be applicable for statutory accounting and reporting purposes and the NAIC designation category will be used for investment schedule reporting and establishing RBC and AVR charges. The final NAIC designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 27.a.ii.).
- b. All Other Loan-Backed and Structured Securities: For securities not subject to paragraph 27.a. (financial modeling) follow the established designation procedures according to the appropriate section of the P&P Manual. The NAIC designation shall be applicable for statutory accounting and reporting purposes (including determining the carrying value method and establishing the AVR charges). The carrying value method is established as described in paragraph 26.

Specific Interim Reporting Guidance Financially Modeled Securities

28. For securities that will be financially modeled under paragraph 27, the guidance in this paragraph shall be applied in determining the reporting method for such securities acquired in the current year for quarterly financial statements. Securities reported as of the prior-year end shall continue to be reported under the prior-year end methodology for the current-year quarterly financial statements. For year-end reporting, securities shall be reported in accordance with paragraph 27, regardless of the quarterly methodology used.

- a. Reporting entities that acquired the entire financial modeling database for the prior-year end are required to follow the financial modeling methodology (paragraph 27.a.) for all securities acquired in the subsequent year that were included in the financial modeling data acquired for the prior year-end.
- b. Reporting entities that acquired identical securities (identical CUSIP) to those held and financially modeled for the prior year-end are required to follow the prior year-end financial modeling methodology (paragraph 27.a.) for these securities acquired subsequent to year-end.

- c. Reporting entities that do not acquire the prior-year financial modeling information for current-year acquired individual CUSIPS, and are not captured within paragraphs 28.a. or 28.b., are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate) until the current year financial modeling information becomes available and then follow the procedures for financially modeled securities (paragraph 27.a., as appropriate). Reporting entities that do acquire the individual CUSIP information from the prior-year financial modeling database shall use that information for interim reporting.
- d. Reporting entities that acquire securities not previously modeled at the prior year-end are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate) until the current year financial modeling information becomes available and then follow the procedures for financially modeled securities (paragraph 27.a., as appropriate).

Staff Review Completed by: Julie Gann, NAIC Staff – February 2023

Status:

On March 22, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 43R to incorporate changes to add CLOs to the financial modeling guidance and to clarify that CLOs are not captured as legacy securities.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to SSAP No. 43R which incorporate changes to add collateralized loan obligations (CLOs) to the financial modeling guidance and to clarify that CLOs are not captured as legacy securities.

[https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/APPTF/2023-2 Summer/Summary and Minutes/SAPWG/Attachments/Att1G-2023-02 SSAP 43R.docx](https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member%20Meetings/E%20CMTE/APPTF/2023-2%20Summer/Summary%20and%20Minutes/SAPWG/Attachments/Att1G-2023-02%20SSAP%2043R.docx)

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

Issue: ASU 2022-06, Reference Rate Reform (Topic 848), Deferral of the Sunset Date of Topic 848

Check (applicable entity):

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

Description of Issue:

The Financial Accounting Standards Board (FASB) issued *ASU 2022-06, Reference Rate Reform (Topic 848), Deferral of the Sunset Date of Topic 848* to extend the sunset date of the reference rate reform guidance that was included in *ASU 2020-04, Reference Rate Reform (Topic 848) Facilitation of the Effects of Reference Rate Reform on Financial Reporting* and *ASU 2021-01, Reference Rate Reform (Topic 848), Scope*.

As background, reference rate reform refers to the transition away from referencing the London Interbank Offered Rate (LIBOR), and other interbank offered rates (IBORs), and moving toward alternative reference rates that are more observable or transaction based. In July 2017, the governing body responsible for regulating LIBOR announced it would no longer require banks to continue rate submissions after 2021 – thus, likely sunsetting both the use and publication of LIBOR. An important item to note is that while LIBOR is the primary interbank offering rate, other similar rates are potentially affected by reference rate reform. For simplicity, LIBOR will be the sole IBOR referenced throughout this agenda item.

With a significant number of financial contracts referencing LIBOR, its discontinuance will require organizations to reevaluate and modify any contract which does not contain a substitute reference rate. A large volume of contracts and other arrangements, such as debt agreements, lease agreements, and derivative instruments, will likely need to be modified to replace all references of interbank offering rates that are expected to be discontinued. While operational, logistical, and legal challenges exist due to the sheer volume of contracts that will require modification, accounting challenges were presented as contract modifications typically require an evaluation to determine whether the modifications result in the establishment of a new contract or the continuation of an existing contract. As is often the case, a change to the critical terms (including reference rate modifications) typically requires remeasurement of the contract, or in the case of a hedging relationship, a dedesignation of the transaction.

To address ASU 2020-04 the Working Group issued *INT 20-01: Reference Rate Reform*, and this interpretation was then revised to incorporate guidance from ASU 2021-01. This agenda item intends to again revise INT 20-01 to include the revised sunset date of December 31, 2024.

Existing Authoritative Literature:

The Working Group adopted INT 20-01 to address ASU 2020-04, and further revised that interpretation to address ASU 2021-01. The modifications in ASU 2020-04 address hedge accounting and the allowance for a reporting entity to change the reference rate and other critical terms related to reference rate reform without having to dedesignate the hedging relationship. Alternative benchmark interest rates were previously addressed in agenda item 2018-46 – Benchmark Interest Rate.

ASU 2021-01 increased the scope of the optional, expedient accounting guidance for derivative instruments in ASU 2020-04 which would primarily affect *SSAP No. 86—Derivatives*. While detailed in the original agenda item (Ref

#2020-12), additional SSAPs impacted by ASU 2020-04 were *SSAP No. 15—Debt and Holding Company Obligations* and *SSAP No. 22R—Leases*.

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 Working Group has taken several actions related to reference rate reform; each are summarized below.

1. Agenda item 2018-46 – Benchmark Interest Rate, incorporated revisions to SSAP No. 86, adding the Securities Industry and Financial Markets (SIFMA) Municipal Swap Rate and the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as acceptable benchmark interest rates for hedge accounting. Prior to this change, only LIBOR and the Fed Funds Effective Swap Rate (also referred to as the Overnight Index Swap Rate) were considered acceptable benchmark interest rates.
2. Agenda item 2020-12 reviews ASU 2020-04, the foundation of which this agenda item and related ASU (2021-01) are based. Agenda item 2020-12 resulted in the Working Group adopting INT 20-01.
3. *INT 20-01: ASU 2020-04 - Reference Rate Reform*, adopted by the Working Group in April 2020, broadly adopted ASU 2020-04 for statutory accounting stating that for statutory accounting:
 - For all contracts within scope of ASU 2020-04, modifications due to reference rate reform are afforded an optional expedient to be accounted for as a continuation of the existing contract.
 - Debt and service agreement modifications, as a result of reference rate reform, should not typically rise to the level of requiring a reversal and rebooking of the liability, as *SSAP No. 15—Debt and Holding Company Obligations* states such liabilities should only be derecognized if extinguished.
 - Lease modifications, solely caused by reference rate reform and ones eligible for optional expedience, likely do not rise to the level of a modification requiring re-recognition as a new lease under *SSAP No. 22R—Leases*.
 - For derivative transactions within scope of ASU 2020-04, a change to the critical terms of the hedging relationship (due to reference rate reform), shall be afforded similar treatment in that the hedging relationship can continue the original hedge accounting rather than dedesignate the hedging relationship.
4. *INT 20-09: Basis Swaps as a Result of the LIBOR Transition*, adopted by the Working Group in July 2020, provided statutory accounting and reporting guidance for basis swaps issued by CCPs. This INT designated that basis swaps, issued by CCPs, in response to reference rate reform (i.e., the discounting transition), shall be classified as a derivative used for hedging. This categorization allowed for the basis swap derivatives to be admitted under SSAP No. 86. Additionally, the INT directed that basis swap derivatives shall not be reported as “effective” unless the instrument qualifies, with the required documentation, as highly effective under SSAP No. 86.
5. Agenda item 2021-09 further revised INT 20-01 and increased the scope of the optional, expedient accounting guidance for derivative instruments in ASU 2020-04.

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 SAP clarification and expose temporary (optional) expedient and exception interpretative guidance, to revise the expiration date of the guidance in *INT 20-01: ASU 2020-04 & 2021-01 - Reference Rate Reform* to be December 31, 2024.

The proposed modifications to INT 20-01 temporarily override SSAP No. 15, SSAP No. 22R and SSAP No. 86 guidance, therefore the policy statement in Appendix F requires 2/3rd (two-thirds) of the Working Group members to be present and voting and a supermajority of the Working Group members present to vote in support of the interpretation before it can be finalized.

Staff Review Completed by: Jake Stultz—February 2023

Status:

On March 22, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed temporary (optional) expedient and exception interpretative guidance, to revise the expiration date of the guidance in *INT 20-01: 2020-04, 2021-01 & 2022-06 - Reference Rate Reform* to be December 31, 2024, as reflected in INT 20-01.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as reflected in *INT 20-01: ASUs 2020-04, 2021-01 & 2022-06 - Reference Rate Reform* which revises expiration date of the interpretation to December 31, 2024.

[https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/APPTF/2023-2 Summer/Summary and Minutes/SAPWG/Attachments/Att1H-2023-05 ASU 2022-06.docx](https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member%20Meetings/E%20CMTE/APPTF/2023-2%20Summer/Summary%20and%20Minutes/SAPWG/Attachments/Att1H-2023-05%20ASU%2022-06.docx)

Interpretation of the Statutory Accounting Principles (E) Working Group

INT 20-01: *ASUs 2020-04, ~~& 2021-01~~ & 2022-06 – Reference Rate Reform*

INT 20-01 Dates Discussed

March 26, 2020; April 15, 2020; March 15, 2021, May 20, 2021, [March 22, 2023](#), [August 13, 2023](#)

INT 20-01 References

Current:

SSAP No. 15—*Debt and Holding Company Obligations*

SSAP No. 22R—*Leases*

SSAP No. 86—*Derivatives*

This INT applies to all SSAPs with contracts within scope of ASU 2020-04, which allows for modifications due to reference rate reform and provides for the optional expedient to be accounted for as a continuation of the existing contract.

INT 20-01 Issue

1. This interpretation has been issued to provide statutory accounting and reporting guidance for the adoption with modification of *ASU 2020-04, Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*, ~~and ASU 2021-01, Reference Rate Reform (Topic 848)~~, and ASU 2022-06, Reference Rate Reform (Topic 848) for applicable statutory accounting principles. The Financial Accounting Standards Board (FASB) issued ~~both~~ ASU 2020-04, ~~and~~ ASU 2021-01 and ASU 2022-06 to provide optional, transitional and expedient guidance as a result of reference rate reform.
2. “Reference rate reform” typically refers to the transition away from referencing the London Interbank Offered Rate (LIBOR), and other interbank offered rates (IBORs), and moving toward alternative reference rates that are more observable or transaction based. In July 2017, the governing body responsible for regulating LIBOR announced it will no longer require banks to continue LIBOR submissions after 2021 – likely sunseting both the use and publication of LIBOR. An important note is that while LIBOR is the primary interbank offering rate, other similar rates are potentially affected by reference rate reform.
3. With a significant number of financial contracts solely referencing IBORs, their discontinuance will require organizations to reevaluate and modify any contract that does not contain a substitute reference rate. A large volume of contracts and other arrangements, such as debt agreements, lease agreements, and derivative instruments, will likely need to be modified to replace all references of interbank offering rates that are expected to be discontinued. While operational, logistical, and legal challenges exist due to the sheer volume of contracts that will require modification, accounting challenges were presented as contract modifications typically require an evaluation to determine whether the modifications result in the establishment of a new contract or the continuation of an existing contract. As is often the case, a change to the critical terms (including reference rate modifications) typically requires remeasurement of the contract, or in the case of a hedging relationship, a dedesignation of the transaction.
4. The overall guidance in ASU 2020-04 is that a qualifying modification (as a result of reference rate reform) should not be considered an event that requires contract remeasurement at the modification date or reassessment of a previous accounting determination. FASB concluded that as reference rate changes are a market-wide initiative, one that is required primarily due to the discontinuance of LIBOR, it is outside the control of an entity and is the sole reason compelling an entity to make modifications to contracts or hedging strategies. As such, FASB

determined that the traditional financial reporting requirements of discontinuing such contracts and treating the modified contract as an entirely new contract or hedging relationship would 1) not provide decision-useful information to financial statement users and 2) require a reporting entity to incur significant costs in the financial statement preparation and potentially reflect an adverse financial statement impact, one of which may not accurately reflect the intent or economics of a modification to a contract or hedging transaction.

5. Guidance in ASU 2020-04 allows a method to ensure that the financial reporting results would continue to reflect the intended continuation of contracts and hedging relationships during the period of the market-wide transition to alternative reference rates – thus, generally not requiring remeasurement or dedesignation if certain criteria are met.

6. Guidance in ASU 2021-01 expanded the scope of ASU 2020-04 by permitting the optional, transitional, expedient guidance to also include derivative contracts that undergo a similar transition but do not specifically reference a rate that is expected to be discontinued. While these contract modifications do not reference LIBOR (or another reference rate expected to be discontinued), the changes are the direct result of reference rate reform and were deemed to be eligible for similar exception treatment. ASU 2021-01 allows for modifications in interest rates indexes used for margining, discounting or contract price alignment, as a result of reference rate reform initiatives (commonly referred to as a “discounting transition”) to be accounted for as a continuation of the existing contract and hedge accounting. [On August 13, 2023, the Working Group added the guidance in ASU 2022-06 which only acts to defer the sunset date of Topic 848 from December 31, 2022, to December 31, 2024, after which entities will no longer be permitted to apply the relief from the prior ASUs.](#)

7. The optional, expedient and exceptions guidance provided by the amendments in ASU 2020-04, ~~and~~ ASU 2021-01 [and ASU 2022-04](#) are applicable for all entities. However, they are only effective as of March 12, 2020 through December 31, ~~2022~~[2024](#). This is because the amendments are intended to provide relief related to the accounting requirements in generally accepted accounting principles (GAAP) due to the effects of the market-wide transition away from IBORs. The relief provided by the amendments is temporary in its application in alignment with the expected market transition period. However, the FASB will monitor the market-wide IBOR transition to determine whether future developments warrant any changes, including changes to the end date of the application of the amendments in this ASU. If such an update occurs, the Working Group may also consider similar action. It is not expected that the Working Group will take action prior to or in the absence of a FASB amendment.

8. The accounting issues are:

- a. Issue 1: Should a reporting entity interpret the guidance in ASU 2020-04 as broadly accepted for statutory accounting?
- b. Issue 2: Should the optional, expedient and exception guidance in ASU 2020-04 apply to debt and other service agreements addressed in SSAP No. 15?
- c. Issue 3: Should the optional, expedient and exception guidance in ASU 2020-04 apply to lease transactions addressed in SSAP No. 22R?
- d. Issue 4: Should the optional, expedient and exception guidance in ASU 2020-04 apply to derivative transactions addressed in SSAP No. 86?
- e. Issue 5: Should the optional, expedient and exception guidance in ASU 2021-01 apply to derivative transactions addressed in SSAP No. 86?

INT 20-01 Discussion

9. For Issue 1, the Working Group came to the consensus that ASU 2020-04 shall be adopted, to include the same scope of applicable contracts or transactions for statutory accounting with the only modification related to a concept not utilized by statutory accounting, as noted below. The Working Group agreed the amendments provide appropriate temporary guidance that alleviate the following concerns due to reference rate reform:

- a. Simplifies accounting analyses under current GAAP and statutory accounting principles (SAP) for contract modifications.
 - i. All contracts within scope of ASU 2020-04, which allows for modifications due to reference rate reform and provides for the optional expedient to be accounted for as a continuation of the existing contract.
- b. Allows hedging relationships to continue without dedesignation upon a change in certain critical terms.
- c. Allows a change in the designated benchmark interest rate to a different eligible benchmark interest rate in a fair value hedging relationship.
- d. Suspends the assessment of certain qualifying conditions for fair value hedging relationships for which the shortcut method for assuming perfect hedge effectiveness is applied.
- e. Simplifies or temporarily suspends the assessment of hedge effectiveness for cash flow hedging relationships.
- f. The only SAP modification to this ASU is related to the option to sell debt currently classified held-to-maturity. This concept is not employed by statutory accounting and thus is not applicable.

10. For Issue 2, the Working Group came to the consensus that debt and service agreement modifications, as a result of reference rate reform, should not typically rise to the level of requiring a reversal and rebooking of the liability, as SSAP No. 15 states such liabilities should only be derecognized if extinguished. A reference rate modification should not generally require de-recognition and re-recognition under statutory accounting. Nonetheless, for clarity and consistency with ASU 2020-04, the Working Group came to the consensus that should an eligible contract be affected by reference rate reform, then the temporary guidance in ASU 2020-04 shall apply.

11. For Issue 3, the Working Group came to the consensus that lease modifications, solely caused by reference rate reform and ones eligible for optional expedience, likely do not rise to the level of a modification requiring re-recognition as a new lease under statutory accounting. SSAP No. 22R, paragraph 17 states only modifications in which grant the lessee additional rights shall be accounted for as a new lease. These changes are outside the scope allowed for optional expedience in ASU 2020-04. Nonetheless, for clarity and consistency with ASU 2020-04, the Working Group came to a consensus that if an eligible lease affected by reference rate reform, then the temporary guidance in ASU 2020-04 shall apply.

12. For Issue 4, the Working Group came to the consensus that ASU 2020-04 shall be applied to derivative transactions as the following considerations provided in the ASU are appropriate for statutory accounting:

- a. For any hedging relationship, upon a change to the critical terms of the hedging relationship, allow a reporting entity to continue hedge accounting rather than dedesignate the hedging relationship.

- b. For any hedging relationship, upon a change to the terms of the designated hedging instrument, allow an entity to change its systematic and rational method used to recognize the excluded component into earnings and adjust the fair value of the excluded component through earnings.
- c. For fair value hedges, allow a reporting entity to change the designated hedged benchmark interest rate and continue fair value hedge accounting.
- d. For cash flow hedges, adjust the guidance for assessment of hedge effectiveness to allow an entity to continue to apply cash flow hedge accounting.

13. For Issue 5, the Working Group came to a consensus on May 20, 2021, that ASU 2021-01 shall be applied to derivative transactions for statutory accounting. Accordingly, derivative instruments that are modified to change the reference rate used for margining, discounting, or contract price alignment that is a result of reference rate reform (regardless of whether the reference rate that is expected to be discontinued) are eligible for the exception guidance afforded in ASU 2020-04 in that such a modification is not considered a change in the critical terms that would require dedesignation of the hedging relationship. In addition, for all derivatives (those qualifying for hedge accounting, those that do not qualify for hedge accounting and replication (synthetic asset) transactions (RSAT)), a reporting entity may account for and report modifications (that are within the scope of INT 20-01) as a continuation of the existing contract even when the legal form of the modification is a termination of the original contract and its replacement with a new reference rate reform contract. This includes in-scope modifications of centrally cleared swap contracts whether they are automatically transitioned at a cessation date or voluntarily executed prior to cessation.

14. Additionally, for GAAP purposes, if an entity has not adopted the amendments in *ASU 2017-12, Derivatives and Hedging*, it is precluded from being able to utilize certain expedients for hedge accounting. For statutory accounting purposes, only the hedge documentation requirements were adopted from ASU 2017-12, while the remainder of the items are pending statutory accounting review. The Working Group concluded that all allowed expedient methods are permitted as elections for all reporting entities under statutory accounting. However, if a reporting entity is a U.S. GAAP filer, the reporting entity may only make elections under ASU 2017-12 if such elections were also made for their U.S. GAAP financials.

INT 20-01 Status

15. ~~No further~~Further discussion is planned.

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

Issue: ASU 2019-08, Codification Improvements to Topic 718 and Topic 606

Check (applicable entity):

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

Description of Issue: In November 2019, FASB issued *ASU 2019-08 Compensation—Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606): Codification Improvements—Share-Based Consideration Payable to a Customer*, which includes amendments to Topics 718 and 606. The changes to Topic 718 include share-based payment transactions for acquiring goods and services from nonemployees and in doing so superseded guidance in Subtopic 505-50, *Equity—Equity-Based Payments to Non-Employees*. The changes to Topic 606 expand the scope of the codification to include share-based payment awards granted to a customer in conjunction with selling goods or services.

The amendments in ASU 2019-08 require that an entity measure and classify share-based payment awards granted to a customer by applying the guidance in Topic 718. The amount recorded as a reduction of the transaction price is required to be measured on the basis of the grant-date fair value of the share-based payment award in accordance with Topic 718. The grant date is the date at which a grantor (supplier) and a grantee (customer) reach a mutual understanding of the key terms and conditions of a share-based payment award. The classification and subsequent measurement of the award are subject to the guidance in Topic 718 unless the share-based payment award is subsequently modified and the grantee is no longer a customer.

For statutory accounting assessments, prior U.S. GAAP guidance related to share-based payments has been predominantly adopted with modification in *SSAP No. 104R—Share-Based Payments*. Statutory accounting modifications to the U.S. GAAP guidance have mostly pertained to statutory terms and concepts. (For example, statutory reporting lines, nonadmittance of prepaid assets, etc.)

Existing Authoritative Literature:

Stock Compensation is covered by *SSAP No. 104R—Share-Based Payments* and *SSAP No. 95—Nonmonetary Transactions*.

The ASUs related to ASC Topic 606 have been rejected in *SSAP No. 47—Uninsured Plans*.

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 2018-35 adopted with modification *ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting* and incorporated the U.S. GAAP amendments from that project into SAP.

Agenda items 2016-19 and 2017-37 address the main ASUs related to *ASC Topic 606* and there have been several other agenda items for minor updates to revenue recognition guidance, all of which have been rejected in *SSAP No. 47*.

Per the comment letter received on June 9, 2023, interested parties had no comments on Agenda item 2023-07.

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 a SAP clarification, and expose revisions to adopt with modification *ASU 2019-08 Compensation—Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606): Codification Improvements—Share-Based Consideration Payable to a Customer* for statutory accounting. These revisions would add language to include share-based consideration payable to customers under SSAP No. 104R guidance in the same manner as U.S. GAAP. With the revisions proposed to SSAP No. 104R, revisions are also proposed to *SSAP No. 95—Nonmonetary Transactions* to update previously adopted U.S. GAAP guidance. In addition, proposed revisions to *SSAP No. 47—Uninsured Plans*, reject Topic 606 guidance in ASU 2019-08. The proposed revisions to SSAP No. 95, SSAP No. 104R, and *SSAP No. 47—Uninsured Plans*, are illustrated in the Form A.

Proposed Revisions to SSAP No. 95—Nonmonetary Transactions

Accounting for a Convertible Instrument Granted or Issued to a Nonemployee for Goods or Services or Services and Cash (in combination or individually), or a ~~Combination of Goods or Services and Cash~~ as Consideration Payable to a Customer

17. The guidance in paragraph 18 addresses a convertible instrument that is issued or granted to a nonemployee in exchange for goods or services or a combination of goods or services and cash or consideration payable to a customer. The convertible instrument contains a nondetachable conversion option that permits the holder to convert the instrument into the issuer's stock.

19. To determine the fair value of a convertible instrument granted as part of a share-based payment transaction to a nonemployee in exchange for goods or services or as consideration payable to a customer that is equity in form or, if debt in form, that can be converted into equity instruments of the issuer, the entity shall first apply SSAP No. 104R.

Proposed Revisions to SSAP No. 104R—Share-Based Payments

SUMMARY OF ISSUE

2. The objective of accounting for transactions under share-based payment arrangements is to recognize in the financial statements the goods or services received in exchange for equity instruments granted or liabilities incurred and the related cost to the entity as those goods or services are received. This statement uses the terms “compensation” and “payment” in their broadest senses to refer to the consideration paid for goods, ~~or~~ services, or the consideration paid to a customer.

Scope and Scope Exceptions

4. This statement applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in the grantor’s own operations or provides consideration payable to a

[customer](#) by issuing (or offering to issue) its shares, share options, or other equity instruments or by incurring liabilities to an employee or nonemployee that meet either of the following conditions:

- a. The amounts are based, at least in part, on the price of the entity's shares or other equity instruments.
 - b. The awards require or may require settlement by issuing the entity's equity shares or other equity instruments.
5. Share-based payments awarded to a grantee by a related party or other holder of an economic interest in the entity as compensation for goods or services provided to the reporting entity are share-based payment transactions to be accounted for under this statement unless the transfer is clearly for a purpose other than compensation for goods or services to the reporting entity. The substance of such a transaction is that the economic interest holder makes a capital contribution to the reporting entity, and that entity makes a share-based payment to the grantee in exchange for services rendered or goods received. An example of a situation in which such a transfer is not compensation is a transfer to settle an obligation of the economic interest holder to the grantee that is unrelated to goods or services to be used or consumed in a grantor's own operations.
6. The guidance in this statement does not apply to:
- a. Equity instruments held by an employee stock ownership plan. Such equity instruments shall follow the guidance in SSAP No. 12—Employee Stock Ownership Plans.
 - b. Transactions involving equity instruments granted to a lender or investor that provides financing to the issuer.
 - c. Transactions involving equity instruments granted in conjunction with selling goods or services to customers as part of a contract (for example, sales incentives). If consideration payable to a customer is payment for a distinct good or service from the customer, then the entity shall account for the purchase of the good or service in the same way it accounts for other purchases from suppliers. Therefore, share-based payment awards granted to a customer for a distinct good or service to be used or consumed in the grantor's own operations are accounted for under this statement.

Recognition

11. This guidance does not address the period(s) or the manner (that is, capitalize versus expense) in which an entity granting the share-based payment award (the purchaser or grantor) to a nonemployee shall recognize the cost of the share-based payment award that will be issued, other than to require that a nonadmitted prepaid asset or expense be recognized (or previous recognition reversed) in the same period(s) and in the same manner as if the grantor had paid cash for the goods or services instead of paying with or using the share-based payment award.

Initial Measurement

35. An entity shall account for the compensation cost from share-based payment transactions in accordance with the fair-value-based method set forth in this statement. That is, the cost of goods obtained or services received in exchange for awards of share-based compensation generally shall be measured based on the grant-date fair value of the equity instruments issued or on the fair value of the liabilities incurred.

The cost of goods obtained or services received by an entity as consideration for equity instruments issued or liabilities incurred in share-based compensation transactions with employees shall be measured based on the fair value of the equity instruments issued or the liabilities settled. The portion of the fair value of an instrument attributed to goods obtained or services received is net of any amount that a grantee pays (or becomes obligated to pay) for that instrument when it is granted. For example, if a grantee pays \$5 at the grant date for an option with a grant-date fair value of \$50, the amount attributed to goods or services provided by the grantee is \$45.

Measurement Objective – Fair Value at Grant Date

38. The measurement objective for equity instruments awarded to grantees is to estimate the fair value at the grant date of the equity instruments that the entity is obligated to issue when grantees have delivered the good or rendered the service and satisfied any other conditions necessary to earn the right to benefit from the instruments (for example, to exercise share options). That estimate is based on the share price and other pertinent factors, such as expected volatility, at the grant date.

- a. Measurement Objective and Measurement Date for Awards Classified as Liabilities: At the grant date, the measurement objective for liabilities incurred under share-based compensation arrangements is the same as the measurement objective for equity instruments awarded to grantees as described in paragraph 38. However, the measurement date for liability instruments is the date of settlement.
- b. Intrinsic Value Option for Awards Classified as Liabilities: A reporting entity shall make a policy decision of whether to measure all of its liabilities incurred under share-based payment arrangements (for employee and nonemployee awards) issued in exchange for goods or services at fair value or to measure all such liabilities at intrinsic value. However, the reporting entity shall initially and subsequently measure awards determined to be consideration payable to a customer at fair value.

52. A reporting entity may not be able to reasonably estimate the fair value of its equity share options, nonemployee awards and similar instruments because it is not practicable for the reporting entity to estimate the expected volatility of its share price. In that situation, the entity shall account for its equity share options, nonemployee awards and similar instruments based on a value calculated using the historical volatility of an appropriate industry sector index instead of the expected volatility of the entity's share price (~~the calculated-permitted~~ value). A reporting entity's use of ~~calculated-permitted~~ value shall be consistent between employee share-based payment transactions and nonemployee share-based payment transactions. Throughout the remainder of this statement, provisions that apply to accounting for share options, nonemployee awards and similar instruments at fair value also apply to calculated value.

Staff Note: Paragraph 98 references "permitted value in accordance with paragraph 52", but terminology was not consistent between paragraphs. NAIC staff changed "calculated value" to "permitted value" to allow for easier cross-referencing.

54. A reporting entity that elects to apply the practical expedient in paragraph 53 shall apply the practical expedient to a share option or similar award that has all of the following characteristics:

- a. The share option or similar award is granted at the money.

- b. The grantee has only a limited time to exercise the award (typically 30-90 days) if the grantee no longer provides goods ~~or~~, terminates service after vesting, or ceases to be a customer.
- c. The grantee can only exercise the award. The grantee cannot sell or hedge the award.
- d. The award does not include a market condition.

Subsequent Measurement

68. The total amount of compensation cost recognized for share-based payment awards to nonemployees shall be based on the number of instruments for which a good has been delivered or a service has been rendered. To determine the amount of compensation cost to be recognized in each period, an entity shall make an entity-wide accounting policy election for all nonemployee share-based payment awards, including share-based payment awards granted to customers, to do either of the following:

- a. Estimate the number of forfeitures expected to occur. The entity shall base initial accruals of compensation cost on the estimated number of nonemployee share-based payment awards for which a good is expected to be delivered or service is expected to be rendered. The entity shall revise that estimate if subsequent information indicates that the actual number of instruments is likely to differ from previous estimates. The cumulative effect on current and prior periods of a change in the estimates shall be recognized in compensation cost in the period of the change.
- b. Recognize the effect of forfeitures in compensation cost when they occur. Previously recognized compensation cost for a nonemployee share-based payment award shall be reversed in the period that the award is forfeited.

80. A freestanding financial instrument issued to a grantee ~~in exchange for goods or services received (or to be received)~~ that is subject to initial recognition and measurement guidance within this statement shall continue to be subject to the recognition and measurement provisions of this statement throughout the life of the instrument, unless its terms are modified after a ~~nonemployee grantee~~ vests in the award and is no longer providing goods or services, a grantee vests in the award and is no longer a customer, or a grantee is no longer an employee. Only for purposes of this paragraph, a modification does not include a change to the terms of an award if that change is made solely to reflect an equity restructuring provided that both of the following conditions are met:

- a. There is no increase in fair value of the award (or the ratio of intrinsic value to the exercise price of the award is preserved, that is, the holder is made whole) or the antidilution provision is not added to the terms of the award in contemplation of an equity restructuring.
- b. All holders of the same class of equity instruments (for example, stock options) are treated in the same manner.

81. Other modifications of that instrument that take place after a ~~nonemployee grantee~~ vests in the award and is no longer providing goods or services, is no longer a customer, or ~~a grantee~~ is no longer an employee shall be subject to the modification guidance in paragraph 83. Following modification, recognition and measurement of the instrument shall be determined through reference to other applicable statutory accounting principles.

Subsequent Measurement - Awards Classified as Liabilities

97. Changes in the fair value (or intrinsic value for a reporting entity that elects that method) of a liability incurred under a share-based payment arrangement [issued in exchange for goods or services](#) that occur during the employee's requisite service period or the nonemployee's vesting period shall be recognized as compensation cost over that period. The percentage of the fair value (or intrinsic value) that is accrued as compensation cost at the end of each period shall equal the percentage of the requisite service that has been rendered for an employee award or the percentage that would have been recognized had the grantor paid cash for the goods or services instead of paying with a nonemployee award at that date. Changes in the fair value (or intrinsic value) of a liability [issued in exchange for goods or services](#) that occur after the end of the employee's requisite service period or the nonemployee's vesting period are compensation costs of the period in which the changes occur. Any difference between the amount for which a liability award [issued in exchange for goods or services](#) is settled and its fair value at the settlement date as estimated in accordance with the provisions of this statement is an adjustment of compensation cost in the period of settlement.

98. Reporting entities shall measure a liability award under a share-based payment arrangement based on the award's fair value (or permitted value in accordance with paragraph 52) remeasured at each reporting date until the date of settlement. Compensation costs for each period until settlement shall be based on the change (or a portion of the change, depending on the percentage of the requisite service that has been rendered for an employee award or the percentage that would have been recognized had the grantor paid cash for the goods and services instead of paying with a nonemployee award at the reporting date) in the fair value of the instrument for each reporting period. [A reporting entity shall subsequently measure awards determined to be consideration payable to a customer at fair value.](#)

Effective Date and Transition

132. Since the initial adoption of SSAP No. 104, subsequent revisions were effective as follows:

- b. [ASU 2019-08, Compensation—Stock Compensation \(Topic 718\) and Revenue from Contracts with Customers \(Topic 606\): Codification Improvements—Share-Based Consideration Payable to a Customer.](#)

REFERENCES

Other

- *SSAP No. 12—Employee Stock Ownership Plans*

Proposed Revisions to SSAP No. 47—Uninsured Plans

RELEVANT LITERATURE

15. This statement rejects *ASU 2014-09, Revenue from Contracts with Customers*; *ASU 2015-14, Revenue From Contracts With Customers*; *ASU 2016-08, Revenue From Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*; *ASU 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing*; *ASU 2016-12, Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients*; *ASU 2016-20,*

Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers; ASU 2018-18, Collaborative Arrangements (Topic 808), Clarifying the Interaction between Topic 808 and Topic 606, [the Topic 606 guidance included in ASU 2019-08, Codification Improvements to Stock Compensation \(Topic 718\) and Share-Based Consideration Payable to a Customer \(Topic 606\)](#), ASU 2021-02, Franchisors—Revenue from Contracts with Customers, ASU 2021-08, Business Combinations, Accounting for Contract Assets and Contract Liabilities from Contracts with Customers

Staff Review Completed by:

NAIC Staff – William Oden, February 2023

Status:

On March 22, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 95, SSAP No. 104R, and SSAP No. 47 to adopt, with modification, *ASU 2019-08 Compensation—Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606): Codification Improvements—Share-Based Consideration Payable to a Customer*, as illustrated above.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to SSAP Nos. 47, 95, and 104R to adopt, with modification, ASU 2019-08 which expands the scope of stock compensation guidance to share-based consideration payable to customers.

[https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/APPTF/2023-2 Summer/Summary and Minutes/SAPWG/Attachments/Att1J-2023-07 ASU 2019-08.docx](https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member%20Meetings/E%20CMTE/APPTF/2023-2%20Summer/Summary%20and%20Minutes/SAPWG/Attachments/Att1J-2023-07%20ASU%202019-08.docx)

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

Issue: ASU 2019-07, Codification Updates to SEC Sections

Check (applicable entity):

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

Description of Issue:

FASB issued *ASU 2019-07—Codification Updates to SEC Sections: Amendments to SEC Paragraphs Pursuant to SEC Final Rule Releases No. 33-10532, Disclosure Update and Simplification, and Nos. 33-10231 and 33-10442, Investment Company Reporting Modernization, and Miscellaneous Updates*, which primarily effects the codifications of Financial Services—Depository and Lending (Topic 942), Financial Services—Insurance (Topic 944), and Financial Services—Investment Companies (Topic 946). The update amends and supersedes certain SEC sections in Topic 942, 944, and 946 to align codification guidance with SEC Releases No. 33-10532, 33-10231, and 33-10442. These SEC Releases amend a wide range of disclosure requirements which were determined to be redundant, duplicative, overlapping, outdated, or superseded by other relevant literature. Additionally, the SEC Releases include several miscellaneous updates and corrections intended to clarify SEC guidance.

Existing Authoritative Literature:

Historically, SEC guidance from ASUs have been rejected as not applicable for statutory accounting in Appendix D. Regardless, all ASUs are reviewed for statutory accounting purposes to determine if the guidance should be considered for statutory accounting.

Debt is covered in *SSAP No. 15—Debt and Holding Company Obligations*, surplus is covered in *SSAP No. 72—Surplus and Quasi-Reorganizations*, and consolidation guidance is discussed in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated 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.

Per the comment letter received on June 9, 2023, interested parties had no comments on Agenda item 2023-08.

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 a SAP clarification, and expose revisions to *Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2019-07—Codification Updates to SEC Sections: Amendments to SEC Paragraphs Pursuant to SEC Final Rule Releases No. 33-10532, Disclosure Update and Simplification, and Nos. 33-10231 and 33-10442, Investment Company Reporting Modernization, and Miscellaneous Updates* as not applicable to statutory accounting. This

item is proposed to be rejected as not applicable as ASU 2019-07 is specific to amendment of SEC paragraphs, which are not applicable for statutory accounting purposes.

Staff Review Completed by: William Oden – February 2023

Status:

On March 22, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to Appendix D to reject *ASU 2019-07—Codification Updates to SEC Sections: Amendments to SEC Paragraphs Pursuant to SEC Final Rule Releases No. 33-10532, Disclosure Update and Simplification, and Nos. 33-10231 and 33-10442, Investment Company Reporting Modernization, and Miscellaneous Updates* as not applicable to statutory accounting.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject ASU 2019-07 as not applicable to statutory accounting.

[https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/APPTF/2023-2 Summer/Summary and Minutes/SAPWG/Attachments/Att1K-2023-08 ASU 2019-07.docx](https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member%20Meetings/E%20CMTE/APPTF/2023-2%20Summer/Summary%20and%20Minutes/SAPWG/Attachments/Att1K-2023-08%20ASU%202019-07.docx)

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

Issue: *ASU 2020-09—Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)*

Check (applicable entity):

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

Description of Issue:

FASB issued *ASU 2020-09, Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)*, which effects the codification in Debt (Topic 470). The update amends and supersedes certain SEC sections in Topic 470 to align codification guidance with SEC Release No. 33-10762. No. 33-10762 amends the SEC financial disclosure requirements for guarantors and issuers of guaranteed securities registered or being registered, and issuers' affiliates whose securities collateralize securities registered or being registered in Regulation S-X to improve those requirements for both investors and registrants. The changes are intended to provide investors with material information given the specific facts and circumstances, make the disclosures easier to understand, and reduce the costs and burdens to registrants.

Existing Authoritative Literature:

Historically, SEC guidance from ASUs have been rejected as not applicable for statutory accounting in Appendix D. Regardless, all ASUs are reviewed for statutory accounting purposes to determine if the guidance should be considered for statutory accounting.

Debt is covered in *SSAP No. 15— Debt and Holding Company Obligations*. Basic discussion of the nature of liabilities is covered in *SSAP No. 5R— Liabilities, Contingencies and Impairments of Assets*.

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):

Per the comment letter received on June 9, 2023, interested parties had no comments on Agenda item 2023-09.

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 a SAP clarification, and expose revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2020-09, Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)* as not applicable to statutory accounting. This guidance is not applicable as it pertains to an exception of issuers or guarantors filing financial statements with the SEC when the issuer or guarantor is included in filed consolidated financial statements and other conditions are met.

Staff Review Completed by: William Oden – February 2023

Status:

On March 22, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to Appendix D to reject *ASU 2020-09, Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)* as not applicable to statutory accounting.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject ASU 2020-09 as not applicable to statutory accounting.

[https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/APPTF/2023-2 Summer/Summary and Minutes/SAPWG/Attachments/Att1L-2023-09 ASU 2020-09.docx](https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member%20Meetings/E%20CMTE/APPTF/2023-2%20Summer/Summary%20and%20Minutes/SAPWG/Attachments/Att1L-2023-09%20ASU%2020-09.docx)

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

Issue: *ASU 2022-05, Transition for Sold Contracts*

Check (applicable entity):

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

Description of Issue: This agenda item has been drafted to consider *ASU 2022-05, Transition for Sold Contracts* (ASU) for statutory accounting. The FASB issued the ASU in December 2022 to amend specific sections of *ASU 2018-12, Targeted Improvements for Long-Durations Contracts* (LDTI). The amendments made by the ASU are intended to reduce implementation costs and complexity associated with the adoption of LDTI for contracts that have been derecognized in accordance with the ASU before the LDTI effective date. The revisions captured in the ASU are summarized as follows:

The amendments in the ASU amend the LDTI transition guidance to allow an insurance entity to make an accounting policy election on a transaction-by-transaction basis. An insurance entity may elect to exclude contracts that meet certain criteria from applying the amendments in the LDTI. To qualify for the accounting policy election, as of the LDTI effective date both of the following conditions must be met:

- a. The insurance contracts must have been derecognized because of a sale or disposal of individual or a group of contracts or legal entities.
- b. The entity has no significant continuing involvement with the derecognized contracts.

ASU 2018-12, as amended by 2022-05, is effective for public entities for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. For nonpublic entities, the LDTI is effective for fiscal years beginning after December 15, 2024, and interim periods within fiscal years beginning after December 15, 2025. The LDTI 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 rejected 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 |
|--|---|
| <i>FAS 60, Accounting and Reporting by Insurance Entities</i> | 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 |
| <i>FAS 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments</i> | Rejected in SSAP No. 50, SSAP No. 51R, SSAP No. 52 and SSAP No. 71 |
| <i>FSP FAS 97-1, Situations in Which Paragraphs 17(b) and 20 of FAS 97 Permit or Require Accrual of an Unearned Revenue Liability</i> | Not Board Directed |
| <i>SOP 95-1, Accounting for Certain Insurance Activities of Mutual Life Insurance Enterprises</i> | Rejected in SSAP No. 51R and SSAP No. 52 |
| <i>SOP 03-1, Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts</i> | Rejected in SSAP No. 56 |
| <i>SOP 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchange of Insurance Contracts</i> | Rejected in SSAP No. 71 |
| <i>SOP 00-3, Accounting by Insurance Enterprises for Demutualizations and Formations of Mutual Insurance Holding Companies and for Certain Long-Duration Participating Contracts</i> | Pending SAP |
| <i>AICPA Practice Bulletin 8, Application of FAS 97 to Insurance Enterprises</i> | Rejected in SSAP No. 51R and SSAP No. 52R |
| <u>ASU 2018-12, Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts</u> | <u>Rejected in Preamble, SSAP No. 50, SSAP No. 51R, SSAP No. 52, SSAP No. 54R, SSAP No. 55, SSAP No. 56, SSAP No. 71, and SSAP No. 86</u> |

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):

Per the comment letter received on June 9, 2023, interested parties support the conclusion reached on Agenda item 2023-07.

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 a SAP clarification, and expose proposed revisions to reject *ASU 2022-05, Transition for Sold Contracts* as not applicable for statutory accounting 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*. The guidance in *ASU 2022-05* provides updated transition guidance for *ASU 2018-12*, which had previously been rejected for statutory accounting. The proposed revisions are illustrated below:

SSAP No. 50—Classifications of Insurance or Managed Care Contracts

46. This statement rejects the U.S. GAAP classifications (i.e., short-duration and long-duration) found in [ASU 2022-05 Transition for Sold Contracts](#), *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

56. This statement rejects [ASU 2022-05 Transition for Sold Contracts](#), *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

25. This statement rejects [ASU 2022-05 Transition for Sold Contracts](#), *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

41. This statement rejects [ASU 2022-05 Transition for Sold Contracts](#), 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.

SSAP No. 71—Policy Acquisition Costs and Commissions

6. This statement rejects [ASU 2022-05 Transition for Sold Contracts](#), 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*.

SSAP No. 86—Derivatives

73. This statement rejects [ASU 2022-05 Transition for Sold Contracts](#), 2020-06, *Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity’s Own Equity (Subtopic 815-40)*, *Accounting for Convertible Instruments and Contracts in an Entity’s Own Equity*, ASU 2020-01, *Investments—Equity Securities (Topic 321)*, *Investments—Equity Method and Joint Ventures (Topic 323)*, and *Derivatives and Hedging (Topic 815)*, *Clarifying the Interactions between Topic 321, Topic 323 and Topic 815*, 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*.

Staff Review Completed by:

William Oden, NAIC Staff – December 2022

Status:

On March 22, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification to reject ASU 2022-05, *Transition for Sold 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*, which is consistent with prior agenda items related to this topic.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to reject ASU 2022-05 in SSAP Nos. 50, 51R, 52, 56, 71, and 86.

[https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/APPTF/2023-2 Summer/Summary and Minutes/SAPWG/Attachments/Att1M-2023-10 ASU 2022-05.docx](https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member%20Meetings/E%20CMTE/APPTF/2023-2%20Summer/Summary%20and%20Minutes/SAPWG/Attachments/Att1M-2023-10%20ASU%2022-05.docx)

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

Issue: PIK Interest Disclosure Clarification

Check (applicable entity):

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

Description of Issue: This agenda item has been developed to further clarify, and incorporate a practical expedient, to the paid-in-kind (PIK) interest aggregate disclosure adopted in *SSAP No. 34—Investment Income Due and Accrued* for year-2023. In response to questions received on how paydowns / disposals would impact PIK interest included in the cumulative balance, it was noted that clarifying guidance would assist with consistent application. Furthermore, without clarification it was identified that companies and investment software vendors may interpret the need to detail the retrospective PIK allocations and paydowns / disposals as evidence for the resulting amount.

To eliminate the potential inconsistent application on how paydowns / disposals impact PIK interest included in cumulative principal / par balance, as well as to streamline the calculation, this agenda item proposes the following clarifications:

- Any decreasing amounts to principal balances (paydowns / disposals / sales, etc.) shall first be applied to any PIK interest included in the principal balance. For example, if original par was \$100, PIK interest received overtime was \$50 and paydowns received were \$30, the resulting PIK included in the cumulative balance would be \$20 - (\$50 less \$30). No reduction to the original principal would occur until the PIK interest had been fully eliminated from the balance. If in this scenario paydowns of \$70 had occurred, the company would report zero in the disclosure for cumulative PIK interest, as the amount received would have fully eliminated the \$50 in PIK interest.
- The determination of PIK interest in cumulative balance can be calculated through a practical expedient calculation of original par / principal value to current par / principal value, not to go less than zero. This calculation will determine the resulting balance from PIK interest over time as well as paydowns / disposals, etc. The intent of this calculation is to prevent companies and investment software vendors from creating a schedule that details PIK interest and paydowns received retroactively since the origination of the investment. The practical expedient calculation from the original to current par / principal value shall result with the same resulting PIK interest amount included in the cumulative balance without the retroactive scheduling required.

The adopted disclosure in SSAP No. 34 is not intended to change, but the proposed clarification and practical expedient guidance is intended to be captured in the annual statement instructions. This agenda item is being exposed at the SAPWG, as the source of the adopted disclosure, and will be used to subsequently provide a memo to blanks for year-end 2023 application and to revise the formal instructions for 2024.

Existing Authoritative Literature:

• **SSAP No. 34—Investment Income Due and Accrued**

Disclosures

7. The following disclosures shall be made for investment income due and accrued in the financial statements. (SSAP No. 37 captures disclosures for mortgage loans on nonaccrual status pursuant to paragraph 6.)

- a. The bases by category of investment income for excluding (nonadmitting) any investment income due and accrued;
- b. Disclose total amount excluded;
- c. Disclose the gross, nonadmitted and admitted amounts for interest income due and accrued;
- d. Disclose aggregate deferred interest;
- e. Disclose cumulative amounts of paid-in-kind (PIK) interest included in the current principal balance.

• **A/S Instructions – Life, Accident and Health / Fraternal Companies**

7. Investment Income Instruction:

Disclose the following for investment income due and accrued in the financial statements:

- A. The bases, by category of investment income, for excluding (nonadmitting) any investment income due and accrued,
- B. The total amount excluded.
- C. The gross, nonadmitted and admitted amounts for interest income due and accrued. (1) Gross amount for interest income due and accrued. (2) Nonadmitted amount for interest income due and accrued. (3) Admitted amount for interest income due and accrued.
- D. The aggregate deferred interest.
- E. The cumulative amounts of paid-in-kind (PIK) interest included in the current principal balance.

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 2022-17: Interest Income Disclosure update was adopted March 22, 2023. This disclosure data-captured existing and incorporated new disclosures, to SSAP No. 34, which included the cumulative amount of paid-in-kind (PIK) interest included in the current principal balance. The revisions were adopted for year-end 2023 and are shown in the authoritative literature section above.

- Blanks Proposal 2023-11BWG intends to adopt instructions and illustrations for the revised disclosures in May 2023.

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

Convergence with International Financial Reporting Standards (IFRS): NA

Recommendation:

NAIC staff recommend that the Working Group include this item on their maintenance agenda as a SAP clarification and expose this agenda item to clarify and incorporate a practical expedient, to the paid-in-kind (PIK) interest aggregate disclosure for SSAP No. 34 and annual statement instruction purposes. For annual statement purposes, this instruction will be an editorial change only and can be provided by the SAPWG in a memo posted on the Blanks Working (E) Group page if adopted after the deadline to incorporate into the annual statement instructions for 2023. Comments on this exposure are requested by June 30, 2023, to allow for adoption consideration at the 2023 Summer National Meeting.

Proposed Revisions to SSAP No. 34

7. The following disclosures shall be made for investment income due and accrued in the financial statements. (SSAP No. 37 captures disclosures for mortgage loans on nonaccrual status pursuant to paragraph 6.)
- a. The bases by category of investment income for excluding (nonadmitting) any investment income due and accrued;
 - b. Disclose total amount excluded;
 - c. Disclose the gross, nonadmitted and admitted amounts for interest income due and accrued;
 - d. Disclose aggregate deferred interest;
 - e. Disclose cumulative amounts of paid-in-kind (PIK) interest included in the current principal balance: par value^{FN}.

New Footnote: In disclosing the cumulative amount of PIK interest, identify the specific amounts of PIK interest by lot and aggregate the amounts by CUSIP/PPN that have a net increase to the original par value. The net increase includes PIK interest added to the par value less disposals (i.e., repayments; sales) that are first applied to any PIK interest outstanding. As a practical expedient, an insurer may calculate the cumulative amount of PIK interest on a bond by subtracting the original principal / par value from the current principal / par value, but not less than \$0.

Proposed instruction for inclusion in the Annual Statement Instructions (or 2023 memo to Blanks):

7. Investment Income Instruction:
- Disclose the following for investment income due and accrued in the financial statements:
- A. The bases, by category of investment income, for excluding (nonadmitting) any investment income due and accrued,
 - B. The total amount excluded.

- C. The gross, nonadmitted and admitted amounts for interest income due and accrued. (1) Gross amount for interest income due and accrued. (2) Nonadmitted amount for interest income due and accrued. (3) Admitted amount for interest income due and accrued.
- D. The aggregate deferred interest.
- E. The cumulative amounts of paid-in-kind (PIK) interest included in the current principal balance.

For the PIK interest included in the current principal balance, include the amount of reported interest in which the terms permit "paid in kind" (PIK) instead of cash. The amount reported shall reflect the cumulative amount of PIK interest included in the current principal balance / par value. In disclosing the cumulative amount of PIK interest, identify the specific amounts of PIK interest by lot and aggregate the amounts by CUSIP/PPN that have a net increase to the original par value. The net increase includes PIK interest added to the par value less disposals (i.e., repayments; sales) that are first applied to any PIK interest outstanding. As a practical expedient, an insurer may calculate the cumulative amount of PIK interest on a bond by subtracting the original principal / par value from the current principal / par value, but not less than \$0.

Staff Review Completed by: Julie Gann - NAIC Staff, May 2023

Status:

On May 16, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 34 and the Annual Statement Instructions to clarify and incorporate a practical expedient to the paid-in-kind (PIK) interest aggregate disclosure. These SSAP No. 34 revisions, when adopted, will also result in editorial changes to the annual statement instructions.

August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to SSAP No. 34 and directed that the proposed updates to the Annual Statement Instructions be forwarded to the Blanks (E) Working Group. These revisions provide a practical expedient to the paid-in-kind (PIK) interest aggregate disclosure.

[https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/APPTF/2023-2 Summer/Summary and Minutes/SAPWG/ Attachments/Att1N-2023-13 SSAP 34.docx](https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member%20Meetings/E%20CMTE/APPTF/2023-2%20Summer/Summary%20and%20Minutes/SAPWG/Attachments/Att1N-2023-13%20SSAP%2034.docx)

The Guidance in this Statement is Effective January 1, 2025

Statement of Statutory Accounting Principles No. 26

Bonds

STATUS

| | |
|-----------------------------------|--|
| Type of Issue..... | Common Area |
| Issued | August 13, 2023 |
| Effective Date | January 1, 2025 |
| Affects..... | Replaces SSAP No. 26R on January 1, 2025 |
| Affected by..... | No other pronouncements |
| Interpreted by | INT 01-25; INT 06-02; INT 06-07; INT 07-01 |
| Relevant Appendix A Guidance..... | None |

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|--|-----------|
| STATUS..... | 1 |
| SCOPE OF STATEMENT | 2 |
| SUMMARY CONCLUSION..... | 3 |
| Principles-Based Bond Definition | 3 |
| Accounting and Reporting Guidance for Investments that Qualify as Issuer Credit Obligations..... | 9 |
| Acquisitions, Disposals and Changes in Unrealized Gains and Losses | 9 |
| Amortized Cost..... | 10 |
| Application of Yield-to-Worst..... | 10 |
| Balance Sheet Amount | 11 |
| Impairment | 11 |
| Income | 12 |
| Origination Fees | 13 |
| Origination, Acquisition and Commitment Costs..... | 13 |
| Commitment Fees..... | 13 |
| Exchanges and Conversions | 13 |
| SVO-Identified Bond Exchange-Traded Funds..... | 13 |
| Disclosures | 16 |
| Relevant Literature | 18 |
| Effective Date and Transition..... | 19 |
| Historical Adoption and Revisions to Original SSAP No. 26R..... | 20 |
| REFERENCES | 22 |
| Other | 22 |
| Relevant Issue Papers | 22 |
| EXHIBIT A - EXAMPLES OF ANALYSIS FOR ASSET-BACKED SECURITIES..... | 23 |
| EXHIBIT B – SYSTEMATIC VALUE CALCULATION..... | 26 |
| EXHIBIT C – AMORTIZATION TREATMENT FOR CALLABLE BONDS | 27 |

The Guidance in this Statement is Effective January 1, 2025

SCOPE OF STATEMENT

1. The principles-based definition of a bond within this statement shall be utilized to identify whether security structures should be reported as bonds. Investments that qualify within the principles-based definition as an issuer credit obligation shall follow the accounting guidance within this statement. Investments that qualify within the principles-based definition as an asset-backed security (ABS) shall follow the accounting guidance in *SSAP No. 43R—Asset-Backed Securities*.

2. In addition to security investments that qualify under the principles-based definition as issuer credit obligations, certain specific instruments are also captured in scope of this statement:

- a. Certificates of deposit that have a fixed schedule of payments and a maturity date in excess of one year from the date of acquisition;
- b. Bank loans that are obligations of operating entities issued directly by a reporting entity or acquired through a participation, syndication or assignment¹;
- c. Debt instruments in a certified capital company (CAPCO) ^(INT 06-02)
- d. Exchange Traded Funds (ETFs) that qualify for bond treatment as identified in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and included in the ‘SVO-Identified Bond ETF List’ published on the SVO’s webpage. (These instruments are referred to as SVO-Identified Bond ETFs.)
- e. Mortgage loans in scope of *SSAP No. 37—Mortgage Loans* that qualify under an SVO structural assessment and are identified as SVO-Identified Credit Tenant Loans.

3. Securities that qualify as issuer credit obligations with a maturity date of one year or less from date of acquisition that qualify as cash equivalents or short-term investments shall follow the accounting requirements of this statement. These investments are also captured in *SSAP No. 2R—Cash, Cash*

¹ **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.

The Guidance in this Statement is Effective January 1, 2025

Equivalents, Drafts and Short-Term Investments and shall follow the reporting and disclosure requirements of that statement.

4. This statement excludes:
- a. Mortgage loans and other real estate lending activities made in the ordinary course of business. These investments are addressed in *SSAP No. 37—Mortgage Loans* and *SSAP No. 39—Reverse Mortgages*.
 - b. Investments that qualify within the principles-based definition as an ABS. These investments shall follow the guidance in *SSAP No. 43R—Asset-Backed Securities*
 - c. Securities that provide varying principal or interest based on underlying equity appreciation or depreciation, an equity-based derivative, real estate or other non-debt variable, as described in paragraph 6.d.
 - d. Securities that do not qualify as bonds pursuant to the principles-based bond definition, including first loss positions that lack contractual payments or substantive credit enhancement. These investments shall follow the appropriate guidance in *SSAP No. 21R—Other Admitted Assets*.
 - e. Replication (synthetic asset) transactions addressed in *SSAP No. 86—Derivatives*. The admissibility, classification and measurement of a replication (synthetic asset) transactions are not preemptively determined by the principles-based bond definition and should be evaluated in accordance with the guidance on replication (synthetic asset) transactions within *SSAP No. 86*.
 - f. Investments that are captured specifically within other SSAPs. For example, reporting entity acquired structured settlements are captured in scope of *SSAP No. 21R—Other Admitted Assets*, held surplus notes are captured in scope of *SSAP No. 41R—Surplus Notes* and working capital finance investments are captured in scope of *SSAP No. 105—Working Capital Finance Investments*. Investments captured in scope of other SSAPs are subject to the measurement and admittance provisions of those SSAPs. Furthermore, investments that have specific reporting lines on dedicated schedules (such as with both surplus notes and WCFI) shall be reported on their dedicated lines.

SUMMARY CONCLUSION

Principles-Based Bond Definition

5. A bond shall be defined as any security² representing a creditor relationship, whereby there is a fixed schedule for one or more future payments, and which qualifies as either an issuer credit obligation or

² This statement adopts the GAAP definition of a security as it is used in FASB Accounting Standards Codification Topics 320 and 860. Evaluation of an investment under this definition should consider the substance of the instrument rather than solely its legal form.

Security: 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:

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

The Guidance in this Statement is Effective January 1, 2025

an asset-backed security as described in this statement. Determining whether a security represents a creditor relationship should consider its substance, rather than solely the legal form of the instrument. The analysis of whether a security represents a creditor relationship should consider all other investments the reporting entity owns in the investee as well as any other contractual arrangements. A security that in substance possesses equity-like characteristics or represents an ownership interest in the issuer does not represent a creditor relationship. While not intended to be all-inclusive, paragraphs 6.a.-6.d. discuss specific elements that may introduce equity-like characteristics:

- a. Determining whether a debt instrument represents a creditor relationship in substance when the source of cash flows for repayment is derived from underlying equity interests inherently requires significant judgment and analysis. Unlike a debt instrument collateralized by assets with contractual cash flows, debt instruments collateralized by equity interests are dependent on cash flow distributions that are not contractually required to be made and are not controlled by the issuer of the debt. As a result, there is a rebuttable presumption that a debt instrument collateralized by equity interests does not represent a creditor relationship in substance. Notwithstanding this rebuttable presumption, it is possible for such a debt instrument to represent a creditor relationship if the characteristics of the underlying equity interests lend themselves to the production of predictable cash flows and the underlying equity risks have been sufficiently redistributed through the capital structure of the issuer. Factors to consider in making this determination include but are not limited to:
 - i. Number and diversification of the underlying equity interests
 - ii. Characteristics of the underlying equity interests (vintage, asset-types, etc.)
 - iii. Liquidity facilities
 - iv. Overcollateralization
 - v. Waiting period for distributions/paydowns to begin
 - vi. Capitalization of interest
 - vii. Covenants (e.g., loan-to-value trigger provisions)
 - viii. Reliance on ongoing sponsor commitments
- b. While reliance of the debt instrument on sale of underlying equity interests or refinancing at maturity does not preclude the rebuttable presumption from being overcome, it does require that the other characteristics mitigate the inherent reliance on equity valuation risk to support the transformation of underlying equity risk to bond risk. As reliance on sale or refinancing increases, the more compelling the other factors needed to overcome the rebuttable presumption become.
- c. Analysis of whether the rebuttable presumption for underlying equity interests is overcome shall be conducted and documented by a reporting entity at the time such an investment is acquired. The level of documentation and analysis required will vary based on the characteristics of the individual debt instrument, as well as the level of third-party and/or non-insurance company market validation to which the issuance has been subjected. For example, a debt instrument collateralized by fewer, less diversified equity interests would require more extensive and persuasive documented analysis than one collateralized by a larger diversified portfolio of equity interests. Likewise, a debt instrument that has been successfully marketed to unrelated and/or non-insurance company investors, may provide enhanced market validation of the structure compared to one held only by related party and/or insurance company investors where capital relief may be the primary motivation for the securitization.

The Guidance in this Statement is Effective January 1, 2025

- d. In order for a debt instrument to represent a creditor relationship in accordance with Paragraph 6, it must have pre-determined principal and interest payments (whether fixed interest or variable interest) with contractual amounts that do not vary based on the appreciation or depreciation (i.e., performance) of any underlying collateral value or other non-debt variable. For example, an issued security that has varying principal and interest payments based on the appreciation of referenced equity, real estate or other non-debt variable is precluded from bond treatment. This exclusion is not intended to restrict variables that are commonly related to debt instruments such as, but not limited to, plain-vanilla³ inflation or benchmark interest rate adjustments (such as with U.S. TIPs or SOFR-linked coupons, respectively), scheduled interest rate step-ups, or credit-quality related interest rate adjustments. This exclusion is also not intended to encompass nominal interest rate adjustments⁴. For clarification purposes, all returns from a debt instrument in excess of principal are required to be considered as interest. Therefore, investments with “stated” interest and then “additional returns” to which the holder of the debt instrument is entitled are collectively considered as interest and shall be assessed together in determining whether the investment has variable principal or interest due to underlying referenced non-debt variables. Examples of securities excluded from the bond definition under this guidance:
- i. Structured Notes, which are securities that otherwise meet the definition of a bond, but for which the contractual amount of the instrument to be paid at maturity (or the original investment) is at risk for other than the failure of the borrower to pay the principal amount due, are excluded from the bond definition. These investments, although in the form of a debt instrument, incorporate the risk of an underlying variable in the terms of the agreement, and the issuer obligation to return the full principal is contingent on the performance of the underlying variable. These investments are addressed in *SSAP No. 86—Derivatives*. Mortgage-referenced securities issued by a government sponsored enterprise are explicit inclusions in scope of *SSAP No. 43*. Foreign-denominated bonds subject to variation as a result of foreign currency fluctuations are not structured notes.
 - ii. Principal-protected securities, as defined in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* are excluded from the bond definition as they have a performance component whose payments originate from, or are determined by, non-fixed income securities. These investments shall follow the guidance for non-bond securities in *SSAP No. 21—Other Admitted Assets*.

³ Inflation or benchmark interest rate adjustment mechanisms are considered plain-vanilla if based on widely recognized measures of inflation or interest rate benchmarks and excludes those that involve either leverage (such as a multiplier) or an inverse adjustment relationship.

⁴ Nominal interest rate adjustments are those that are too small to be taken into consideration when assessing the investment’s substance as a bond. Nominal adjustments are not typically influential factors in an investors’ evaluation of investment return and are often included to incentivize certain behavior of the issuer. An example would include sustainability-linked bonds where failure to achieve performance metrics could cause interest rate adjustments. In general, interest rate adjustments that adjust the total return from interest by more than 10% (e.g., >0.4% for a 4% yielding bond), would not be considered nominal. Further, any such adjustments that cause an investment to meet the definition of a structured note would not be considered nominal.

The Guidance in this Statement is Effective January 1, 2025

6. An issuer credit obligation is a bond, for which the general creditworthiness of an operating entity or entities through direct or indirect recourse, is the primary⁵ source of repayment. Operating entity or entities includes holding companies with operating entity subsidiaries where the holding company has the ability to access the operating subsidiaries' cash flows through its ownership rights. An operating entity may be any sort of business entity, not-for-profit organization, governmental unit, or other provider of goods or services, but not a natural person or "ABS Issuer" (as defined in paragraph 8). Examples of issuer credit obligations include, but are not limited to:

- a. U.S. Treasury securities, including U.S. Treasury Inflation-Indexed Securities;^(INT 01-25)
- b. U.S. government agency securities;
- c. Municipal securities issued by the municipality or supported by cash flows generated by a municipally-owned asset or entity that provides goods or services (e.g., airport, toll roads, etc.);
- d. Corporate bonds issued by operating entities, including Yankee bonds and zero-coupon bonds;
- e. Corporate bonds, issued by holding companies that own operating entities;
- f. Project finance bonds issued by operating entities;
- g. Investments in the form of securities for which repayment is fully supported by an underlying contractual obligation of a single operating entity (e.g., Credit Tenant Loans (CTLs), Equipment trust certificates (ETCs), other lease backed securities, Funding Agreement Backed Notes (FABNs), etc.). For purposes of applying this principal concept, repayment is fully-supported by the underlying operating entity obligation if it provides cash flows for the repayment of all interest and at least 95% of the principal of the security.
- h. Bonds issued by real estate investment trusts (REITs) or similar property trusts;
- i. Bonds issued by business development corporations, closed-end funds, or similar operating entities, in each case registered under the 1940 Act.
- j. Convertible bonds issued by operating entities, including mandatory convertible bonds as defined in paragraph 20.b.

⁵ "Primary" refers to the first in order of repayment source, not to a majority of the sources of repayment. For example, an issuer obligation may have secondary recourse to collateral upon default of the operating entity but would otherwise be expected to be fully repaid with cash flows of the operating entity. This differs from an asset-backed security for which the primary source of repayment is from cash flows of the collateral.

The Guidance in this Statement is Effective January 1, 2025

7. An asset-backed security⁶ is a bond issued by an entity (an “ABS Issuer”) created for the primary purpose of raising debt capital backed by financial assets⁷ or cash generating non-financial assets owned by the ABS Issuer, for which the primary source of repayment is derived from the cash flows associated with the underlying defined collateral rather than the cash flows of an operating entity⁸. In most instances, the ABS Issuer is not expected to continue functioning beyond the final maturity of the debt initially raised by the ABS Issuer. Also, many ABS Issuers are in the form of a trust or special purpose vehicle (“SPV”), although the presence or lack of a trust or SPV is not a definitive criterion for determining that a security meets the definition of an asset-backed security. The provisions in paragraphs 9-10 detail the two defining characteristics that must be present for a security to meet the definition of an asset-backed security.

8. The assets owned by the ABS Issuer are either financial assets or cash-generating non-financial assets. Cash-generating non-financial assets are defined as assets that are expected to generate a meaningful level of cash flows toward repayment of the bond through use, licensing, leasing, servicing or management fees, or other similar cash flow generation. For the avoidance of doubt, there must be a meaningful level of cash flows to service the debt, other than through the sale or refinancing of the underlying assets held by the ABS Issuer. Reliance on cash flows from the sale or refinancing of cash generating non-financial assets does not preclude a security from being classified as an asset-backed security so long as the conditions in this paragraph are met.

- a. *Meaningful Level of Cash Flows*: Determining what constitutes a “meaningful” level of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral pursuant to paragraph 9 is specific to each transaction, determined at origination, and shall consider the following factors:
- i. The price volatility in the principal market for the underlying collateral;
 - ii. The liquidity in the principal market for the underlying collateral;
 - iii. The diversification characteristics of the underlying collateral (i.e., types of collateral, geographic location(s), source(s) of cash flows within the structure, etc.);
 - iv. The overcollateralization of the underlying collateral relative to the debt obligation; and
 - v. The variability of cash flows, from sources other than sale or refinancing, expected to be generated from the underlying collateral.

⁶ The underlying collateral supporting an asset-backed security shall meet the definition of an asset by the ABS Issuer. Certain forms of collateral, such as rights to future cash flows, may not be recognized as assets by the selling entity but may be recognized as assets when sold to an ABS Issuer. These assets are permitted as the collateral supporting an asset-backed security, although they may not represent an asset that can be liquidated to provide payment toward the issued debt obligations (i.e., if the future cash flows do not materialize). The limited ability to liquidate the underlying collateral supporting an asset-backed security does not impact the structural determination of whether an issued security meets the definition of an asset-backed security but may impact the recoverability of the investment, as well as the consideration of whether there is sufficient credit enhancement.

⁷ *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* defines a financial asset as cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right (a) to receive cash or another financial instrument from a second entity or (b) to exchange other financial instruments on potentially favorable terms with the second entity. As a point of clarity, for the purposes of this standard, financial assets do not include assets for which the realization of the benefits conveyed by the above rights depends on the completion of a performance obligation (e.g., leases, mortgage servicing rights, royalty rights, etc.). These assets represent non-financial assets, or a means through which non-financial assets produce cash flows, until the performance obligation has been satisfied.

⁸ Dedicated cash flows from an operating entity can form the underlying defined collateral in an asset-backed security. This dynamic, perhaps noted in a whole-business securitization, still reflects an asset-backed security and is not an issuer credit obligation.

The Guidance in this Statement is Effective January 1, 2025

The factors for price variability and the variability of cash flows are directly related to the “meaningful” requirement. That is, as price volatility or variability of cash flows increase, the required percentage of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral must also increase. The factors for liquidity, diversification and overcollateralization are inversely related to the “meaningful” concept. That is, as liquidity, diversification or overcollateralization increase, the required percentage of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral may decrease.

- b. As a practical expedient to determining whether a cash generating non-financial asset is expected to produce meaningful cash flows, a reporting entity may consider an asset for which less than 50% of the original principal relies on sale or refinancing to meet the meaningful criteria. In applying this practical expedient, only contractual cash flows of the non-financial assets may be considered. This practical expedient should not be construed to mean that assets cannot meet the meaningful criteria if they rely on sale or refinancing to service greater than 50% of the original principal or if they rely on cash flows that are not contracted at origination. Rather, such instances would require a complete analysis of the considerations described within the meaningful level of cash flows definition in paragraph 9.

9. The holder of a debt instrument issued by an ABS Issuer is in a different economic position than if the holder owned the ABS Issuer’s assets directly. The holder of the debt instrument is in a different economic position if such debt instrument benefits from substantive credit enhancement through guarantees (or other similar forms of recourse), subordination and/or overcollateralization.

- a. *Substantive Credit Enhancement:* The intent of the criteria requiring the holder to be in a different economic position is to distinguish qualifying bonds from instruments with equity-like characteristics or where the substance of the transaction is more closely aligned with that of the underlying collateral. To qualify as an ABS under this standard, there is a requirement that there are substantive credit enhancements within the structure that absorb losses before the debt instrument being evaluated would be expected to absorb losses. This is inherent in the context of an issuer credit obligation in scope of SSAP No. 26R as the owners of the equity in the operating entity are the first to absorb any variability in performance of the operating entity. The same concept applies to asset-backed securities. If substantive credit enhancement did not exist, the substance of the debt instrument being evaluated would be more closely aligned with that of the underlying collateral than that of a bond. Credit enhancement that is merely nominal or lacks economic substance does not put a holder in a different economic position. The substantive credit enhancement required to be in a different economic position is specific to each transaction; determined at origination; and refers to the level of credit enhancement a market participant (i.e., knowledgeable investor transacting at arm’s length) would conclude is substantive.
- b. The first loss position may be issued as part of a securitization in the form of a debt or equity interest, or it may be retained by the sponsor and not issued as part of the securitization. If the first loss position (or a more senior position(s), if the first loss position(s) lacks contractual payments along with a substantive credit enhancement) is issued as part of the securitization, and does not have contractual principal and interest payments along with substantive credit enhancement and is held by a reporting entity, the investment(s) does not qualify for reporting as a bond and shall be reported on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value

The Guidance in this Statement is Effective January 1, 2025

consistent with the treatment for residuals. (These items are further addressed in *SSAP No. 21R—Other Admitted Assets*.)

10. Whether an issuer of debt represents an operating entity or ABS Issuer is unambiguous in most instances, but certain instances may be less clear. For example, an entity may operate a single asset such as a toll road or power generation facility (e.g., project finance) which serves to collateralize a debt issuance, and the cash flows produced by the operation of the assets are pledged to service the debt. In many such instances, the entity is structured as a bankruptcy-remote entity that is separate from the municipality or project sponsor. Such entities have characteristics of operating entities as the operation of the asset constitutes a stand-alone business. They also have many common characteristics of ABS Issuers as they are formed for the purpose of raising debt capital backed by the cash flows from collateral held by a bankruptcy-remote entity. When viewed more holistically, these issuing entities are typically being used to facilitate the financing of an operating component of a project sponsor or municipality. The use of a bankruptcy-remote entity facilitates the efficient raising of debt to finance the operating project, but the primary purpose is to finance an operating project. Therefore, structures in which the issuing entity represents a stand-alone business producing its own operating revenues and expenses, where the primary purpose is to finance an operating project, shall be considered operating entities despite certain characteristics they may share with ABS Issuers.

11. The definition of a creditor relationship, per **paragraph 6**, does not include equity/fund investments (such as mutual funds or exchanged-traded funds), or securities that possess equity-like characteristics or that represent an ownership interest in the issuer. However, as identified in **paragraph 2**, exchange traded funds (ETFs), which qualify for bond treatment, as identified in Part Three of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and included in the ‘SVO-Identified Bond ETF List’ published on the SVO’s webpage are provided special statutory accounting treatment and are included within the scope of this statement. These investments shall follow the guidance within this statement, as if they were issuer credit obligations, unless different treatment is specifically identified in **paragraphs 32-38**.

12. 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, admittance assessments and disclosure requirements of *SSAP No. 25—Affiliates and Other Related Parties*.

13. 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*.

Accounting and Reporting Guidance for Investments that Qualify as Issuer Credit Obligations⁹

Acquisitions, Disposals and Changes in Unrealized Gains and Losses

14. A bond acquisition or disposal shall be recorded on the trade date (not the settlement date) except for the acquisition of private placement bonds which shall be recorded on the funding date. At acquisition, bonds shall be reported at their cost, including brokerage and other related fees. The reported cost of a bond received as a property dividend or capital contribution shall be the initial recognized value. *SSAP No. 25* shall be used to determine whether a transfer is economic or noneconomic for initial recognition.

15. For reporting entities required to maintain an interest maintenance reserve (IMR), the accounting for realized capital gains and losses on sales of bonds shall be in accordance with *SSAP No. 7—Asset*

⁹ For all references to “bond” investments beginning in **paragraph 15**, this term intends to refer to investments that are permitted accounting and reporting treatment within scope of this standard.

The Guidance in this Statement is Effective January 1, 2025

Valuation Reserve and Interest Maintenance Reserve. For reporting entities required to maintain an asset valuation reserve (AVR), the accounting for unrealized gains and losses shall be in accordance with SSAP No. 7.

16. For reporting entities not required to maintain an IMR, realized gains and losses on sales of bonds shall be reported as net realized capital gains or losses in the statement of income. For reporting entities not required to maintain an AVR, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus).

Amortized Cost

17. Amortization of bond premium or discount shall be calculated using the scientific (constant yield) interest method taking into consideration specified interest and principal provisions over the life of the bond.¹⁰ (INT 07-01) Bonds containing call provisions (where the issuer can be called away from the reporting entity at the issuer's discretion), except "make-whole" call provisions, shall be amortized to the call or maturity value/date which produces the lowest asset value (yield-to-worst). Although the concept for yield-to-worst shall be followed for all callable bonds, make-whole call provisions, which allow the bond to be callable at any time, shall not be considered in determining the timeframe for amortizing bond premium or discount unless information is known by the reporting entity indicating that the issuer is expected to invoke the make-whole call provision.

Application of Yield-to-Worst

18. For callable bonds¹¹, the first call date after the lockout period (or the date of acquisition if no lockout period exists) shall be used as the "effective date of maturity." Depending on the characteristics of the callable bonds, the yield-to-worst concept in [paragraph 18](#) shall be applied as follows:

- a. For callable bonds with a lockout period, premium in excess of the next call price¹² (subsequent to acquisition¹³ and lockout period) shall be amortized proportionally over the length of the lockout period. After each lockout period (if more than one), remaining premium shall be amortized to the call or maturity value/date which produces the lowest asset value.
- b. For callable bonds without a lockout period, the book adjusted carrying value (at the time of acquisition) of the callable bonds shall equal the lesser of the next call price (subsequent to acquisition) or cost. Remaining premium shall then be amortized to the call or maturity value/date which produces the lowest asset value.
- c. For callable bonds that do not have a stated call price, all premiums over par shall be immediately expensed. For callable bonds with a call price at par in advance of the maturity date, all premiums shall be amortized to the call date.

¹⁰ For perpetual bonds with an effective call option, any applicable premium shall be amortized utilizing the yield-to-worst method.

¹¹ Callable bonds within the scope of [paragraph 19](#) excludes bonds with make-whole call provisions unless information is known by the reporting entity indicating that the issuer is expected to invoke the make-whole call provision. [Exhibit C](#) includes illustrations for the amortization of callable bonds.

¹² Reference to the "next call price" indicates that the reporting entity shall continuously review the call dates/prices to ensure that the amortization (and resulting BACV) follows the yield-to-worst concept throughout the time the reporting entity holds the bond.

¹³ The reporting entity shall only consider call dates/prices that occur after the reporting entity acquires the bond. If all of the call dates had expired prior to the reporting entity acquiring the bond, the reporting entity would consider the bond continuously callable without a lockout period.

The Guidance in this Statement is Effective January 1, 2025

Balance Sheet Amount

19. Bonds shall be valued and reported in accordance with this statement, the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*, and the designation assigned in the NAIC *Valuations of Securities* product prepared by the NAIC Securities Valuation Office (SVO).

- a. Bonds, except for mandatory convertible bonds: For reporting entities that maintain an asset valuation reserve (AVR), the bonds shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value. For reporting entities that do not maintain an AVR, bonds that are designated highest-quality and high-quality (NAIC designations 1 and 2, respectively) shall be reported at amortized cost; all other bonds (NAIC designations 3 to 6) shall be reported at the lower of amortized cost or fair value. For perpetual bonds which do not possess or no longer possess an effective call option, the bond shall be reported at fair value regardless of NAIC designation.
- b. Mandatory convertible bonds: Mandatory convertible bonds are subject to special reporting instructions and are not assigned NAIC designations or unit prices by the SVO. The balance sheet amount for mandatory convertible bonds shall be reported at the lower of amortized cost or fair value during the period prior to conversion. This reporting method is not impacted by NAIC designation or information received from credit rating providers (CRPs). Upon conversion, these securities will be subject to the accounting guidance of the statement that reflects their revised characteristics. (For example, if converted to common stock, the security will be in scope of *SSAP No. 30R—Unaffiliated Common Stock*, if converted to preferred stock, the security will be in scope of *SSAP No. 32R—Preferred Stocks*.)

20. The premium paid on a zero coupon convertible bond that produces a negative yield as a result of the value of a warrant exceeding the bond discount shall be written off immediately so that a negative yield is not produced. The full amount of the premium should be recorded as amortization within investment income on the date of purchase.

Impairment

21. An other-than-temporary^(INT 06-07) impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of a debt security in effect at the date of acquisition.¹⁴ A decline in fair value which is other-than-temporary includes situations where a reporting entity has made a decision to sell a security prior to its maturity at an amount below its carrying value. If it is determined that a decline in the fair value of a bond is other-than-temporary, an impairment loss shall be recognized as a realized loss equal to the entire difference between the bond's carrying value and its fair value at the balance sheet date of the reporting period for which the assessment is made. The measurement of the impairment loss shall not include partial recoveries of fair value subsequent to the balance sheet date. For reporting entities required to maintain an AVR/IMR, the accounting for the entire amount of the realized capital loss shall be in accordance with SSAP No. 7. The other-than-temporary impairment loss shall be recorded entirely to either AVR or IMR (and not bifurcated between credit and non-credit components) in accordance with the annual statement instructions.

¹⁴ If a bond has been modified from original acquisition, the guidance in *SSAP No. 36—Troubled Debt Restructuring* and paragraph 22 of *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* shall be followed, as applicable. After modification of original terms, future assessments to determine other-than-temporary impairment shall be based on the modified contractual terms of the debt instrument.

The Guidance in this Statement is Effective January 1, 2025

22. In periods subsequent to the recognition of an other-than-temporary impairment loss for a bond, the reporting entity shall account for the other-than-temporarily impaired security as if the security had been purchased on the measurement date of the other-than-temporary impairment. The fair value of the bond on the measurement date shall become the new cost basis of the bond and the new cost basis shall not be adjusted for subsequent recoveries in fair value. The discount or reduced premium recorded for the security, based on the new cost basis, shall be amortized over the remaining life of the security in the prospective manner based on the amount and timing of future estimated cash flows. The security shall continue to be subject to impairment analysis for each subsequent reporting period. Future declines in fair value which are determined to be other-than temporary shall be recorded as realized losses.

Income

23. Interest income for any period consists of interest collected during the period, the change in the due and accrued interest between the beginning and end of the period as well as reductions for premium amortization and interest paid on acquisition of bonds, and the addition of discount accrual. In accordance with *SSAP No. 34—Investment Income Due and Accrued*, investment income shall be reduced for amounts which have been determined to be uncollectible. Contingent interest may be accrued if the applicable provisions of the underlying contract and the prerequisite conditions have been met.

24. A bond may provide for a prepayment penalty or acceleration fee in the event the bond is liquidated prior to its scheduled termination date. Such fees shall be reported as investment income when received.

25. The amount of prepayment penalty and/or acceleration fee to be reported as investment income or loss shall be calculated as follows:

- a. For called or tendered bonds in which the total proceeds (consideration) received exceeds par:
 - i. The amount of investment income reported is equal to the consideration received less the par value of the investment; and
 - ii. Any difference between the book adjusted carrying value (BACV) and the par value at the time of disposal shall be reported as realized capital gains and losses, subject to the authoritative literature in SSAP No. 7.
- b. For called or tendered bonds in which the consideration received is less than par¹⁵:
 - i. To the extent an entity has in place a process to identify an explicit prepayment penalty or acceleration fee, these should be reported as investment income. (An entity shall consistently apply their process. Once a process is in place, an entity is required to maintain a process to identify prepayment penalties for called bonds in which consideration received is less than par.)
 - ii. After determining any explicit prepayment penalty or acceleration fee, the reporting entity shall calculate the resulting realized gain as the difference between

¹⁵ This guidance applies to situations in which consideration received is less than par but greater than the book adjusted carrying value (BACV). Pursuant to the yield-to-worst concept, bonds shall be amortized to the call or maturity date that produces the lowest asset value. In the event a bond has not been amortized to the lowest value prior to the call, or in cases of an accepted tender bond offer (BACV is greater than the consideration received), the entire difference between consideration received and the BACV shall be reported to investment income.

The Guidance in this Statement is Effective January 1, 2025

the remaining consideration and the BACV, which shall be reported as realized capital gain, subject to the authoritative literature in SSAP No. 7.

Origination Fees

26. Origination fees represent fees charged to the borrower in connection with the process of originating or restructuring a transaction such as the private placement of bonds. The fees include, but are not limited to, points, management, arrangement, placement, application, underwriting and other fees pursuant to such a transaction. Origination fees shall not be recorded until received in cash. Origination fees intended to compensate the reporting entity for interest rate risks (e.g., points) shall be amortized into income over the term of the bond consistent with paragraph 18 of this statement. Other origination fees shall be recorded as income upon receipt.

Origination, Acquisition and Commitment Costs

27. Costs related to origination when paid in the form of brokerage and other related fees shall be capitalized as part of the cost of the bond, consistent with paragraph 15 of this statement. All other costs, including internal costs or costs paid to an affiliated entity related to origination, purchase or commitment to purchase bonds shall be charged to expense when incurred.

Commitment Fees

28. Commitment fees are fees paid to the reporting entity that obligate the reporting entity to make available funds for future borrowing under a specified condition. A fee paid to the reporting entity to obtain a commitment to make funds available at some time in the future, generally, is refundable only if the bond is issued. If the bond is not issued, then the fees shall be recorded as investment income by the reporting entity when the commitment expires.

29. A fee paid to the reporting entity to obtain a commitment to be able to borrow funds at a specified rate and with specified terms quoted in the commitment agreement, generally, is not refundable unless the commitment is refused by the reporting entity. This type of fee shall be deferred, and amortization shall depend on whether or not the commitment is exercised. If the commitment is exercised, then the fee shall be amortized in accordance with paragraph 18 of this statement over the life of the bond as an adjustment to the investment income on the bond. If the commitment expires unexercised, the commitment fee shall be recognized in income on the commitment expiration date.

Exchanges and Conversions

30. If a bond is exchanged or converted into other securities (including conversions of mandatory convertible securities addressed in paragraph 20.b.), the fair value of the bond surrendered at the date of the exchange or conversion shall become the cost basis for the new securities with any gain or loss realized at the time of the exchange or conversion. However, if the fair value of the securities received in an exchange or conversion is more clearly evident than the fair value of the bond surrendered, then it shall become the cost basis for the new securities.

SVO-Identified Bond Exchange –Traded Funds

31. SVO-identified bond exchange-traded fund (ETF) investments, as discussed in paragraph 2.d., are captured within the scope of this statement for accounting and reporting¹⁶ purposes only. The inclusion of these investments within this statement is not intended to contradict state law regarding the classification

¹⁶ With the inclusion of these SVO-identified investments as bonds, specific guidelines are detailed in the annual statement instructions for reporting purposes.

The Guidance in this Statement is Effective January 1, 2025

of these investments and does not intend to provide exceptions to state investment limitations involving types of financial instruments (e.g., equity/fund interests), or with regards to concentration risk (e.g., issuer).

32. SVO-identified bond ETF investments shall be initially reported at cost, including brokerage and other related fees. Subsequently, SVO-identified bond ETF investments shall be reported at fair value,¹⁷ with changes in fair value recorded as unrealized gains or losses) unless the reporting entity has elected use¹⁸ of a documented systematic approach to amortize or accrete the investment in a manner that represents the expected cash flows from the underlying bond holdings. This special measurement approach is referred to as the “systematic value” measurement method and shall only be used for the SVO-identified bond ETF investments within the scope of this statement.

33. Use of the systematic value for SVO-identified bond ETF investments is limited as follows:

- a. Systematic value is only permitted to be designated as the measurement method for AVR filers acquiring qualifying investments that have an NAIC designation of 1 to 5, and for non-AVR filers acquiring qualifying investments with an NAIC designation of 1 or 2. SVO-identified investments that have an NAIC designation of 6 for AVR filers or 3-6 for non AVR filers shall be measured at fair value.
- b. Designated use of a systematic value is an irrevocable election per qualifying investment (by CUSIP) at the time investment is originally acquired¹⁹. Investments owned prior to being identified by the SVO as a qualifying SSAP No. 26R investment are permitted to be subsequently designated to the systematic value measurement method. This designation shall be applied as a change in accounting principle pursuant to *SSAP No. 3—Accounting Changes and Corrections of Errors*, which requires the reporting entity to recognize a cumulative effect to adjust capital and surplus as if the systematic value measurement method had been applied retroactively for all prior periods in which the investment was held. The election to use systematic value for investments shall be made before the year-end reporting of the investment in the year in which the SVO first identifies the investment as a qualifying SSAP No. 26R investment.
- c. Once designated for a particular investment, the systematic value measurement method must be retained as long as the qualifying investment is held by the reporting entity and the investment remains within the scope of this statement with an allowable NAIC designation per paragraph 34.a. Upon a full sale/disposal of an SVO-identified investment (elimination of the entire CUSIP investment), after 90 days the reporting entity can reacquire the SVO-identified investment and designate a different measurement method. If the reporting entity was to reacquire the same investment within 90 days after it was sold/disposed, the reporting entity must utilize the measurement method previously designated for the investment. Subsequent/additional purchases of the same SVO-identified investment (same CUSIP) already held by a reporting entity must follow the election previously made by the reporting entity. If an investment no longer qualifies for a systematic value

¹⁷ For these investments, net asset value (NAV) is allowed as a practical expedient to fair value.

¹⁸ The election to use systematic value is not a permitted or prescribed practice as it is an accounting provision allowed within this SSAP. Similarly, this election does not override state statutes, and if a state does not permit reporting entities the election to use systematic value as the measurement method, this is also not considered a permitted or prescribed practice. SVO-identified investments reported at fair value (NAV) or systematic value, if in accordance with the provisions of this standard, are considered in line with SSAP No. 26R and do not require permitted or prescribed disclosures under *SSAP No. 1—Accounting Policies, Risks & Uncertainties and Other Disclosures*.

¹⁹ This guidance requires investments purchased in lots to follow the measurement method established at the time the investment was first acquired.

The Guidance in this Statement is Effective January 1, 2025

measurement because the NAIC designation has declined, then the security must be subsequently reported at the lower of “systematic value” or fair value. If the security has been removed from the SVO-identified listings, and is no longer in scope of this statement, then the security shall be measured and reported in accordance with the applicable SSAP.

- d. Determination of the designated systematic value must follow the established²⁰ approach, which is consistently applied for all SVO-identified bond ETF investments designated for a systematic value. In all situations, an approach that continuously reflects “original” or “historical cost” is not an acceptable measurement method. The designated approach shall result with systematic amortization or accretion of the equity/fund investment in a manner that represents the expected cash flows from the underlying bond holdings.

34. Income distributions received from SVO-identified bond ETF investments (cash or shares) shall be reported as interest income in the period in which it is earned. For those SVO-identified bond ETF investments where the systematic value method is applied, interest income shall be recognized based on the book yield applied to the carrying value each period, similar to bonds.

35. For reporting entities required to hold an IMR and AVR reserve, realized and unrealized gains and losses for the SVO-identified bond ETF investments shall be consistent with bonds within the scope of this standard. With this guidance, recognition of gains/losses (and corresponding AVR/IMR impacts) will be based on the ETF, and not activity that occurs within the ETF (e.g., such as changes in the underlying bonds held within the ETF). Also consistent with the guidance for bonds, recognized losses from other-than-temporary impairments shall be recorded entirely to either AVR or IMR (and not bifurcated between credit and non-credit components) in accordance with the annual statement instructions.

36. SVO-identified bond ETF investments reported at systematic value shall recognize other-than-temporary impairments in accordance with the following guidance:

- a. A decision to sell an SVO-identified bond ETF investment that has a fair value less than systematic value results in an other-than-temporary impairment that shall be recognized.
- b. In situations in which an SVO-identified bond ETF investment has a fair value that is less than systematic value, the reporting entity must assess for other-than-temporary impairment. For these investments, a key determinant, along with other impairment indicators in *INT 06-07: Definition of Phrase “Other Than Temporary,”* shall be whether the net present value of the projected cash flows for the underlying bonds in the SVO-identified investment have materially²¹ declined from the prior reporting period (most recent issued financial statements) or from the date of acquisition. In calculating the net present value of the projected cash flows for each reporting period, entities shall discount cash flows using a constant purchase yield, which is the initial book yield at acquisition. Consistent with INT 06-07, a predefined threshold to determine whether the decline in projected cash flows (e.g., percentage change) shall result in an other than temporary impairment has not been set, as exclusive reliance on such thresholds removes the ability of management to apply its judgement.

²⁰ Exhibit B details the established systematic value approach.

²¹ The net present value of cash flows will decline in a declining interest rate environment. Reporting entities shall use judgment when assessing whether the decline in cash flows is related to a decline in interest rates or the result of a non-interest related decline, and determine whether the decline represents an OTTI pursuant to INT 06-07.

The Guidance in this Statement is Effective January 1, 2025

- c. Upon identification of an SVO-identified investment as OTTI, the reporting entity shall recognize a realized loss equal to the difference between systematic value and the current fair value. (Although the determination of OTTI is likely based on projected cash flows, the realized loss recognized for the OTTI is based on the difference between systematic value and fair value.) The fair value of the SVO-identified investment on the date of the OTTI shall become the new cost basis of the investment.
- d. Subsequent to recognition of an OTTI, the SVO-identified bond ETF investment is required to be reported at the lower of the then-current period systematic value or fair value. As the underlying bonds can be replaced within an ETF, it is possible for a subsequent period systematic value and fair value to recover above the fair value that existed at the time an OTTI was recognized. As such, the requirement for subsequent reporting at the lower of systematic value or fair value is intended to be a current period assessment. For example, in reporting periods after an OTTI, the systematic value for an SVO-identified investment may exceed the fair value at the time of the OTTI, but in no event shall the reported systematic value exceed the then-current period fair value. If current calculated systematic value is lower than the current fair value, systematic value is required.

37. Impairment guidance for SVO-identified bond ETF investments reported at fair value is consistent with impairment guidance for investments captured under SSAP No. 30R. Pursuant to this guidance, realized losses are required to be recognized when a decline in fair value is considered to be other-than-temporary. Subsequent fluctuations in fair value shall be recorded as unrealized gains or losses. Future declines in fair value which are determined to be other-than-temporary shall be recorded as realized losses. A decision to sell an impaired security results with an other-than-temporary impairment that shall be recognized.

Disclosures

38. The financial statements shall include the following disclosures:
- a. Fair value in accordance with *SSAP No. 100R—Fair Value*;
 - b. Concentrations of credit risk in accordance with *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures*;
 - c. The basis at which the bonds, mandatory convertible securities, and SVO-identified bond ETF investments identified in **paragraph 2.d.**, are stated;
 - d. Amortization method for bonds and mandatory convertible securities, and if elected by the reporting entity, the approach for determining the systematic value for SVO-identified securities per **paragraph 33**. If utilizing systematic value measurement method approach for SVO-identified investments, the reporting entity must include the following information:
 - i. Whether the reporting entity consistently utilizes the same measurement method for all SVO-identified investments²² (e.g., fair value or systematic value). If

²² As identified in **paragraph 34.d.**, a consistent approach must be followed for all investments designated to use the systematic value method. As such, this disclosure is limited to situations in which a reporting entity uses both fair value and systematic value for reported SVO-identified investments.

The Guidance in this Statement is Effective January 1, 2025

different measurement methods are used²³, information on why the reporting entity has elected to use fair value for some SVO-identified investments and systematic value for others.

- ii. Whether SVO-identified investments are being reported at a different measurement method from what was used in an earlier current-year interim and/or in a prior annual statement. (For example, if reported at systematic value prior to the sale, and then reacquired and reported at fair value.) This disclosure is required in all interim reporting periods and in the year-end financial statements for the year in which an SVO-identified investment has been reacquired and reported using a different measurement method from what was previously used for the investment. (This disclosure is required regardless of the length of time between the sale/reacquisition of the investments, but is only required in the year in which the investment is reacquired.)
 - iii. Identification of securities still held that no longer qualify for the systematic value method. This should separately identify those securities that are still within the scope of SSAP No. 26R and those that are being reported under a different SSAP.
- e. For each balance sheet presented, the book/adjusted carrying values, fair values, excess of book/carrying value over fair value or fair value over book/adjusted carrying values for each pertinent bond or assets in scope of this statement.
- f. For the most recent balance sheet, the book/adjusted carrying values and the fair values of bonds and assets in scope of this statement, reported in statutory Annual Statement Schedule D – **Part 1A** due:
- i. In one year or less (including items without a maturity date which are payable on demand and in good standing);
 - ii. After one year through five years;
 - iii. After five years through ten years;
 - iv. After ten years (including items without a maturity date which are either not payable on demand or not in good standing).
- g. For each period for which results of operations are presented, the proceeds from sales of bonds and assets in scope of this Statement and gross realized gains and gross realized losses on such sales.
- h. For each balance sheet presented, all items in scope of this Statement in an unrealized loss position for which other-than-temporary declines in value have not been recognized:
- i. The aggregate amount of unrealized losses (that is, the amount by which cost or amortized cost exceeds fair value) and
 - ii. The aggregate related fair value of bonds with unrealized losses.

²³ The guidance in this statement allows different measurement methods by qualifying investment (CUSIP), but it is anticipated that companies will generally utilize a consistent approach for all qualifying investments.

The Guidance in this Statement is Effective January 1, 2025

- i. The disclosures in paragraphs 39.h.i. and 39.h.ii. should be segregated by items that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer using fair values determined in accordance with SSAP No. 100R.
- j. As of the most recent balance sheet date presented, additional information should be included describing the general categories of information that the investor considered in reaching the conclusion that the impairments are not other-than-temporary.
- k. When it is not practicable to estimate fair value in accordance with SSAP No. 100R, the investor should disclose the following additional information, if applicable, as of each date for which a statement of financial position is presented in its annual financial statements:
 - i. The aggregate carrying value of the investments not evaluated for impairment, and
 - ii. The circumstances that may have a significant adverse effect on the fair value.
- l. For securities sold, redeemed or otherwise disposed as a result of a call or tender offer feature (including make-whole call provisions), disclose the number of CUSIPs sold, disposed or otherwise redeemed and the aggregate amount of investment income generated as a result of a prepayment penalty and/or acceleration fee.

39. Refer to the Preamble for further discussion regarding disclosure requirements. The disclosures in paragraphs 39.b., 39.e., 39.f., 39.g., 39.h., 39.i., 39.j. and 39.k. shall be included in the annual audited statutory financial reports only.

Relevant Literature

40. This statement adopts *AICPA Statement of Position 90-11, Disclosure of Certain Information by Financial Institutions About Debt Securities Held as Assets*, and *AICPA Practice Bulletin No. 4, Accounting for Foreign Debt/Equity Swaps*. This statement also adopts *FASB Staff Position 115-1/124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, paragraph 16, with modification to be consistent with statutory language in the respective statutory accounting statements. This statement adopts the GAAP definition of “security” as it is used in FASB Codification Topic 320 and 860. This statement refers to the definition of “financial assets” captured in SSAP No. 103R adopted from U.S. GAAP. As noted in footnote 7, for purposes of this statement, and in applying the principles-based bond definition, financial assets do not include assets that depend on the completion of a performance obligation. When there is a performance obligation, the asset represents non-financial assets, or a means through which non-financial assets produce cash flows, until the performance obligation has been satisfied.

41. This statement rejects the GAAP guidance for debt securities, which is contained in *ASU 2020-08, Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs*, *ASU 2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities*, *ASU 2017-08, Premium Amortization on Purchased Callable Debt Securities*, *ASU 2016-01, Financial Instruments – Overall*, *FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities*, *FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*, *FASB Emerging Issues Task Force No. 89-18, Divestitures of Certain Investment Securities to an Unregulated Commonly Controlled Entity under FIRREA*, and *FASB Emerging Issues Task Force No. 96-10, Impact of Certain Transactions on Held-to-Maturity Classifications Under FASB Statement No. 115*.

The Guidance in this Statement is Effective January 1, 2025

Effective Date and Transition

42. Revisions to SSAP No. 26R, adopted August 2023, to incorporate the principle-based bond concepts are effective January 1, 2025. These revisions incorporate principle concepts on what should be reported as a long-term bond. Securities that qualify as issuer credit obligations within the principle concepts are captured within scope of SSAP No. 26R. Securities that qualify as asset-backed securities within the principle concepts are captured within scope of SSAP No. 43R. Securities that do not qualify as issuer credit obligations or ABS, unless specifically permitted in scope of these statements, are not permitted to be reported as a bond.

43. At the time of transition, reporting entities shall make their best efforts to assess investments to determine whether they qualify within the bond definition for reporting on Schedule D-1. The bond definition requires assessments at the time of acquisition (as of the origination date), and it is recognized that reporting entities may not have the means to complete historical assessments for securities held at the time of transition. For these instances, if information is not readily available for reporting entities to assess a security as of the date at origination, reporting entities may utilize current or acquisition information in concluding that a security qualifies for reporting as a bond as either an issuer obligation or asset-backed security.

44. Investments that were reported as a bond on Schedule D-1: Long-Term Bonds as of December 31, 2024, that do not qualify under the principle-based bond concepts shall be reported as a disposal from that schedule, with a reacquisition on the appropriate reporting schedule as of January 1, 2025. These investments shall be accounted for in accordance with the resulting SSAP that addresses the specific investment structure. For securities that are reported at the lower of amortized cost or fair value under the new applicable guidance, this could result with an unrealized loss in the measurement of the investment at the time of the reclassification. Although the adoption of this guidance is considered a change in accounting principle under SSAP No. 3, the following transition guidance shall be applied on January 1, 2025, to ensure consistency in reporting and to allow investment schedules to roll appropriately:

- a. Securities reclassified from Schedule D-1 as they no longer qualify under the bond definition shall be reported as a disposal from Schedule D-1 at amortized cost. Although no proceeds are received, amortized cost at the time of disposal shall be reported as consideration on Schedule D-4.
 - i. For securities held at amortized cost at the time of disposal, book adjusted carrying value and amortized cost shall agree, preventing gain or loss recognition at the time of reclassification.
 - ii. For securities held at fair value under the lower of amortized cost or fair value measurement method, previously reported unrealized losses shall be reversed on Jan. 1, 2025, prior to disposal, resulting with a reported value that mirrors amortized cost at the time of disposal. This action prevents realized loss recognition at time of reclassification.
- b. Securities reclassified from Schedule D-1 shall be recognized on the subsequent schedule (e.g., Schedule BA) with an actual cost that agrees to the disposal value (amortized cost). Immediately subsequent to recognition on the resulting schedule, the securities shall be reported in accordance with the measurement method prescribed by the applicable SSAP:
 - i. For securities previously reported at fair value on Schedule D-1 (under a lower of amortized cost or fair value measurement method), the reporting entity will

The Guidance in this Statement is Effective January 1, 2025

recognize an unrealized loss to match the previously reported book adjusted carrying value. Subsequently, the security will continue to reflect a lower of amortized cost or fair value measurement method.

- ii. For securities previously reported at amortized cost on Schedule D-1, if the subsequent statement requires a lower of amortized cost or fair value measurement method, then the reporting entity shall recognize an unrealized loss to the extent fair value is less than amortized cost.
- iii. After application of paragraph 45.b.i. and 45.b.ii. all securities shall reflect either the same reported value as of December 31, 2024 (amortized cost or fair value) or a lower reported value (if the security is subject to the lower of amortized cost or fair value measurement method). There should be no instances that result with a security having a greater reported value than what was presented on December 31, 2024. Subsequent to transition, securities reported at fair value may incur unrealized gains or losses due to fair value fluctuations, but should never have unrealized gains that result with a book adjusted carrying value that exceeds amortized cost.

45. With this transition guidance, changes in measurement for securities reclassified under the bond definition will be reported as a change in unrealized capital gains (losses) in the first quarter 2025 financial statements (unless sold in the interim with a realized gain or loss) and not as a change in accounting principle. To enable regulators the ability to identify the impact of securities reclassified under the bond definition, the following disclosure for the 2025 first quarter financial statement is required:

- a. Aggregate book adjusted carrying value for all securities reclassified off Schedule D-1.
- b. Aggregate book adjusted carrying value after transition for all securities reclassified off Schedule D-1 that resulted with a change in measurement basis. (This shall be a subset of paragraph 46.a. and captures the securities that moved from an amortized cost to a fair value measurement method under the lower of amortized cost or fair value approach.)
- c. Aggregate surplus impact for securities reclassified off Schedule D-1. This shall include the difference between book adjusted carrying value as of December 31, 2024, and book adjusted carrying value after transition for those securities that moved from an amortized cost to a fair value measurement method under the lower of amortized cost or fair value approach.

46. For clarification purposes, the transition guidance shall be applied prospectively beginning with the first year of adoption (Jan. 1, 2025). For disclosures that provide comparative information, reporting entities shall not restate the prior year's information in the 2025 disclosure.

Historical Adoption and Revisions to Original SSAP No. 26R

47. For historical reference, the original adoption, and subsequent revisions to SSAP No. 26R prior to the adoption of the principles-based bond definition are detailed below:

- a. SSAP No. 26R was originally effective for years beginning January 1, 2001.
- b. Guidance for the accounting of securities subsequent to other than temporary impairments was originally effective for reporting periods beginning on January 1, 2009, with early

The Guidance in this Statement is Effective January 1, 2025

adoption permitted. This guidance was incorporated from *SSAP No. 99—Accounting for Securities Subsequent to an Other-Than-Temporary Impairment* in 2010. The original impairment guidance included in this standard, and the substantive revisions reflected in SSAP No. 99 are retained for historical purposes in Issue Paper No. 131.

- c. Guidance pertaining to the accounting for zero-coupon convertible bonds was originally effective December 8, 2002, and was subsequently incorporated into this statement from *INT 02-05: Accounting for Zero Coupon Convertible Bonds*.
- d. Guidance adopted in December 2013 clarifying the ‘yield-to-worst’ concept for bonds with make-whole call provisions was initially effective January 1, 2014, unless the company had previously been following the guidance. (Companies that have previously been following the original intent, as clarified in the revisions, were not impacted by these changes.)
- e. The guidance on the calculation of investment income for prepayment penalties and/or acceleration fees was effective January 1, 2017, on a prospective basis and was required for interim and annual reporting periods thereafter, with early application permitted.
- f. In April 2017, revisions were incorporated in accordance with the investment classification project. These revisions are detailed in Issue Paper No. 156 and were effective December 31, 2017. These revisions clarified the scope of the bond definition as well as incorporated new guidance for SVO-Identified Bond ETFs identified in scope of this statement. Retained transition / application guidance is captured as follows:
 - i. For situations in which there is an interval of time between when a company purchases an investment and when the investment is designated as an SVO-identified investment eligible for systematic value, the book yield should be calculated by equating the book/adjusted carrying value at that time to the portfolio’s aggregate cash flows (ACF). For these situations, the ETF shall be reported as a disposed security on the prior reporting schedule and reported as an acquisition.
 - ii. In accordance with the systematic value methodology, at the next reporting period date, the reporting entity shall amortize or accrete the carrying value by the difference between the effective interest using the initial book yield, and the distributions received, and shall recalculate the new effective book yield using the new carrying value and ACF as of the last day of the reporting period.
 - iii. As the necessary historical ACF data is not available for calculating the initial book yield at acquisition for the net present value constant purchase yield (NPV-CPY) method for impairment recognition, reporting entities shall use recently published yield-to-maturity (YTM) as their constant purchase yield to be applied for NPV-CPY impairment recognition.
 - iv. If the investment no longer qualifies as an SVO-Identified Bond ETF in scope of statement, this change shall be reflected prospectively from the effective date. Investments previously captured in this statement, that will move within the scope of another SSAP and reporting schedule shall be shown as dispositions on and shown as an acquisition on the schedule for which it will be subsequently reported.

The Guidance in this Statement is Effective January 1, 2025

- g. The guidance to explicitly exclude securities for which the contract amount of the instrument to be paid at maturity (or the original investment) is at risk for other than failure of the borrower to pay the contractual amount due, were effective December 31, 2019.
- h. Revisions to clarify existing guidance that all prepayment penalties and acceleration fees for when a bond is liquidated prior to its scheduled maturity date, including those from tendered bonds, shall follow the guidance in SSAP No. 26R was effective January 1, 2021. Reporting entities that have historically applied this guidance shall not change historical practices, but the effective date of January 1, 2021, with early application permitted, was allowed for reporting entities to make systems changes to capture tendered bonds in scope of this guidance.

REFERENCES

Other

- *Purposes and Procedures Manual of the NAIC Investment Analysis Office*
- NAIC Valuation of Securities product prepared by the Securities Valuation Office

Relevant Issue Papers

- *Issue Paper No. 26—Bonds, Excluding Loan-Backed and Structured Securities*
- *Issue Paper No. 131—Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment*
- *Issue Paper No. 156—Bonds*
- *Issue Paper No. XX—Principles-Based Bond Definition*

The Guidance in this Statement is Effective January 1, 2025

EXHIBIT A - EXAMPLES OF ANALYSIS FOR ASSET-BACKED SECURITIES

1. As detailed in paragraphs 9-10, the holder of an asset-backed securities is 1) required to be in a different economic position than if the holder owned the ABS Issuer's assets directly, and 2) if the assets owned by the ABS Issuer are cash generating non-financial assets, then the assets are expected to generate a meaningful level of cash flows towards repayment of the bond through use, licensing, leasing servicing or management fees, or other similar cash flow generation. (This guidance requires a meaningful level of cash flows to service the debt other than through the sale or refinancing of the assets.) This appendix details example analysis for these meaningful cash flow and substantive credit enhancements.

2. **Example 1:** A reporting entity invests in debt instruments issued from a SPV sponsored by the Government National Mortgage Association (GNMA), the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, "Agency or Agencies"). These debt instruments pass through principal and interest payments received from underlying mortgage loans held by the SPV to the debtholders proportionally, with principal and interest guaranteed by the Agencies. While there is prepayment and extension risk associated with the repayment of the underlying mortgage loans, the credit risk associated with the mortgage loans is assumed by the Agencies.

3. **Example 1 Rationale:** Although the reporting entity participates on a proportional basis in the cash flows from the underlying mortgage loans held by the SPV, the reporting entity is in a different economic position than if it owned the underlying mortgage loans directly because the credit risk has been redistributed and assumed by the Agencies. This is a substantive credit enhancement because a market participant (i.e., a knowledgeable investor transacting at arm's length) would conclude the Agency guarantee is expected to absorb all losses before the debt instrument being evaluated. Therefore, the holder of the debt instrument is in a substantively different economic position than if the holder owned the ABS Issuer's unguaranteed assets directly, in accordance with the requirements in paragraph 10. When guarantees do not cover 100% of principal and interest as the Agency guarantees do in this example, it is still appropriate to determine if the guarantee is substantive in accordance with the requirements in paragraph 10, to determine if the holder is in a substantively different economic position that if the holder held the ABS Issuer's assets directly.

4. **Example 2:** A reporting entity invested in a debt instrument issued by a SPV. Payments under the instrument are secured by a note, a legal assignment from the borrower of a lease for real property and an assignment of the lease payments from an operating entity tenant. Additional security is provided by a mortgage on the leased property (the "underlying collateral"). The leased property is owned by the borrower under the note -- the SPV does not have any ownership interest in the underlying collateral, though it has legal recourse to it through the mortgage. The tenant makes contractually-fixed payments over the life of the lease to the borrower, who has assigned both the lease and the lease payments to the SPV as security for the debt. While the debt is outstanding, the lease, the lease payments, and the mortgage all serve as security for the debtholders. Should a default occur, the debtholders can foreclose on and liquidate the real property as well as submit an unsecured lease claim in the lessee's bankruptcy for all or a portion of the defaulted lease payments. The loan-to-value (as a percentage of property value) at origination is 100%.

5. The existing lease payments are sufficient to cover all interest payments and all scheduled debt amortization payments over the life of the debt instrument. However, at debt maturity, there is a balloon payment due, totaling 50% of the original outstanding debt principal amount. The corresponding lease has no balloon payment due at lease maturity, so the SPV will either need to refinance the debt or sell the underlying collateral to service the final debt balloon payment. The property has a high probability of appreciating in value over the term, however ignoring any potential for appreciation, the 50% loan-to-value at maturity is the expected figure at the end of the debt term based solely on scheduled amortization payments. The real property is expected to be subject to some market value volatility and periods of lower

The Guidance in this Statement is Effective January 1, 2025

liquidity at certain points in time but has a predictable value range and ready market over a longer period of time, such that the property could be liquidated over a reasonable period of time, if necessary.

6. **Example 2 Rationale:** The reporting entity determined that the debtholder was in a fundamentally different position than if the real estate was owned directly. The lease is a cash generating non-financial asset which is expected to generate a meaningful level of cash flows for the repayment of the bonds which covers all interest payments and 50% of the principal payments. The level of reliance on the collateral value for sale or refinancing is just over the cutoff for using the practical expedient (<50%), so a full analysis is required. In reaching its determination, the reporting entity considered the predictable nature of the cash flows, which are contractually fixed for the life of the debt instrument, as well as the ability of the underlying collateral value to provide for the balloon payment through sale or refinancing in light of its characteristics. While the real property may have some market value volatility and periods of lower liquidity at points in time, the cash flows produced by the lease were concluded to reduce the loan balance to a level (50% loan-to-value) that would be able to be recovered by sale or refinancing at the maturity of the loan.

7. The reporting entity also determined that the structure provides substantive credit enhancement in the form of overcollateralization to conclude that investors are in a different economic position than holding the real property directly, in accordance with the requirements in paragraph 10. In reaching this conclusion, the reporting entity noted that although the debt instrument starts with a 100% loan-to-value (not including the value of the contractually required lease payments), contractual fixed payments from the lease provide additional security such that the reporting entity is in a different economic position than owning the property directly. Lease cash flows are sufficient to cover the payment of all interest and 50% of the outstanding principal over the term of the lease. In the context of the predictable nature of the cash flows and collateral value range over time, the reporting entity concluded that a market participant (i.e., knowledgeable investor transacting at arm's length) would consider this level of overcollateralization to put the investor in a substantively different economic position than owning the underlying property directly.

8. For the purposes of determining whether there is substantive overcollateralization, it is appropriate to consider any expected economic depreciation, if it is reasonably expected, but it is not appropriate to consider any expected economic appreciation. Note that a debt instrument with a loan-to-value that is expected to decrease over time is not necessarily deemed to have substantive overcollateralization.

9. **Example 3:** A reporting entity invested in a debt instrument with the same characteristics as described in Example 2, except that the existing lease at the time of origination has a contractual term that is shorter than that of the debt instrument. It is expected with a high degree of probability that the lease will be renewed, and a substantial leasing market exists to replace the lessee should they not renew. However, in the unlikely circumstance that the property cannot be re-leased, there would not be enough cash flows to service the scheduled principal and interest payments, and the property would have to be liquidated to pay off the debt upon default.

10. **Example 3 Rationale:** All details of Example 3, including the expected collateral cash flows, are consistent with those in Example 2, except that the cash flows in Example 2 are contractually fixed for the duration of the debt while the cash flows in Example 3 are subject to re-leasing risk. Notwithstanding the involvement of re-leasing risk, the reporting entity concluded that the ability to re-lease the property was highly predictable and supported the conclusion that the underlying collateral was expected to produce meaningful cash flows to service the debt.

11. This distinction is to highlight that the expected cash flows of a cash-generating non-financial asset may or may not be contractually fixed for the term of the bond. Certain securitized cash flow streams may not by their nature lend themselves to long-term contracts (e.g., single-family home rentals), but may nevertheless lend themselves to the production of predictable cash flows. While the non-contractual nature of the cash flows is an important consideration in determining whether a non-financial asset is expected to

The Guidance in this Statement is Effective January 1, 2025

produce meaningful cash flows to service the debt, it does not, in and of itself, preclude a reporting entity from concluding that the assets are expected to produce meaningful cash flows.

12. **Example 4:** A reporting entity invested in a debt instrument issued by a SPV that owns equipment which is leased to an equipment operator. The equipment operator makes lease payments to the SPV, which are passed through to service the SPV's debt obligation. While the debt is outstanding, the equipment and lease are held in trust and pledged as collateral for the debtholders. Should a default occur, the debtholders can foreclose on and liquidate the equipment as well as submit an unsecured lease claim in the lessee's bankruptcy for any defaulted lease payments. The loan-to-value at origination is 70%.

13. The existing lease payments are sufficient to cover all interest payments and all scheduled debt amortization payments over the life of the debt instrument. However, at maturity, there is a balloon payment due, totaling 80% of the original outstanding principal amount. The corresponding lease has no balloon payment due at lease maturity, so the SPV will either need to refinance the debt or sell the underlying equipment to service the final debt balloon payment. The loan-to-value at maturity is expected to increase to 95% considering the scheduled principal amortization payments net of the expected economic depreciation in the equipment value over the term of the debt. The equipment is expected to be subject to some market value volatility and periods of lower liquidity at certain points in time, but has a predictable value range and ready market over a longer period of time, such that the equipment could be liquidated over a reasonable period of time, if necessary.

14. **Example 4 Rationale:** The equipment is a cash generating non-financial asset which is not expected to generate a meaningful level of cash flows for the repayment of the bonds via the existing lease that covers all interest payments and 20% of principal payments. In reaching this determination, the reporting entity considered that, while the cash flows being produced are predictable, the ability to recover the principal of the debt investment is almost entirely reliant on the equipment retaining sufficient value to sell or refinance to satisfy the debt.

15. The reporting entity also determined that the structure lacks substantive credit enhancement to conclude that investors are in a different economic position than holding the equipment directly, in accordance with the requirements in [paragraph 10](#). In reaching this conclusion, the reporting entity noted that the debt starts with a 70% loan-to-value, but the overcollateralization is expected to deteriorate over the term of the debt as the equipment economically depreciates more quickly than the debt amortizes. This results in a high loan-to-value (i.e., 95%) at maturity, relative to the market value volatility of the underlying collateral. Despite the predictable nature of the cash flows, the reporting entity concluded that the debt instrument lacked a substantive level of overcollateralization to conclude that the investor is in a different economic position than owning the underlying equipment directly. It was determined that the level of overcollateralization, as determined by a market participant (i.e., a knowledgeable investor transacting at arm's length), is nominal. Therefore, the reporting entity concluded that it was in a substantively similar position as if it owned the equipment directly.

16. For the purposes of determining whether there is substantive overcollateralization, it is appropriate to consider any expected economic depreciation, if it is reasonably expected, but it is not appropriate to factor in any expected economic appreciation. Note that a debt instrument with a loan-to-value that is expected to increase over time is not necessarily deemed to have nominal overcollateralization.

The Guidance in this Statement is Effective January 1, 2025

EXHIBIT B – SYSTEMATIC VALUE CALCULATION

The established systematic value method is considered an “aggregated cash flow” (ACF) method in which the cash flow streams from the individual bond holdings are aggregated into a single cash flow stream. These cash flows are scaled such that, when equated with the market price at which the ETF was purchased or sold, an internal rate of return is calculated, representing the investor’s initial book yield for the ETF. Although the initial book yield is utilized to determine the current period effective yield, and the resulting adjustments to the ETF’s reported (systematic) value, the book yield is recalculated at least quarterly in order to adjust the investor’s book yield to reflect current cash flow projections of the current bond holdings within the ETF.

The following calculation shall be followed by reporting entities electing systematic value:

| 1. Download cash flows file from <u>ETF provider website</u> . | |
|---|---|
| NAV: | \$115.07 (Official end-of-day NAV found on <u>ETF provider website</u>) |
| Maturity: | 12/8/2027 = SUMPRODUCT (CASHFLOW_DATE column, PRINCIPAL column)/SUM (PRINCIPAL column) |
| When Paid: | Monthly |
| Par Value: | 2,500 # shares purchased |
| Monthly Effective Interest: | \$0.40 = (Recalculated Effective Book Yield from prior month x Prior Month Ending Book Value /12) |
| Distribution: | \$0.34 Found on <u>provider website</u> |
| Net Amortization/Accretion: | \$0.06 = (Monthly Effective Interest) – (Distribution) |
| Prior Month Ending Book Value: | \$115.35 |
| NPV Constant Yield Method: | \$117.10 = XNPV (Initial Book Yield, CASHFLOW column, CASHFLOW_DATE column) / 1000000 |
| Initial Book Yield: | 4.15% |
| Book (Systematic) Value: | \$115.41 = (Prior Period Ending Book Value) + (Net “amortization/ accretion”) |
| Expense Ratio: | 0.1500% |
| Recalculated Effective Book Yield: | 4.1639% =XIRR(CASHFLOW column, CASHFLOW_DATE column, 0.05) |

All formulas on the left are at a per share level (excepting “Par Value” which represents the number of shares purchased for this lot).

The resulting values calculated on the left are aggregated to reflect the total number of shares held on the previous tabs reflecting how one might populate the reporting schedule with these values.

Additionally, the cash flows in the data file are based on 1 million shares. This was done in order to make the cash flows easier to observe and work with (i.e., at a single share level, cash flows would be at fractional dollar levels). Therefore, in order to calculate the yield, investors must multiply the price of the ETF by 1 million shares and then use that value as a cash outflow against the positive cash inflows from the bond portfolio in order to calculate the IRR.

| CUSIP | ASOF_DATE | CALL_TYPE | CASHFLOW_DATE | INTEREST | PRINCIPAL | CASHFLOW |
|--|-----------|---|------------------|---|------------|--|
| 2. Insert a row in between the column headings and the cash flow data. | | 3. Filter for “Call Type” is WORST. (Click “Data” at the top of Excel sheet, then click “Filter” and click the new dropdown box in the “Call Type” cell and select only “WORST.”) | | 4. Enter the date of the cash flow data file underneath cash flow date. | | 5. Under the column “CASHFLOW” enter the following formula in Excel: =(-Ending Book Value)*1000000 |
| | | | 8/31/20X1 | | | (115,414,059.56) |
| “Ticker” | 8/31/20X1 | WORST | 9/8/20X1 | 136,538.564 | 81,472.372 | 218,010.937 |
| “Ticker” | 8/31/20X1 | WORST | 9/9/20X1 | 5,990.106 | 0 | 5,990.106 |
| “Ticker” | 8/31/20X1 | WORST | 9/10/20X1 | 9,706.324 | 0 | 9,706.324 |

The Guidance in this Statement is Effective January 1, 2025

EXHIBIT C – AMORTIZATION TREATMENT FOR CALLABLE BONDS

Example 1: Call Price Less Than BACV Throughout the Life of the Bond

12/31/2008 – Issuance of Bond. Par = 100/10-Year Bond (Matures 12/31/2018)

01/01/2009 – Call Date/Call Price 107

12/15/2010 – Reporting Entity Acquires Bond. Cost = 106

01/01/2012 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 104

01/01/2014 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 103

01/01/2016 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 102

General Note for Examples: The reporting entity purchased the bond at a premium (cost was greater than par). The 1/1/2009 call date and price is ignored as it occurred prior to the reporting entity acquiring the bond. The bolded numbers represent the lowest asset value at each reporting period. The bond is amortized to the lowest asset value, which in this scenario is amortizing to the call dates and prices. (The standard amortization to the maturity date is shown as it should be compared to the amortization to the call date/price to verify that the BACV at any given reporting date reflects the lowest asset value.)

| Date | Action | Cost | Call Price | BACV (Under Call Date/Price) | Amortization to the Lowest Value | BACV Under Standard Amortization |
|------------|---------------------|------|------------|------------------------------|----------------------------------|----------------------------------|
| 12/15/2010 | Acquired | 106 | | 106 | | 106 |
| 12/31/2011 | Lockout Period | | | 104 | 2 | 105.25 |
| 01/01/2012 | Call Date | | 104 | 104 | | |
| 12/31/2012 | Year-End Reporting | | | 103.5 | 0.5 | 104.50 |
| 12/31/2013 | Year-End Reporting | | | 103 | 0.5 | 103.75 |
| 01/01/2014 | Call Date | | 103 | 103 | | |
| 12/31/2014 | Year-End Reporting | | | 102.5 | 0.5 | 103 |
| 12/31/2015 | Year-End Reporting | | | 102 | 0.5 | 102.25 |
| 01/01/2016 | Call Date Exercised | | 102 | 102 | | |

| Standard Amortization | | | | | | | | |
|--|------------|------------|------------|------------|------------|------------|------------|------------|
| This table shows the amortization with a purchase date of 12/15/2010 at \$106 through the maturity date of 12/31/2018. | | | | | | | | |
| 12/15/2010 | 12/31/2011 | 12/31/2012 | 12/31/2013 | 12/31/2014 | 12/31/2015 | 12/31/2016 | 12/31/2017 | 12/31/2018 |
| Amortization | .75 | .75 | .75 | .75 | .75 | .75 | .75 | .75 |
| BACV | 105.25 | 104.50 | 103.75 | 103 | 102.25 | 101.50 | 100.75 | 100 |

| | Consideration | Par Value | BACV at Disposal Date | Realized Gain/Loss* |
|------------------------------|---------------|-----------|-----------------------|---------------------|
| 01/01/2016 Call Exercised | 102 | 100 | 102 | (2) |

* Per paragraph 26, the entity would recognize a \$(2) loss (BACV less par), and investment income of \$2 (consideration less par).

The Guidance in this Statement is Effective January 1, 2025

Example 2: Call Price Could be Greater Than BACV

12/31/2008 – Issuance of Bond. Par = 100/10-Year Bond (Matures 12/31/2018)

01/01/2009 – Call Date/Call Price 107

12/15/2010 – Reporting Entity Acquires Bond. Cost = 104

01/01/2012 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 106

01/01/2014 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 103

01/01/2016 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 102

The bolded numbers represent the lowest asset value:

| Date | Action | Cost | Call Price | BACV (Under Call Date / Price) | Amortization To the Lowest Asset Value | BACV Under Standard Amortization |
|------------|------------------------|------|------------|--------------------------------------|---|---|
| 12/15/2010 | Acquired | 104 | | 104 | | 104 |
| 12/31/2011 | Lockout Period | | 106 | 104 | 0.5 | 103.50 |
| 01/01/2012 | Call Date | | 106 | 104 | | 103.50 |
| 12/31/2012 | Year-End Reporting | | | 103.5 | 0.5 | 103 |
| 12/31/2013 | Year-End Reporting | | | 103 | 0.5 | 102.50 |
| 01/01/2014 | Call Date | | 103 | 103 | | 102.50 |
| 12/31/2014 | Year-End Reporting | | | 102.5 | 0.5 | 102 |
| 12/31/2015 | Year-End Reporting | | | 102 | 0.5 | 101.50 |
| 01/01/2016 | Call Date Exercised | | 102 | 102 | | 101.50 |

| Standard Amortization | | | | | | | | |
|--|------------|------------|------------|------------|------------|------------|------------|------------|
| This table shows the amortization with a purchase date of 12/15/2010 at \$104 through the maturity date of 12/31/2018. | | | | | | | | |
| 12/15/2010 | 12/31/2011 | 12/31/2012 | 12/31/2013 | 12/31/2014 | 12/31/2015 | 12/31/2016 | 12/31/2017 | 12/31/2018 |
| Amortization | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| BACV | 103.50 | 103 | 102.50 | 102 | 101.50 | 101 | 100.50 | 100 |

| | Consideration | Par Value | BACV at Disposal Date | Realized Gain/Loss* |
|------------------------------|---------------|-----------|-----------------------|---------------------|
| 01/01/2016 Call Exercised | 102 | 100 | 101.50 | (1.50) |

* Per paragraph 26, the entity would recognize a \$(1.50) loss (BACV less par), and investment income of \$2 (consideration less par).

The Guidance in this Statement is Effective January 1, 2025

Example 3: Call Price Could be Greater Than BACV

12/31/2008 – Issuance of Bond. Par = 100/10-Year Bond (Matures 12/31/2018)
 01/01/2009 – Call Date/Call Price 107
 12/15/2010 – Reporting Entity Acquires Bond. Cost = 104
 01/01/2012 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 106
 01/01/2014 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 102
 01/01/2016 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 101

Note – This illustration shows that the evaluation of whether standard amortization (to the maturity date) or the call date price may change over the time. The bolded numbers represent the lowest asset value:

| Date | Action | Cost | Call Price | BACV (Under Call Date / Price) | Amortization To the Lowest Asset Value | BACV Under Standard Amortization |
|------------|---------------------|------|------------|--------------------------------|--|----------------------------------|
| 12/15/2010 | Acquired | 104 | | 104 | | |
| 12/31/2011 | Lockout Period | | 106 | 104 | 0.5 | 103.50 |
| 01/01/2012 | Call Date | | 106 | 104 | | 103.50 |
| 12/31/2012 | Year-End Reporting | | | 103 | 0.5 | 103 |
| 12/31/2013 | Year-End Reporting | | | 102 | 1 | 102.50 |
| 01/01/2014 | Call Date | | 102 | 102 | | 102.50 |
| 12/31/2014 | Year-End Reporting | | | 101.5 | 0.5 | 102 |
| 12/31/2015 | Year-End Reporting | | | 101 | 0.5 | 101.50 |
| 01/01/2016 | Call Date Exercised | | 101 | 101 | | 101.50 |

| Standard Amortization | | | | | | | | |
|--|------------|------------|------------|------------|------------|------------|------------|------------|
| This table shows the amortization with a purchase date of 12/15/2010 at \$104 through the maturity date of 12/31/2018. | | | | | | | | |
| 12/15/2010 | 12/31/2011 | 12/31/2012 | 12/31/2013 | 12/31/2014 | 12/31/2015 | 12/31/2016 | 12/31/2017 | 12/31/2018 |
| Amortization | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| BACV | 103.50 | 103 | 102.50 | 102 | 101.50 | 101 | 100.50 | 100 |

| | Consideration | Par Value | BACV at Disposal Date | Realized Gain/Loss* |
|------------------------------|---------------|-----------|-----------------------|---------------------|
| 01/01/2016 Call Exercised | 101 | 100 | 101 | (1) |

* Per paragraph 26, the entity would recognize a \$(1) loss (BACV less par), and investment income of \$1 (consideration less par).

The Guidance in this Statement is Effective January 1, 2025

Example 4: Continuously Callable Bond – Callable at Par After Initial Lockout Period

12/31/2008 – Issuance of Bond. Par = 100/10-Year Bond (Matures 12/31/2018)
01/01/2009 – Call Date / Call Price 107 – Continuously Callable Thereafter at Par
12/15/2010 – Reporting Entity Acquires Bond. Cost = 104

The bolded numbers represent the lowest asset value:

| Date | Action | Cost | Call Price | BACV (Under Call Date/Price) | Amortization To the Lowest Asset Value | BACV Under Standard Amortization |
|------------|--------------------|------|------------|------------------------------|---|----------------------------------|
| 12/15/2010 | Acquired | 104 | | 100 | 4 | |
| 12/31/2010 | Year-End Reporting | | 100 | 100 | There is no subsequent amortization as the premium was fully expensed at acquisition. | 104 |
| 12/31/2011 | Year-End Reporting | | 100 | 100 | | 103.50 |
| 12/31/2012 | Year-End Reporting | | 100 | 100 | | 103 |
| 12/31/2013 | Year-End Reporting | | 100 | 100 | | 102.50 |
| 12/31/2014 | Year-End Reporting | | 100 | 100 | | 102 |
| 12/31/2015 | Year-End Reporting | | 100 | 100 | | 101.50 |
| 01/01/2016 | Year-End Reporting | | 100 | 100 | | 101.50 |

| Standard Amortization | | | | | | | | |
|--|------------|------------|------------|------------|------------|------------|------------|------------|
| This table shows the amortization with a purchase date of 12/15/2010 at \$104 through the maturity date of 12/31/2018. | | | | | | | | |
| 12/15/2010 | 12/31/2011 | 12/31/2012 | 12/31/2013 | 12/31/2014 | 12/31/2015 | 12/31/2016 | 12/31/2017 | 12/31/2018 |
| Amortization | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| BACV | 103.50 | 103 | 102.50 | 102 | 101.50 | 101 | 100.50 | 100 |

| | Consideration | Par Value | BACV at Disposal Date | Realized Gain/Loss* |
|------------------------------|---------------|-----------|-----------------------|---------------------|
| 01/01/2016 Call Exercised | 100 | 100 | 100 | 0 |

* Since the call price is par and could occur immediately after acquisition, the premium is immediately expensed. When the bond is called, there is no gain or loss as the consideration received equals the BACV.

The Guidance in this Statement is Effective January 1, 2025

Example 5: Determination of Prepayment Penalty When Call Price is Less Than Par

| Call Price Less than Par | | | | |
|--------------------------|-----|--|-------------------------|-----|
| Entity 1 | | | Entity 2 | |
| Par | 100 | | Par | 100 |
| BACV | 24 | | BACV | 25 |
| Consideration | 26 | | Consideration | 26 |
| Explicit fee | 1 | | Explicit fee | 1 |
| Remaining consideration | 25 | | Remaining consideration | 25 |
| Gain | 2 | | Gain | 0 |
| Income* | 0 | | Income** | 1 |

*Entity 1 does not have in place a process to identify explicit an prepayment penalty or acceleration fee.

**Entity 2 has in place a process to identify an explicit prepayment penalty or acceleration fee.

[https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/APPTF/2023-2 Summer/Summary and Minutes/SAPWG/Attachments/Att1O-2019-21 SSAP 26R.docx](https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member%20Meetings/E%20CMTE/APPTF/2023-2%20Summer/Summary%20and%20Minutes/SAPWG/Attachments/Att1O-2019-21%20SSAP%2026R.docx)

The Guidance in this Statement is Effective January 1, 2025

Statement of Statutory Accounting Principles No. 43

Asset-Backed Securities

STATUS

| | |
|------------------------------------|--|
| Type of Issue..... | Common Area |
| Issued | August 13, 2023 |
| Effective Date | January 1, 2025 |
| Affects..... | Replaces SSAP No. 43R on January 1, 2025 |
| Affected by | No other pronouncements |
| Interpreted by | INT 06-07; INT 07-01; INT 22-01 |
| Relevant Appendix A Guidance | None |

| | |
|--|-----------|
| STATUS..... | 1 |
| SCOPE OF STATEMENT..... | 1 |
| SUMMARY CONCLUSION | 3 |
| Principles-Based Bond Definition - Asset-Backed Security..... | 3 |
| Initial Reporting Value and Recognition of Origination and Commitment Fees & Costs | 3 |
| Subsequent Carrying Value Method, Amortization, Accruals and Prepayment Penalties | 5 |
| Assessment of Cash Flows and Impact of Prepayments..... | 6 |
| Accretable Yield and Changes to Effective Yield for Application of Prospective Method..... | 7 |
| Recognition of Realized and Unrealized Gains and Losses and Impairment Guidance | 8 |
| Designation Guidance..... | 12 |
| Giantization/Megatization of FHLMC or FNMA Mortgage-Backed Securities | 13 |
| Disclosures..... | 14 |
| Relevant Literature..... | 15 |
| Effective Date and Transition | 15 |
| REFERENCES..... | 17 |
| Other | 17 |
| Relevant Issue Papers | 17 |
| EXHIBIT A – QUESTION AND ANSWER IMPLEMENTATION GUIDE | 18 |

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for each security investment that qualifies as an asset-backed security (ABS) under the principles-based bond definition detailed in *SSAP No. 26R—Bonds*. Each security shall be individually assessed under the bond definition to determine applicability as an asset-backed security and reported separately regardless of whether the security was issued in combination or as a unit with other investments. Items captured in scope of this statement are collectively referred to as asset-backed securities.

The Guidance in this Statement is Effective January 1, 2025

2. In addition to security investments that qualify under the principles-based definition as an asset-backed security, certain specific investments are also captured in scope of this statement:

- a. Mortgage Referenced Securities that do not meet the definition of an asset-backed security. In order to qualify as a mortgage-referenced security, the security must be issued by a government sponsored enterprise¹ or by a special purpose trust in a transaction sponsored by a government sponsored enterprise in the form of a “credit risk transfer.” In these situations, the issued security is tied to a referenced pool of mortgages and the payments received are linked to the credit and principal payment risk of the underlying mortgage loan borrowers captured in the referenced pool of mortgages. For these instruments, reporting entity holders may not receive a return of their full principal as principal repayment is contingent on repayment by the mortgage loan borrowers in the referenced pool of mortgages. Unless specifically noted, the provisions within this standard apply to mortgage-referenced securities.
- b. Freddie-Mac When Issued K-Deal (WI Trust) Certificates fully guaranteed by Freddie Mac are included in scope of this statement from original acquisition, and not initially reported as a derivative forward contract. ^(INT 22-01)

3. Securities captured in scope of this statement are not permitted to be reported as cash equivalents or short-term investments in scope of *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* even if acquired within one year or less from the maturity date. Investments captured in scope of *SSAP No. 2R* are intended to reflect situations in which limited risk remains, either from changes in credit quality or interest rates, due to the short-duration until maturity. As ultimate cash flows from asset-backed securities may have other risks beyond default risk or interest rate risk (such as performance factors, balloon payments, collateral quality) reporting as a cash equivalent or short-term investment is not permitted to prevent inappropriate assumptions of the investment’s remaining potential risk.

4. This statement excludes:

- a. Securities captured in scope of *SSAP No. 26R—Bonds*.
- b. Mortgage loans in scope of *SSAP No. 37—Mortgage Loans* that qualify under an SVO structural assessment as SVO-Identified Credit Tenant Loans. These investments are excluded as these are captured as issuer credit obligations under *SSAP No. 26R*.
- c. Securities that do not qualify as Asset-Backed Securities per the bond definition in *SSAP No. 26R—Bonds*. This exclusion includes residual or interests, as well as first loss positions, that do not have contractual payments or substantive credit enhancement. Debt securities that do not qualify and residual interests shall follow guidance in *SSAP No. 21R—Other Admitted Assets*.

¹ Currently, only Fannie Mae and Freddie Mac are the government sponsored entities that either directly issue qualifying mortgage-referenced securities or sponsor transactions in which a special purpose trust issues qualifying mortgage-reference securities. However, this guidance would apply to mortgage-referenced securities issued by any other government sponsored entity that subsequently engages in the transfer of mortgage credit risk.

The Guidance in this Statement is Effective January 1, 2025

SUMMARY CONCLUSION

Principles-Based Bond Definition - Asset-Backed Security

5. Investments within the scope of this statement issued by a related party or acquired through a related party transaction or arrangement are also subject to the provisions, admittance assessments and disclosure requirements of *SSAP No. 25—Affiliates and Other Related Parties*. In determining whether a security is a related party investment, consideration should be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security. Asset-backed 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*.

- a. Although an asset-backed security may be acquired from a non-related issuer, if the assets held in trust predominantly² 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. In such situations where the underlying collateral assets are issued by related parties that do not qualify as affiliates, these securities shall be identified as related party investments in the investment schedules.
- b. An asset-backed security may involve a relationship with a related party but not be considered an affiliated investment. This may be because the relationship does not result in direct or indirect control of the issuer or because there is an approved disclaimer of control or affiliation. Regardless of whether investments involving a related party relationship are captured in the affiliated investment reporting lines, these securities shall be identified as related party investments in the investment schedules. Examples of related party relationships would include involvement of a related party in sponsoring or originating the asset-backed security or any type of underlying servicing arrangement. For the avoidance of doubt, investments from any arrangement that results in direct or indirect control, including control through a servicer or other controlling arrangement, shall be reported as affiliated in accordance with *SSAP No. 25—Affiliates and Other Related Parties*.

Initial Reporting Value and Recognition of Origination and Commitment Fees & Costs

6. Items in scope of this statement shall initially be reported at cost, including brokerage and related fees, unless otherwise detailed in [paragraph 8](#). Acquisitions and dispositions shall be recorded on the trade date, not the settlement date, except for the acquisition of private placement asset-backed securities which shall be recorded on the funding date. For securities where all information is not known as of the trade date (e.g., actual payment factors and specific pools), a reporting entity shall make its best estimate based on known facts.

² 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) 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) because of the involvement of a non-related trustee or *SSAP No. 43R* security issuer. As identified in *SSAP No. 25—Affiliates and Other Related Parties*, 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 arrangement.

The Guidance in this Statement is Effective January 1, 2025

7. For assets that qualify in scope of this statement that result from a securitization or transfer of assets by the reporting entity captured in SSAP No. 103R, the guidance in that SSAP determines the initial reporting value:

- a. For asset-backed securities resulting from transfers of participating interests that qualify as a sale, the participating interests in financial assets that continue to be held by the reporting entity transferor shall be measured and reported at the date of transfer by allocating the previous carrying amount between the participating interests transferred and sold, and the participating interests that are not transferred and continue to be held by the reporting entity, based on their relative fair values.
- b. For asset-backed securities resulting from transfers of an entire financial asset or group of entire financial assets that qualify as a sale, assets obtained, including beneficial interests, shall be initially recognized at fair value.
- c. For asset-backed securities resulting from the transfer of assets that do not qualify as sales, the reporting entity transferor shall continue to report the transferred financial assets with no change in measurement.

8. Costs related to origination when paid in the form of brokerage and other related fees shall be capitalized as part of the cost of the asset-backed security. All other costs, including internal costs or costs paid to an affiliated entity related to origination, purchase, or commitment to purchase asset-backed securities, shall be charged to expense when incurred.

9. Origination fees represent fees charged to the borrower (paid to the reporting entity) in connection with the process of originating or restructuring a transaction. The fees include, but are not limited to, points, management, arrangement, placement, application, underwriting, and other fees pursuant to such a transaction. Origination fees shall not be recorded until received in cash. Origination fees intended to compensate the reporting entity for interest rate risks (e.g., points), shall be amortized into income over the term of the asset-backed security consistent with [paragraph 12](#) of this statement. Other origination fees shall be recorded as income upon receipt.

10. Commitment fees are fees paid to the reporting entity that obligate the reporting entity to make available funds for future borrowing under a specified condition:

- a. A fee paid to the reporting entity to obtain a commitment to make funds available at some time in the future is generally refundable only if the asset-backed security is issued. If the security is not issued, then the fees shall be recorded as investment income by the reporting entity when the commitment expires.
- b. A fee paid to the reporting entity to obtain a commitment to borrow funds at a specified rate and with specified terms quoted in the commitment agreement is generally not refundable unless the commitment is refused by the reporting entity. This type of fee shall be deferred, and amortization shall depend on whether or not the commitment is exercised. If the commitment is exercised, then the fee shall be amortized in accordance with [paragraph 12](#) of this statement over the life of the asset-backed security as an adjustment to the investment income on the security. If the commitment expires unexercised, the commitment fee shall be recognized in income on the commitment expiration date.

The Guidance in this Statement is Effective January 1, 2025

Subsequent Carrying Value Method, Amortization, Accruals and Prepayment Penalties

11. After initial recognition, the carrying value shall be determined in accordance with the reported NAIC designation. The determination of NAIC designations shall be in accordance with the requirements detailed in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual)*³:

- a. For reporting entities that maintain an Asset Valuation Reserve (AVR), asset-backed securities, excluding residual tranches or interests, shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value.
- b. For reporting entities that do not maintain an AVR, asset-backed securities designated highest-quality and high-quality (NAIC designations 1 and 2, respectively), excluding residual tranches or interests, shall be reported at amortized cost; loan-backed and structured securities that are designated medium quality, low quality, lowest quality and in or near default (NAIC designations 3 to 6, respectively) shall be reported at the lower of amortized cost or fair value.
- c. For residual tranches or interests⁴, all reporting entities shall report the item on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value. Changes in the reported value from the prior period shall be recorded as unrealized gains or losses. For reporting entities that maintain an AVR, the accounting for unrealized gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. These items are captured in *SSAP No. 21R—Other Admitted Assets* and subject to admittance restrictions detailed in that statement.

12. Amortization of premium or discount shall be calculated using the scientific (constant yield) interest method and shall be recorded as an adjustment to investment income.^(INT 07-01) The interest method results in a constant effective yield equal to the prevailing rate at the time of purchase or at the time of subsequent adjustments to book value. The amortization period shall reflect estimates of the period over which repayment of principal of the asset-backed securities is expected to occur, not the stated maturity period. (P9)

13. Interest shall be accrued using the effective-yield method using the redemption prices and redemption dates used for amortizing premiums and discounts. Interest income consists of interest collected during the period, the change in the due and accrued interest between the beginning and end of the period as well as reductions for premium amortization and interest paid on acquisition of asset-backed securities, and the addition of discount accrual. Contingent interest may be accrued if the applicable provisions of the underlying contract and the prerequisite conditions have been met.

³ Paragraphs 39-40 provide guidance on the NAIC financial modeling approach applicable to certain securities in determining NAIC designations.

⁴ Reference to “residual tranches or interests” intends to capture securitization tranches and beneficial interests as well as other structures that reflect loss layers without any contractual payments, whether principal or interest, or both. Payments to holders of these investments occur after contractual interest and principal payments have been made to other tranches or interests and are based on the remaining available funds. Although payments to holders can occur throughout an investment’s duration (and not just at maturity), such instances still reflect the residual amount permitted to be distributed after other holders have received contractual interest and principal payments.

The Guidance in this Statement is Effective January 1, 2025

14. An asset-backed security may provide for a prepayment penalty or acceleration fee in the event the investment is liquidated prior to its scheduled termination date. These fees shall be reported as investment income when received.

15. The amount of prepayment penalty and/or acceleration fees to be reported as investment income shall be calculated as follows:

- a. The amount of investment income reported is equal to the total proceeds (consideration) received less the par value of the investment; and
- b. Any difference between the book adjusted carrying value (BACV) and the par value at the time of disposal shall be reported as realized capital gains and losses subject to the authoritative literature in SSAP No. 7.

Assessment of Cash Flows and Impact of Prepayments

16. Prepayments can be a significant variable element in the cash flows received from asset-backed securities because they may affect the yield and determine the expected maturity against which the yield is evaluated. For example, with a mortgage-backed security, falling interest rates generate faster prepayment of the mortgages underlying the security, shortening its duration. This causes the reporting entity to reinvest assets sooner than expected at potentially less advantageous rates. This is called prepayment risk. Extension risk is created when rising interest rates slow repayment and can significantly lengthen the duration of the security. In addition to interest rate risk, other factors can influence the cash flows generated from an asset-backed securities. These factors include, but are not limited to, defaults of the underlying payors as well as performance requirements that must occur before cash flows can be generated from the underlying assets (such as with leases or royalty rights). If the underlying assets are delinquent or otherwise not generating expected cash flows, such items should be reflected in the cash flow analysis through diminishing security cash flows. Updated cash flow assessments shall continue to occur even if the underlying assets have not been liquidated and regardless of whether an other-than-temporary loss has been recognized.

17. Changes in currently estimated cash flows, including the effect of prepayment assumptions, on all asset-backed securities shall be reviewed periodically, at least quarterly. The prepayment rates of the underlying assets shall be used to determine prepayment assumptions. Prepayment assumptions shall be applied consistently across portfolios to all asset-backed securities backed by similar collateral (similar with respect to coupon, issuer, and age of collateral). Reporting entities shall use consistent assumptions across portfolios for similar collateral within controlled affiliated groups. Since each reporting entity may have a unique method for determining the prepayment assumptions, it is impractical to set standard assumptions for the industry. Relevant sources and rationale used to determine each prepayment assumption shall be documented by the reporting entity.

18. Asset-backed securities shall be revalued using the currently estimated cash flows, including new prepayment assumptions. Reporting entities may utilize the prospective adjustment method for all asset-backed securities, or they may elect to utilize the retrospective adjustment methodology to specific asset-backed securities that are reported with NAIC designations that are of high credit quality⁵ at the time of acquisition by the reporting entity. That is, the reporting entity shall determine if it will apply the retrospective or prospective method at the time of acquisition depending on the NAIC designation at that time and can only apply retrospective (as a policy election) to securities that of high credit. Subsequently,

⁵ Under U.S. GAAP, application of the retrospective method for beneficial interests in securitized financial assets, which would generally encompass most asset backed securities defined within SSAP 43R, is limited to “high quality” investments. This has been interpreted to be investments with AA or better ratings.

The Guidance in this Statement is Effective January 1, 2025

if an investment is downgraded below high credit quality, the reporting entity may continue to apply the retrospective method unless the security is other-than-temporarily impaired.

19. The prospective approach recognizes, through the recalculation of the effective yield to be applied to future periods, the effects of all cash flows whose amounts differ from those estimated earlier and the effects and changes in projected cash flows. Under the prospective method, the recalculated effective yield will equate the amortized cost of the investment to the present value of the anticipated future cash flows. The recalculated yield is then used to accrue income on the investment balance for subsequent accounting periods. There are no accounting changes in the current period unless the security is determined to be other than temporarily impaired.

20. The retrospective methodology changes both the yield and the amortized cost so that expected future cash flows produce a return on the investment equal to the return now expected over the life of the investment as measured from the date of acquisition. Under the retrospective method, the recalculated effective yield will equate the present value of the actual and anticipated cash flows with the original cost of the investment. The current amortized cost basis for the asset-backed security is then increased or decreased to the amount that would have resulted had the revised yield been applied since inception, and investment income is correspondingly decreased or increased.

Accretable Yield and Changes to Effective Yield for Application of Prospective Method

21. At initial acquisition of an asset-backed security, the reporting entity shall determine the accretable yield. The accretable yield is the excess of cash flows expected to be collected over the reporting entity's initial investment in the asset-backed security. The accretable yield shall be recognized as interest income on an effective-yield basis over the life of the asset-backed security⁶. The nonaccretable difference is the contractually required payments in excess of the cash flows expected to be collected. The nonaccretable difference shall not be recognized as an adjustment to yield, a loss accrual or a valuation allowance for credit risk. For transactions initially captured in SSAP No. 103R resulting from a reporting entity's transfer of assets, all cash flows estimated at the transaction date are defined as the holder's estimate of the amount and timing of estimated future principal and interest cash flows used in determining the purchase price or the holder's fair value for purposes of determining a gain or loss under SSAP No. 103R.

22. After the transaction date, cash flows expected to be collected are defined as the holder's estimate of the amount and timing of the estimated principal and interest cash flows based on the holder's best estimate of current considerations and reasonable and supportable forecasts. Expected cash flows are re-evaluated each quarter to determine if there has been a favorable (or an adverse) change in cash flows versus the previous estimate.

23. If upon evaluation there is a favorable (or an adverse) change in cash flows expected to be collected from the cash flows previously projected, the reporting entity shall recalculate the amount of accretable yield for the asset-backed security on the date of evaluation as the excess of cash flows expected to be collected over the asset-backed security's current amortized cost. The amortized cost is equal to the initial investment minus cash received to date, minus write-offs of the amortized cost basis (e.g., recognized other than temporary impairments) plus the yield accreted to date. If the security is in an impaired state (meaning, fair value is less than amortized cost, regardless if an unrealized loss has been recognized because the security is reported at amortized cost) and there is an adverse change in cash flows expected to be collected, an other-than-temporary impairment shall be considered to have occurred as described in paragraph 30 and

⁶ An asset-backed security may be acquired at a discount because of a change in credit quality or rate or both. When a security is acquired at a discount that relates, at least in part, to the security's credit quality, the effective interest rate is the discount rate that equates the present value of the investor's estimate of the security's future cash flows with the purchase price of the security.

The Guidance in this Statement is Effective January 1, 2025

requires recognition of a realized loss pursuant to paragraph 35. However, an adverse change in cash flows due solely to changes in the interest rate of a “plain-vanilla”, variable-rate asset-backed security generally shall not result in the recognition of an other-than-temporary impairment (a plain-vanilla, variable-rate asset-backed investment does not include those variable-rate investments with interest rate reset formulas that involve either leverage or an inverse floater).

24. A favorable (or an adverse) change in cash flows expected to be collected is considered in the context of both timing and amount of the cash flows expected to be collected. Based on cash flows expected to be collected, interest income may be recognized on an asset-backed security even if the net investment in the asset-backed security is accreted to an amount greater than the amount at which the asset-backed security could be settled if prepaid immediately in its entirety. The adjustment shall be accounted for prospectively as a change in estimate in conformity with SSAP No. 3, with the amount of periodic accretion adjusted over the remaining life of the asset-backed security.

25. Determining whether there has been a favorable (or an adverse) change in cash flows expected to be collected from the cash flows previously projected (taking into consideration both the timing and amount of the cash flows expected to be collected) involves comparing the present value of the remaining cash flows expected to be collected at the initial transaction date (or at the last date previously revised) against the present value of the cash flows expected to be collected at the current financial reporting date. Both the current and previous sets of cash flows shall be discounted at a rate equal to the current yield used to accrete the asset-backed security.

Recognition of Realized and Unrealized Gains and Losses and Impairment Guidance

26. Asset-backed securities required to be reported at the lower of amortized cost or fair value shall report changes from the prior reporting period as unrealized gains or losses unless an other-than-temporary impairment has occurred. For reporting entities required to maintain an AVR, the accounting for unrealized gains and losses shall be reported through the AVR. For reporting entities not required to maintain an AVR, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus). (P29)

27. Assessment of an other-than-temporary impairment is required for all asset-backed securities when fair value is less than the amortized cost basis. The amortized cost basis includes adjustments made to the cost of an investment for accretion, amortization, collection of cash, and previous other-than-temporary impairments recognized as a realized loss. Reporting a security at the lower of amortized cost or fair value is not a substitute for other-than-temporary impairment recognition. For securities reported at fair value where an other-than-temporary impairment has been determined, the loss recognized reflects the realization of unrealized losses previously recorded from fluctuations in fair value. (The extent to which unrealized losses are realized depends on whether the other-than-temporary impairment is considered a full impairment or a bifurcated impairment pursuant to paragraphs 34 and 35.) After the recognition of an other-than-temporary impairment, securities reported at the lower of amortized cost or fair value shall continue to report unrealized gains and losses from fluctuations in fair value.

28. If an entity intends to sell the asset-backed security (that is, it has decided to sell the security), an other-than-temporary impairment shall be considered to have occurred.

29. If an entity does not intend to sell the asset-backed security, the entity shall assess whether it has the intent and ability⁷ to retain the investment in the security for a period of time sufficient to recover the

⁷ This assessment shall be considered a high standard due to the accounting measurement method established for the securities within the scope of this statement (amortized cost).

The Guidance in this Statement is Effective January 1, 2025

amortized cost basis. If the entity does not have the intent and ability to retain the investment for the time sufficient to recover the amortized cost basis, an other-than-temporary impairment shall be considered to have occurred.

30. If the entity does not expect to recover the entire amortized cost basis of the security, the entity would be unable to assert that it will recover its amortized cost basis even if it does not intend to sell the security and the entity has the intent and ability to hold. (This includes situations in which an entity has an adverse change in cash flows expected to be collected for a security that is an impaired position (meaning, fair value is less than amortized cost, regardless of if an unrealized loss has been recognized.) In such situations, an other-than temporary impairment shall be considered to have occurred. (For mortgage-referenced securities, an OTTI is considered to have occurred when there has been a delinquency or other credit event in the referenced pool of mortgages such that the entity does not expect to recover the entire amortized cost basis of the security.) In assessing whether the entire amortized cost basis of the security will be recovered, an entity shall compare the present value of cash flows expected to be collected from the security with the amortized cost basis of the security. If present value of cash flows expected to be collected is less than the amortized cost basis of the security, the entire amortized cost basis of the security will not be recovered, and an other-than-temporary impairment shall be considered to have occurred. A decrease in the present value of cashflows expected to be collected on an asset-backed security that results from an increase or decrease in expected prepayments on the underlying assets shall be considered in the estimate of the present value of cashflows expected to be collected.

31. In determining whether an other than-temporary impairment has occurred, an entity shall calculate the present value of cash flows expected to be collected based on an estimate of the expected future cash flows of the impaired asset-backed security, discounted at the security's effective interest rate. For securities in which there was no nonaccretable yield and for which there has been no changes to estimated cash flows since acquisition, the effective interest rate is the rate of return implicit in the security (that is, the contractual interest rate adjusted for any net deferred fees or costs, premium, or discount existing at the origination or acquisition of the security).⁸ For all other securities, the effective interest rate is the rate implicit immediately prior to the recognition of the other-than-temporary impairment. (Meaning, the effective interest rate as adjusted to reflect the last revised assessment of expected cash flows.)

32. It is inappropriate to automatically conclude that a security is not other-than-temporarily impaired because all of the scheduled payments to date have been received. However, it also is inappropriate to automatically conclude that every decline in fair value represents an other-than-temporary impairment. Further analysis and judgment are required to assess whether a decline in fair value indicates that it is probable that the holder will not collect all of the contractual or estimated cash flows from the security. In addition, the length of time and extent to which the fair value has been less than cost can indicate a decline is other than temporary. The longer and/or the more severe the decline in fair value, the more persuasive the evidence that is needed to overcome the premise that it is probable that the holder will not collect all of the contractual or estimated cash flows from the issuer of the security.

33. In making its other-than-temporary impairment assessment, the holder shall consider all available information relevant to the collectibility of the security, including information about past events, current conditions, and reasonable and supportable forecasts, when developing the estimate of future cash flows. Such information generally shall include the remaining payment terms of the security, prepayment speeds, the financial condition of the issuer(s), expected defaults, and the value of any underlying collateral. To achieve that objective, the holder shall consider, for example, industry analyst reports and forecasts, sector

⁸ An asset-backed security may be acquired at a discount because of a change in credit quality or rate or both. When a security is acquired at a discount that relates, at least in part, to the security's credit quality, the effective interest rate is the discount rate that equates the present value of the investor's estimate of the security's future cash flows with the purchase price of the security.

The Guidance in this Statement is Effective January 1, 2025

credit ratings, and other market data that are relevant to the collectibility of the security. The holder also shall consider how other credit enhancements affect the expected performance of the security, including consideration of the current financial condition of the guarantor of a security (if the guarantee is not a separate contract) and/or whether any subordinated interests are capable of absorbing estimated losses on the loans underlying the security. The remaining payment terms of the security could be significantly different from the payment terms in prior periods (such as for some securities backed by “nontraditional loans”⁹). Thus, the holder shall consider whether a security backed by currently performing loans will continue to perform when required payments increase in the future (including “balloon” payments). The holder also shall consider how the value of any collateral would affect the expected performance of the security. If the fair value of the collateral has declined, the holder needs to assess the effect of that decline on the ability of the holder to collect the balloon payment.

34. When an other-than-temporary impairment has occurred because the entity intends to sell the security or has assessed that they do not have the intent and ability to retain the investments in the security for a period of time sufficient to recover the amortized cost basis, the amount of the other-than-temporary impairment recognized in earnings as a realized loss shall equal the entire difference between the investment’s amortized cost basis and its fair value at the balance sheet date (full impairment). For asset-backed securities held at lower of amortized cost or fair value, upon recognition of an other-than-temporary impairment, all unrealized losses would be considered realized and the current fair value becomes the new cost basis.)

35. When an other-than-temporary impairment has occurred because the entity does not expect to recover the entire amortized cost basis of the security even if the entity has no intent to sell and the entity has the intent and ability to hold, the amount of the other-than-temporary impairment recognized as a realized loss shall equal the difference between the investment’s amortized cost basis and the present value of cash flows expected to be collected, discounted at the security’s effective interest rate in accordance with paragraph 31 (bifurcated impairment). For asset-backed securities held at lower of cost or fair value, unrealized losses would be realized for the non-interest related decline. Hence, unrealized losses could continue to be reflected for these securities based on the difference between the current fair value and the present value of cash flows expected to be collected. (After recognizing an OTTI in these situations, the present value of cash flows expected to be collected becomes the new cost basis of the security.)

36. For reporting entities required to maintain an AVR or IMR, all unrealized gains and losses shall be reported through the AVR. For realized gains and losses, an analysis is required on whether the realized loss reflects an interest or non-interest related decline¹⁰. The analysis required is the same regardless of whether a realized loss results from an impairment write-down or whether there was a gain or loss upon sale. Guidance on specific scenarios resulting in realized gains and losses are as follows:

⁹ A nontraditional loan may have features such as (a) terms that permit principal payment deferral or payments smaller than interest accruals (negative amortization), (b) a high loan-to-value ratio, (c) multiple loans on the same collateral that when combined result in a high loan-to value ratio, (d) option adjustable-rate mortgages (option ARMs) or similar products that may expose the borrower to future increases in repayments in excess of increases that result solely from increases in the market interest rate (for example, once negative amortization results in the loan reaching a maximum principal accrual limit), (e) an initial interest rate that is below the market interest rate for the initial period of the loan term and that may increase significantly when that period ends, and (f) interest-only loans that should be considered in developing an estimate of future cash flows.

¹⁰ Pursuant to INT 06-07, the term interest-related includes a declining value due to both increases in the risk free interest rate and general credit spread widening. Credit spreads can widen or contract for a variety of reasons, including supply/demand imbalances in the marketplace or the perceived higher/lower risk of an entire sector. If the declining value is caused, in whole or in part, due to credit spreads widening, but not due to fundamental credit problems of the issuer, the change in credit spreads is deemed to be interest-related.

The Guidance in this Statement is Effective January 1, 2025

- a. Unrealized Gains and Losses – Record all unrealized gains and losses through AVR. At the time an unrealized gain or loss is realized, allocation between AVR or IMR will depend on the analysis and bifurcation between interest or non-interest related declines. Unrealized gains or losses that are realized shall be reversed from AVR before the recognition of the realized gain or loss within AVR and IMR.
- b. Other-Than-Temporary Impairment – Non-interest related other-than-temporary impairment losses shall be recorded through the AVR and interest-related OTTI losses shall be recorded through the IMR. If the reporting entity wrote the security down to fair value due to the intent to sell or because the entity does not have the intent and ability to retain the investment for a period of time sufficient to recover the amortized cost basis, the entity shall bifurcate the realized loss between non-interest related (AVR) and interest related (IMR). The analysis for bifurcating impairment losses between AVR and IMR shall be completed as of the date when the other-than-temporary impairment is determined. Entities that recognized an OTTI based on the difference between amortized cost and the present value of expected cash flows shall recognize the full realized loss through AVR.
- c. Security Sold at a Loss Without Prior OTTI – An entity shall bifurcate the loss into AVR and IMR portions depending on interest and non-interest related declines in accordance with the analysis performed as of the date of sale.
- d. Security Sold at a Loss With Prior OTTI – An entity shall bifurcate the current realized loss into AVR and IMR portions depending on interest and non-interest related declines in accordance with the analysis performed as of the date of sale. An entity shall not adjust previous allocations to AVR and IMR that resulted from previous recognition of other-than-temporary impairments.
- e. Security Sold at a Gain With Prior OTTI – An entity shall bifurcate the gain into AVR and IMR portions depending on interest and non-interest factors in accordance with the analysis performed as of the date of sale. The bifurcation between AVR and IMR that occurs as of the date of sale may be different from the AVR and IMR allocation that occurred at the time of previous other-than-temporary impairments. An entity shall not adjust previous allocations to AVR and IMR that resulted from previous recognition of other-than-temporary impairments.
- f. Security Sold at a Gain Without Prior OTTI – An entity shall bifurcate the gain into AVR and IMR portions depending on interest and non-interest factors in accordance with the analysis performed as of the date of sale.

37. This statement does not permit reversals of recognized other-than-temporary impairments based on subsequent recoveries of fair value. If there are subsequent changes to the cash flows expected to be collected, the prospective adjustment method shall be used to adjust the effective yield in future periods to reflect those changes.

38. In periods subsequent to the recognition of an other than temporary impairment loss for an asset-backed security, the reporting entity shall account for the other-than-temporarily impaired security as if the security had been purchased on the measurement date of the other-than-temporary impairment at an amortized cost basis equal to the previous amortized cost basis less the other-than-temporary impairment recognized as a realized loss. The difference between the new amortized cost basis and the cash flows expected to be collected shall be accreted as interest income. A reporting entity shall continue to estimate the present value of cash flows expected to be collected over the life of the asset-backed security.

The Guidance in this Statement is Effective January 1, 2025

Designation Guidance

39. For Residential Mortgage-Backed Securities (RMBS), Commercial Mortgage-Backed Securities (CMBS) and Collateralized Loan Obligations (CLOs) securities within the scope of this statement, the initial NAIC designation used to determine the carrying value method and the final NAIC designation for reporting purposes is determined using a multi-step process or the NAIC designation assigned by the NAIC Securities Valuation Office. The P&P Manual provides detailed guidance. A general description of the processes is as follows:

- a. **Financial Modeling:** Pursuant to the P&P Manual, the NAIC identifies select securities where financial modeling must be used to determine the NAIC designation. For a modeled RMBS/CMBS legacy security, meaning one which closed prior to January 1, 2013, the NAIC designation is based on financial modeling incorporating the insurers' carrying value. For a modeled RMBS/CMBS non-legacy security, meaning one which closed after December 31, 2012, or modeled CLO, the NAIC designation and NAIC designation category assigned by the NAIC Securities Valuation Office must be used. For those RMBS/CMBS legacy securities that are financially modeled, the insurer must use NAIC CUSIP specific modeled breakpoints provided by the modelers in determining initial and final designation for these identified securities. As specified in the P&P Manual, a modeled legacy security RMBS or CMBS tranche that has no expected loss, as compiled and published by the NAIC Securities Valuation Office, under any of the selected modeling scenarios would be assigned an NAIC 1 designation and NAIC 1.A designation category regardless of the insurer's book/adjusted carrying value. The three-step process for modeled RMBS/CMBS legacy securities is as follows:
 - i. **Step 1: Determine Initial Designation** – The current amortized cost (divided by remaining par amount) of an asset-backed security is compared to the modeled breakpoint values assigned to each NAIC designation and NAIC designation category for each CUSIP to establish the **initial** NAIC designation.
 - ii. **Step 2: Determine Carrying Value Method** – The carrying value method, either the amortized cost method or the lower of amortized cost or fair value method, is then determined as described in paragraph 11 based upon the initial NAIC designation from Step 1.
 - iii. **Step 3: Determine Final Designation** – The final NAIC designation is determined by comparing the carrying value (divided by remaining par amount) of a security (based on paragraph 39.a.ii.) to the NAIC CUSIP specific modeled breakpoint values assigned to the NAIC designation and NAIC designation category for each CUSIP or is mapped to an NAIC designation category, according to the instructions in the P&P Manual. This final NAIC designation shall be applicable for statutory accounting and reporting purposes and the NAIC designation category will be used for investment schedule reporting and establishing RBC and AVR charges. The final NAIC designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 39.a.ii.).
- b. **All Other Asset-Backed Securities:** For securities not subject to paragraph 39.a. (financial modeling) follow the established designation procedures according to the appropriate section of the P&P Manual. The NAIC designation shall be applicable for statutory accounting and reporting purposes (including determining the carrying value method and

The Guidance in this Statement is Effective January 1, 2025

establishing the AVR charges). The carrying value method is established as described in paragraph 11.

40. For securities that will be financially modeled under paragraph 39, the guidance in this paragraph shall be applied in determining the reporting method for such securities acquired in the current year for quarterly financial statements. Securities reported as of the prior-year end shall continue to be reported under the prior-year end methodology for the current-year quarterly financial statements. For year-end reporting, securities shall be reported in accordance with paragraph 39, regardless of the quarterly methodology used. (P28)

- a. Reporting entities that acquired the entire financial modeling database for the prior-year end are required to follow the financial modeling methodology (paragraph 39.a.) for all securities acquired in the subsequent year that were included in the financial modeling data acquired for the prior year-end.
- b. Reporting entities that acquired identical securities (identical CUSIP) to those held and financially modeled for the prior year-end are required to follow the prior year-end financial modeling methodology (paragraph 39.a.) for these securities acquired subsequent to year-end.
- c. Reporting entities that do not acquire the prior-year financial modeling information for current-year acquired individual CUSIPS, and are not captured within paragraphs 40.a. or 40.b., are required to follow the analytical procedures for non-financially modeled securities (paragraph 39.b. as appropriate) until the current year financial modeling information becomes available and then follow the procedures for financially modeled securities (paragraph 27.a., as appropriate). Reporting entities that do acquire the individual CUSIP information from the prior-year financial modeling database shall use that information for interim reporting.
- d. Reporting entities that acquire securities not previously modeled at the prior year-end are required to follow the analytical procedures for non-financially modeled securities (paragraph 39.b. as appropriate) until the current year financial modeling information becomes available and then follow the procedures for financially modeled securities (paragraph 27.a., as appropriate).

Giantization/Megatization of FHLMC or FNMA Mortgage-Backed Securities

41. Giantization/megatization of mortgage-backed securities is defined as existing pools of FHLMC or FNMA mortgage-backed securities (MBS) with like coupon and prefix which are repooled together by the issuing agency creating a new larger security. The new Fannie Mae “Mega” or Freddie Mac “Giant” is a guaranteed MBS pass-through representing an undivided interest in the underlying pools of loans.

42. Repooled FHLMC and FNMA securities meet the definition of substantially the same as defined in *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The transaction shall not be considered a sale/purchase and no gain or loss shall be recognized. To properly document the repooling, the transaction shall be reported through Schedule D of the annual statement as a disposition and an acquisition.

43. Transaction fees charged by the issuing agencies shall be capitalized and amortized over the life of the repooled security.

The Guidance in this Statement is Effective January 1, 2025

Disclosures

44. In addition to the disclosures required for invested assets in general, the following disclosures regarding asset-backed securities shall be made in the financial statements. Regardless of the allowances within paragraph 63 of the Preamble, the disclosures in paragraph 44.f., 44.g. and 44.h. of this statement are required in separate, distinct notes to the financial statements:

- a. Fair values in accordance with *SSAP No. 100R—Fair Value*.
- b. Concentrations of credit risk in accordance with *SSAP No. 27*;
- c. Basis at which the asset-backed securities are stated;
- d. The adjustment methodology used for each type of security (prospective or retrospective);
- e. Descriptions of sources used to determine prepayment assumptions.
- f. All securities within the scope of this statement with a recognized other-than-temporary impairment, disclosed in the aggregate, classified on the basis for the other-than-temporary impairment: (1) intent to sell, (2) inability or lack of intent to retain the investment in the security for a period of time sufficient to recover the amortized cost basis, or (3) present value of cash flows expected to be collected is less than the amortized cost basis of the security.
- g. For each security with an other-than-temporary impairment, recognized in the current reporting period by the reporting entity, as the present value of cash flows expected to be collected is less than the amortized cost basis of the securities:
 - i. The amortized cost basis, prior to any current-period other-than-temporary impairment.
 - ii. The other-than-temporary impairment recognized in earnings as a realized loss.
 - iii. The fair value of the security.
 - iv. The amortized cost basis after the current-period other-than-temporary impairment.
- h. All impaired securities (fair value is less than cost or amortized cost) for which an other-than-temporary impairment has not been recognized in earnings as a realized loss (including securities with a recognized other-than-temporary impairment for non-interest related declines when a non-recognized interest related impairment remains):
 - i. The aggregate amount of unrealized losses (that is, the amount by which cost or amortized cost exceeds fair value) and
 - ii. The aggregate related fair value of securities with unrealized losses.
- i. The disclosures in (i) and (ii) above should be segregated by those securities that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer using fair values determined in accordance with *SSAP No. 100R*.

The Guidance in this Statement is Effective January 1, 2025

- j. Additional information should be included describing the general categories of information that the investor considered in reaching the conclusion that the impairments are not other-than-temporary.
- k. When it is not practicable to estimate fair value, the investor should disclose the following additional information, if applicable:
 - i. The aggregate carrying value of the investments not evaluated for impairment, and
 - ii. The circumstances that may have a significant adverse effect on the fair value.
- l. For securities sold, redeemed or otherwise disposed as a result of a callable feature (including make whole call provisions), disclose the number of CUSIPs sold, disposed or otherwise redeemed and the aggregate amount of investment income generated as a result of a prepayment penalty and/or acceleration fee.
- m. The items in the scope of this statement are also subject to the annual audited disclosures in *SSAP No. 26R—Bonds*, paragraphs 39.e., 39.f. and 39.g.

45. Refer to the Preamble for further discussion regarding disclosure requirements. All disclosures within this statement, except disclosures included in paragraphs 44.b., 44.k. and 44.m., shall be included within the interim and annual statutory financial statements. Disclosure requirements in paragraphs 44.b., 44.k. and 44.m. are required in the annual audited statutory financial statements only.

Relevant Literature

46. This statement reflects specific statutory accounting guidance for assets that qualify as asset-backed securities under the statutory accounting principles-based bond definition. The classification of investments as ‘bonds’ for statutory accounting and reporting purposes differs from the U.S. GAAP determination of a “debt instrument” and this statement reflects statutory specific measurement and impairment guidance for investments captured in scope. This statement does incorporate limited U.S. GAAP concepts, particularly with the determination of accretible yield and consideration of changes in expected cash flows using the retrospective or prospective method. However, due to the statutory accounting specifications on scope, measurement method and impairment, no U.S. GAAP standards are considered adopted within this statement. Concepts that converge with U.S. GAAP are limited to the extent they are detailed in this statement.

Effective Date and Transition

47. This statement adopted August 13, 2023, is effective for years beginning January 1, 2025. The revisions to this statement, and *SSAP No. 26R—Bonds*, incorporate principal concepts on what should be reported as a long-term bond. Securities that qualify as issuer credit obligations within the principal concepts are captured within scope of *SSAP No. 26R*. Securities that qualify as asset-backed securities within the principal concepts are captured within scope of *SSAP No. 43R*. Securities that do not qualify as issuer credit obligations or ABS, unless specifically permitted in scope of these statements, are not permitted to be reported as a bond.

48. At the time of transition, reporting entities shall make their best efforts to assess investments to determine whether they qualify within the bond definition for reporting as issuer credit obligations on Schedule D-1-1 or asset-backed securities on Schedule D-1-2. The bond definition requires assessments at the time of acquisition (as of the origination date), and it is recognized that reporting entities may not have the means to complete historical assessments for securities held at the time of transition. For these instances,

The Guidance in this Statement is Effective January 1, 2025

if information is not readily available for reporting entities to assess a security as of the date at origination, reporting entities may utilize current or acquisition information in concluding that a security qualifies for reporting as a bond as either an issuer obligation or asset-backed security.

49. Investments that were reported as a bond on Schedule D-1: Long-Term Bonds as of December 31, 2024, that do not qualify under the principle-based bond concepts shall be reported as a disposal from that schedule, with a reacquisition on the appropriate reporting schedule as of January 1, 2025. These investments shall be accounted for in accordance with the resulting SSAP that addresses the specific investment structure. For securities that are reported at the lower of amortized cost or fair value under the new applicable guidance, this could result with an unrealized loss in the measurement of the investment at the time of the reclassification. Although the adoption of this guidance is considered a change in accounting principle under SSAP No. 3, the following transition guidance shall be applied on January 1, 2025, to ensure consistency in reporting and to allow investment schedules to roll appropriately:

- a. Securities reclassified from Schedule D-1 as they no longer qualify under the bond definition shall be reported as a disposal from Schedule D-1 at amortized cost. Although no proceeds are received, amortized cost at the time of disposal shall be reported as consideration on Schedule D-4.
 - i. For securities held at amortized cost at the time of disposal, book adjusted carrying value and amortized cost shall agree, preventing gain or loss recognition at the time of reclassification.
 - ii. For securities held at fair value under the lower of amortized cost or fair value measurement method, previously reported unrealized losses shall be reversed on Jan. 1, 2025, prior to disposal, resulting with a reported value that mirrors amortized cost at the time of disposal. This action prevents realized loss recognition at time of reclassification.
- b. Securities reclassified from Schedule D-1 shall be recognized on the subsequent schedule (e.g., Schedule BA) with an actual cost that agrees to the disposal value (amortized cost). Immediately subsequent to recognition on the resulting schedule, the securities shall be reported in accordance with the measurement method prescribed by the applicable SSAP:
 - i. For securities previously reported at fair value on Schedule D-1 (under a lower of amortized cost or fair value measurement method), the reporting entity will recognize an unrealized loss to match the previously reported book adjusted carrying value. Subsequently, the security will continue to reflect a lower of amortized cost or fair value measurement method.
 - ii. For securities previously reported at amortized cost on Schedule D-1, if the subsequent statement requires a lower of amortized cost or fair value measurement method, then the reporting entity shall recognize an unrealized loss to the extent fair value is less than amortized cost.
 - iii. After application of paragraph 49.b.i. and 49.b.ii. all securities shall reflect either the same reported value as of December 31, 2024 (amortized cost or fair value) or a lower reported value (if the security is subject to the lower of amortized cost or fair value measurement method). There should be no instances that result with a

The Guidance in this Statement is Effective January 1, 2025

security having a greater reported value than what was presented on December 31, 2024. Subsequent to transition, securities reported at fair value may incur unrealized gains or losses due to fair value fluctuations, but should never have unrealized gains that result with a book adjusted carrying value that exceeds amortized cost.

50. With this transition guidance, changes in measurement for securities reclassified under the bond definition will be reported as a change in unrealized capital gains (losses) in the first quarter 2025 financial statements (unless sold in the interim with a realized gain or loss) and not as a change in accounting principle. To enable regulators the ability to identify the impact of securities reclassified under the bond definition, the following disclosure for the 2025 first quarter financial statement is required:

- a. Aggregate book adjusted carrying value for all securities reclassified off Schedule D-1.
- b. Aggregate book adjusted carrying value after transition for all securities reclassified off Schedule D-1 that resulted with a change in measurement basis. (This shall be a subset of paragraph 50.a. and captures the securities that moved from an amortized cost to a fair value measurement method under the lower of amortized cost or fair value approach.)
- c. Aggregate surplus impact for securities reclassified off Schedule D-1. This shall include the difference between book adjusted carrying value as of December 31, 2024, and book adjusted carrying value after transition for those securities that moved from an amortized cost to a fair value measurement method under the lower of amortized cost or fair value approach.

51. Asset-backed securities that were previously reported as short-term (Schedule DA) or as a cash equivalent (Schedule E2) shall be reclassified to be reported on Schedule D-1-2 on Jan. 1, 2025. Similar to the process detailed in paragraph 49, the securities shall be removed from DA and E2 at amortized cost, with reversal of any unrealized loss prior to the reclassification. The amortized cost shall be reported as “consideration received on disposals” on Schedule DA – Verification Between Years or Schedule E-2 – Verification Between Years, as applicable based on the prior reporting location. The security shall be recognized as an ABS acquired on Schedule D-3 at amortized cost. Immediately after initial recognition, if the security was required to be held at fair value, under the lower of amortized cost or fair value measurement method, the reporting entity shall recognize an unrealized loss.

52. For clarification purposes, the transition guidance shall be applied prospectively beginning with the first year of adoption (Jan. 1, 2025). For disclosures that provide comparative information, reporting entities shall not restate the prior year’s information in the 2025 disclosure.

REFERENCES

Other

- *Purposes and Procedures Manual of the NAIC Investment Analysis Office*
- NAIC Valuation of Securities product prepared by the Securities Valuation Office

Relevant Issue Papers

- *Issue Paper No. XX—Principles Based Bond Definition*

The Guidance in this Statement is Effective January 1, 2025

EXHIBIT A – QUESTION AND ANSWER IMPLEMENTATION GUIDE

This exhibit addresses common questions regarding the valuation and impairment guidance detailed in SSAP No. 43R.

Index to Questions

| No. | Question |
|--|---|
| 1 | Are reporting entities permitted to establish an accounting policy to write down a SSAP No. 43R other-than-temporarily impaired security, for which a “non-interest” related decline exists, to fair-value regardless of whether the reporting entity intends to sell, or has the intent and ability to hold? |
| 2 | Can a reporting entity avoid completing a cash-flow assessment or testing for a specific other-than-temporarily impaired security when the entity believes there is a clear cash-flow shortage (i.e., non-interest related impairment) and elect to recognize a full impairment for the SSAP No. 43R security (no impairment bifurcation), with fair value becoming the new amortized cost basis, and recognition of the full other-than-temporary impairment as a realized loss? |
| 3 | Can reporting entities change their “intend to sell” or “unable to hold” assertions and recover previously recognized other-than-temporary impairments? |
| 4 | How do the regulators intend the phrase “intent and ability to hold” as used within SSAP No. 43R to be interpreted? |
| 5 | How do contractual prepayments affect the determination of credit losses? |
| 6 | Are the disclosure requirements within paragraphs 44.f. and 44.g. of SSAP No. 43R required to be completed for the current reporting quarter only, or as a year-to-date cumulative disclosure? |
| 7 | If an impairment loss is recognized based on the "present value of projected cash flows" in one period is the entity required to get new cash flows every reporting period subsequent or just in the periods where there has been a significant change in the actual cash flows from projected cash flows? |
| Questions 8-10 are specific to securities subject to the financial modeling process. (This process is limited to qualifying RMBS/CMBS securities reviewed by the NAIC Structured Securities Group.) The guidance in questions 8-10 shall not be inferred to other securities in scope of SSAP No. 43R. | |
| 8 | Do ABS 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? |
| 9 | The NAIC Designation process for ABS 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? |

The Guidance in this Statement is Effective January 1, 2025

| No. | Question |
|-----|---|
| 10 | 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? |

Questions 8-10 are specific to securities subject to the financial modeling process. (This process is limited to qualifying RMBS/CMBS securities reviewed by the NAIC Structured Securities Group.) The guidance in questions 8-10 shall not be inferred to other securities in scope of SSAP No. 43R.

1. Question - Are reporting entities permitted to establish an accounting policy to write down a SSAP No. 43R other-than-temporarily impaired security, for which a “non-interest” related decline exists, to fair value regardless of whether the reporting entity intends to sell, or has the intent and ability to hold?

1.1 Pursuant to the guidance in SSAP No. 43R, optionality is not permitted. As such, an accounting policy that differs from SSAP No. 43R would be considered a departure from statutory accounting principles as prescribed by the NAIC *Accounting Practices and Procedures Manual*.

2. Question – Can a reporting entity avoid completing a cash-flow assessment or testing for a specific other-than-temporarily impaired security when the entity believes there is a clear cash-flow shortage (i.e., non-interest related impairment) and elect to recognize a full impairment for the SSAP No. 43R security (no impairment bifurcation), with fair value becoming the new amortized cost basis, and recognition of the full other-than-temporary impairment as a realized loss?

2.1 Under the basis of SSAP No. 43R, an entity is not permitted to elect a write-down to fair value in lieu of assessing cash flows and bifurcating “interest” and “non-interest” impairment components. As noted in paragraph 30, if the entity does not have the intent to sell, and has the intent and ability to hold, but does not expect to recover the entire amortized cost basis of the security, the entity shall compare the present value of cash flows expected to be collected with the amortized cost basis of the security. If present value of cash flows expected to be collected is less than the amortized cost basis of the security, the entire amortized cost basis of the security will not be recovered (a non-interest decline exists) and an other-than-temporary impairment shall be considered to have occurred. Pursuant to paragraph 35, when an other-than-temporary impairment has occurred because the entity does not expect to recover the entire amortized cost basis of the security even if the entity has no intent to sell and the entity has the intent and ability to hold, the amount of the other-than-temporary impairment recognized as a realized loss shall equal the difference between the investment’s amortized cost basis and the present value of cash flows expected to be collected, discounted at the asset-backed security’s effective interest rate.

2.2 If the entity does not want to assess cash flows of an impaired security (fair value is less than amortized cost), the entity can designate the security as one the entity intends to sell, or one that the entity does not have the intent and ability to hold, providing it is reflective of the true intent and assessment of the ability of the entity. Once an impaired security has this designation, pursuant to paragraphs 28 or 29, an other-than-temporary impairment shall be considered to have occurred. As detailed in paragraph 34, the amount of the other-than-temporary impairment recognized in earnings as a realized loss shall equal the entire difference between the investment’s amortized cost basis and its fair value at the balance sheet date.

The Guidance in this Statement is Effective January 1, 2025

- 2.3 As addressed in question 3 of this Question and Answer Guide, reporting entities are not permitted to change assertions regarding their intent to sell or their lack of intent and ability to hold. Once the security has been identified as one the entity intends to sell, or as a security that the entity does not have the intent and ability to hold, that assertion shall not change as long as the entity continues to hold the security.
- 3. Question** - Can reporting entities change their “intend to sell” or “unable to hold” assertions and recover previously recognized other-than-temporary impairments?
- 3.1 No, a reporting entity is not permitted to change assertions and reverse previously recognized SSAP No. 43R other-than-temporary impairments. Although an entity may elect to hold a security due to a favorable change in the security’s fair value, once the security has been identified as one the entity intends to sell, or as a security that the entity does not have the intent and ability to hold for purposes of initially recognizing an other-than-temporary impairment, that assertion shall not change as long as the entity continues to hold the security.
- 3.2 Reporting entities that have recognized an other-than-temporary impairment on a SSAP No. 43R security in a manner corresponding with an assertion on the intent to sell or the lack of the intent and ability to hold, for which a subsequent other-than-temporary impairment has been identified, shall recognize a realized loss for the difference between the current amortized cost (reflecting the previously recognized SSAP No. 43R other-than-temporary impairment) and the fair value at the balance sheet date of the subsequent impairment. Thus, bifurcation of impairment between interest and non-interest related declines is not permitted for securities in which an other-than-temporary impairment was previously recognized on the basis that the reporting entity had the intent to sell, or lacked the intent and ability to hold, regardless if the entity has subsequently decided to hold the security.
- 3.3 Reporting entities shall reclassify a security as one for which there is an intent to sell, or for which there is not an intent or ability to hold, regardless if a bifurcated other-than-temporary impairment had previously been recognized, as soon as the entity realizes that they can no longer support a previous assertion to hold the security. In making such reclassifications, if the security is impaired, the difference between the amortized cost (reflecting the initial non-interest other-than-temporary impairment recognized) and fair value at the balance sheet date of the reclassification shall be recognized as a realized loss, with fair value reflecting the new amortized cost basis. Once such a reclassification occurs, and the security is classified as one for which there is an intent to sell, or for which there is not an intent and ability to hold, the security must continue to carry that assertion until it is no longer held by the reporting entity.
- 4. Question** – How do the regulators intend the phrase “intent and ability to hold” as used within SSAP No. 43R to be interpreted?
- 4.1 SSAP No. 43R **paragraph 29** states in part “...the entity shall assess whether it has the intent and ability to retain the investment in the security for a period of time sufficient to recover the amortized cost basis. If the entity does not have the intent and ability to retain the investment for the time sufficient to recover the amortized cost basis, an other-than-temporary impairment shall be considered to have occurred.”

The Guidance in this Statement is Effective January 1, 2025

- 4.2 The intent of this language within SSAP No. 43R is focused on ensuring that, as of the balance sheet date, after considering the entity's own cash or working capital requirements and contractual or regulatory obligations and all known facts and circumstances related to the impaired security, the entity does not have the intention of selling the impaired security and has the current intent and ability to hold the security to recovery. Due to impairment bifurcation provisions provided within SSAP No. 43R, and the amortized cost measurement method generally permitted for asset-backed securities, the assessment of "intent and ability" is intended to be a high standard. Despite the intent of paragraph 29, it is identified that information not known to the entity may become known in subsequent periods and/or facts and circumstances related to an individual holding or group of holdings may change thereby influencing the entity's subsequent determination of intent and ability with respect to a security or securities.
- 4.3 If a reporting entity asserts that it has the intent and ability to hold a security, or group of securities, until recovery of the amortized cost, but sells or otherwise disposes the security or securities prior to such recovery, the reporting entity shall be prepared to justify this departure from their original assertion to examiners and auditors. SSAP No. 43R purposely does not identify specific circumstances in which a change in assertion would be justifiable, but requires judgment from management, examiners and auditors on whether future assertions warrant closer review.
- 4.4 Delaying recognition of other-than-temporary impairments is a cause of serious concern by the regulators, and entities that habitually delay such recognition through false assertions on the "intent and ability to hold" may face increased scrutiny and regulatory action by their domiciliary state. It is imperative that a reporting entity recognize the full other-than-temporary impairment as soon as the entity realizes that they will no longer be able to hold the security until recovery of the amortized cost basis. Greater scrutiny shall be placed on securities sold or otherwise disposed shortly after a financial statement reporting date if such securities had been excluded from the full other-than-temporary impairment recognition on the basis of the reporting entity's intent and ability to hold.
- 4.5 As noted in paragraph 3.3 of this question and answer guide, once a security is classified as one for which there is an intent to sell, or for which there is not an intent and ability to hold, the security must continue to carry that assertion until the security is no longer held by the reporting entity.
5. **Question** – How do contractual prepayments affect the determination of credit losses?
- 5.1 Paragraph 30 of SSAP No. 43R states that "A decrease in cash flows expected to be collected on asset-backed security that results from an increase in prepayments on the underlying assets shall be considered in the estimate of present value of cash flows expected to be collected." Paragraph 18 states that "Asset-backed securities shall be revalued using the currently estimated cash flows, including new prepayment assumptions. Reporting entities may utilize the prospective adjustment method for all asset-backed securities that are reported with NAIC designations that are of high credit at the of acquisition by the reporting entity."
6. **Question** – Are the disclosure requirements within paragraphs 44.f. and 44.g. of SSAP No. 43R required to be completed for the current reporting quarter only, or as a year-to-date cumulative disclosure?
- 6.1 The disclosures should reflect the year-to-date other-than-temporary impairments. The "fair value" reported within the disclosure is intended to reflect the fair value at the date of

The Guidance in this Statement is Effective January 1, 2025

the other-than-temporary impairment and shall not be updated due to the fluctuations identified at subsequent reporting dates. If a security has more than one other-than-temporary impairment identified during a fiscal reporting year, the security shall be included on the disclosure listing separately for each identified other-than-temporary impairment. Notation shall be included in the disclosure identifying the other-than-temporary impairments that were recognized for each respective reporting period.

7. Question – If an impairment loss is recognized based on the "present value of projected cash flows" in one period is the entity required to get new cash flows every reporting period subsequent or just in the periods where there has been a significant change in the actual cash flows from projected cash flows?

7.1 The guidance in paragraph 38 of SSAP No. 43R indicates that a reporting entity shall continue to estimate the present value of cash flows expected to be collected over the life of the asset-backed security. This guidance is explicit that the reporting entity shall continue to estimate the present value of cash flows expected to be collected over the life of the loan-backed or structured security.

7.2 As provided in paragraph 2.2 of this Q&A, if the entity does not want to assess cash flows of an impaired security (fair value is less than amortized cost), the entity can designate the security as one the entity intends to sell, or one that the entity does not have the intent and ability to hold, providing it is reflective of the true intent and assessment of the ability of the entity. Reporting entities subject to the requirements of AVR and IMR should allocate the impairment loss between AVR and IMR accordingly.

8. Question – Do ABS 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.)

9. Question – The NAIC Designation process for ABS 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.

The Guidance in this Statement is Effective January 1, 2025

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.

[https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/APPTF/2023-2 Summer/Summary and Minutes/SAPWG/Attachments/Att1P-2019-21 SSAP 43R.docx](https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member%20Meetings/E%20CMTE/APPTF/2023-2%20Summer/Summary%20and%20Minutes/SAPWG/Attachments/Att1P-2019-21%20SSAP%2043R.docx)

The Revisions Shown in this Document are Effective January 1, 2025

Bond Definition - Revisions to other SSAPs Adopted Aug. 13, 2023

SSAP Reference Revisions

1. ***SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments***

SSAP No. 26R: Updated reference in paragraph 18. No revisions needed to paragraph 7 or 15.

SSAP No. 43R: Adjusted title references in paragraphs 7 and 15.

2. ***SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve***

SSAP No. 43R: Adjusted reference in paragraph 3.

3. ***SSAP No. 15—Debt and Holding Company Obligations***

SSAP No. 26R: No revisions needed to paragraph 13.

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

SSAP No. 26R: Updated footnote 1 and clarified guidance for GICs in paragraphs 14-17.

SSAP No. 43R: Adjusted reference in paragraph 6 to asset-backed securities that qualify.

5. ***SSAP No. 36—Troubled Debt Restructuring***

SSAP No. 26R: No revisions needed to paragraph 29.

6. ***SSAP No. 43R—Asset-Backed Securities***

SSAP No. 26R: Updated disclosure reference that link to SSAP No. 26R, paragraph 51.m.

7. ***SSAP No. 86—Derivatives***

SSAP No. 26R and SSAP No. 43R: Updated the guidance for structured notes in paragraph 5.g. and replication (synthetic assets) in Footnote 5.

8. ***SSAP No. 95—Nonmonetary Transactions***

SSAP No. 26R: No revisions needed to paragraph 6.

SSAP No. 43R: Adjusted the citation to SSAP No. 43R in paragraph 6.

9. ***SSAP No. 100R—Fair Value***

SSAP No. 26R: No revisions needed to Footnote 3.

The Revisions Shown in this Document are Effective January 1, 2025

10. SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

SSAP No. 43R: Revisions remove the direct pointer of beneficial interests as in scope of SSAP No. 43R and incorporate guidance for reporting under the applicable SSAP in paragraphs 2, 11 and 18.

11. INT 01-25: Accounting for U.S. Treasury Inflation-Indexed Securities

SSAP No. 26: No revisions needed.

12. 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)

SSAP No. 26: Updated paragraph reference in paragraph 5.a.

13. 06-07: Definition of Phrase “Other Than Temporary”

SSAP No. 26: No revisions needed.

SSAP No. 43R: Updated reference in list of applicable SSAPs.

14. INT 07-01: Application of the Scientific (Constant Yield) Method in Situations of Reverse Amortization

SSAP No. 26R: Removed quoted guidance.

SSAP No. 43R: Updated reference in list of applicable SSAPs and removed quoted guidance.

15. INT 19-02: Freddie Mac Single Security Initiative

SSAP No. 26R: No revisions needed.

SSAP No. 43R: Updated reference in list of applicable SSAPs and in paragraph 1.

16. INT 22-01: Freddie Mac When Issued K-Deal (WI Trust) Certificates

SSAP No. 43R: Updated reference in list of applicable SSAPs and in paragraph 1.

Summary of SAP Guidance Revisions

17. SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments

Revisions preclude asset-backed securities that are in scope of SSAP No. 43R from being reported as cash equivalents or short-term investments. The revisions also identify items captured on Schedule BA as non-bond securities. (These revisions also add reference to working capital finance investments, but that is not new guidance, but was not explicitly stated in SSAP No. 2R.)

The Revisions Shown in this Document are Effective January 1, 2025

Summary of SAP Reference Revisions:

SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments

7. Regardless of maturity date, related party or affiliated investments that would be in scope of *SSAP No. 26R—Bonds*, *SSAP No. 43R—~~Loan-Backed and Structured~~Asset-Backed Securities*, or that would be reported as “Other Invested Assets” shall be reported as long-term investments if any of the following conditions apply,¹ unless the reporting entity has re-underwritten the investment, maintained appropriate re-underwriting documentation, and each participating party had the ability to independently review the terms and can terminate the transaction prior to renewal.

- a. The reporting entity does not reasonably expect the investment to terminate on the maturity date. This provision includes investments that are expected to be renewed (or rolled) with a maturity date that ends subsequent to the initial 90-day timeframe.
- b. The investment was previously reported as a cash equivalent investment and the initial maturity timeframe has passed. If an investment is reported as a cash equivalent and it is unexpectedly renewed/rolled, the reporting entity is not permitted to continue to report the held security as a cash equivalent, regardless of the updated maturity date, and shall report the security as a long-term investment. An investment is only permitted to be reported as a cash equivalent for one quarter reporting period. Meaning, if an investment was reported as a cash equivalent in the first quarter, it is not permitted to be reported as a cash equivalent in the second quarter.
- c. The reporting entity reacquired the investment (or a substantially similar investment) within one year after the original security matured or was terminated. These reacquired securities shall be reported as long-term investments. (These securities are also not permitted to be reported as short-term investments, regardless of the maturity date of the reacquired investment.)

Footnote 1: Cash equivalents subject to the provisions of paragraph 7 are not permitted to be subsequently reported as short-term investments, even if the updated/reacquired maturity date is within one year. These investments shall be reported as long-term investments. To avoid changes in reporting schedules, reporting entities are permitted to report securities as long-term investments at initial acquisition, regardless of the initial maturity date.

15. Regardless of maturity date, related party or affiliated investments in scope of *SSAP No. 26R—Bonds*, *SSAP No. 43R—~~Loan-Backed and Structured~~Asset-Backed Securities*, or that would be reported as “Other Invested Assets” shall be reported as long-term investments if any of the following conditions apply,^{2, 3} unless the reporting entity has re-underwritten the investment, maintained appropriate re-underwriting documentation, and each participating party had the ability to independently review the terms and can terminate the transaction prior to renewal.

- a. The reporting entity does not reasonably expect the investment to terminate on the maturity date. This provision includes investments that are expected to be renewed (or rolled) with a maturity date that ends subsequent to the initial “less than one year” timeframe.
- b. The investment was previously reported as a short-term investment and the initial maturity timeframe has passed. If an investment is reported as a short-term investment and it is unexpectedly renewed/rolled, the reporting entity is not permitted to continue to report the held security as a short-term investment (or as a cash equivalent) regardless of the updated maturity date and shall report the security as a long-term investment. An investment is only permitted to be reported as a short-term investment for one annual reporting period.

The Revisions Shown in this Document are Effective January 1, 2025

Meaning, if an investment was reported as a short-term investment as of December 31, 2018, it is not permitted to be reported as short-term investment as of December 31, 2019.

- c. The reporting entity reacquired the investment (or a substantially similar investment) within one year after the original security matured or was terminated. These reacquired securities shall be reported as long-term investments. (These securities are also not permitted to be reported as cash equivalent investments regardless of the maturity date of the reacquired investment.)

Footnote 2: Reverse repurchase transactions are excluded from these provisions if admitted in accordance with collateral requirements pursuant to *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

Footnote 3: Short-term investments subject to the provisions of paragraph 15 are not permitted to be subsequently reported as cash equivalents, even if the updated/reacquired maturity date is within 90 days. These investments shall be reported as long-term investments. To avoid changes in reporting schedules, reporting entities are permitted to report securities as long-term investments at initial acquisition, regardless of the initial maturity date.

Disclosures

18. The following disclosures shall be made for short-term investments in the financial statements:
 - a. Fair values in accordance with *SSAP No. 100R—Fair Value*;
 - b. Concentrations of credit risk in accordance with *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures*;
 - c. Basis at which the short-term investments are stated.
 - d. The items in the scope of this statement are also subject to the annual audited disclosures in *SSAP No. 26R—Bonds*, paragraph ~~39.f~~30.f.
 - e. Identification of cash equivalents (excluding money market mutual funds as detailed in paragraph 8) and short-term investments (or substantially similar investments), which remain on the same reporting schedule for more than one consecutive reporting period. This disclosure is satisfied by use of a designated code in the investment schedules of the statutory financial statements.

SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve

3. The IMR and AVR shall be calculated and reported as determined per guidance in the SSAP for the specific type of investment (e.g., SSAP No. 43R for ~~loan-backed and structured~~asset-backed securities), or if not specifically stated in the respective SSAP, in accordance with the NAIC *Annual Statement Instructions* for Life and Accident and Health Insurance Companies.

SSAP No. 15—Debt and Holding Company Obligations - (No Changes)

13. Convertible debt securities and convertible preferred stock with beneficial conversion features are to be valued according to the appropriate statutory accounting statement; *SSAP No. 26R—Bonds* or *SSAP No. 32R—Preferred Stock*.

The Revisions Shown in this Document are Effective January 1, 2025

SSAP No. 21R—Other Admitted Assets

Collateral Loans

4. Collateral loans are unconditional obligations¹ for the payment of money secured by the pledge of an investment² 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:

Footnote 1: For purposes of determining a collateral loan in scope of this statement, a collateral loan does not include investments captured in scope of other statements. For example, *SSAP No. 26R—Bonds* includes securities [that qualify as issuer creditor obligations and SSAP No. 43—Asset-Backed Securities includes securities that qualify as asset-backed securities under the bond definition.](#) ~~(as defined in that statement) representing a creditor relationship whereby there is a fixed schedule for one or more future payments.~~ Investments captured in SSAP No. 26R or SSAP No. 43R that are also secured with collateral shall continue to be captured within scope of ~~SSAP No. 26R~~ [those statements](#).

Footnote 2: Investment defined as those assets listed in Section 3 of *Appendix A-001—Investments of Reporting Entities*.

6. A reporting entity that acquires (directly or indirectly) structured settlement payment rights³ through a factoring company, excluding securitizations [that qualify as asset-backed securities captured in scope of SSAP No. 43R](#), shall report the acquisition as follows:

- a. Period-certain (non-life contingent) structured settlement income streams shall be reported as other long-term invested assets⁴, and are admitted assets if the rights to the future payments from a structured settlement have been legally acquired in accordance with all state and federal requirements. If the structured settlement has not met all legal requirements, including the court-approved transfer from the original recipient, then the reporting entity shall recognize the appropriate excise tax obligation and the structured settlement shall be nonadmitted.
- b. Life-contingent structured settlement income streams shall be reported as other long-term invested assets on Schedule BA and shall be nonadmitted. (Nonadmittance is required regardless if the right to future payments has been legally transferred.)

Footnote 3: This guidance is specific to acquired structured settlement income streams (legal right to receive future payments from a structured settlement) and does not capture accounting and reporting guidance for the acquisition of any insurance product (e.g., life settlement, annuities, etc.).

Footnote 4: Reporting entities that hold qualifying structured settlement payment rights shall report the security on Schedule BA either as an “any other class of asset” or as a “fixed or variable interest rate investment with underlying characteristics of other fixed income instruments” if the structured settlement payment right qualifies for reporting within that reporting line (e.g., NAIC designation).

Guaranteed Investment Contracts

14. Guaranteed Investment Contracts (GICs) purchased for investment purposes 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. [This includes an investment in a GIC payment stream which can be created when an intermediary purchases individual GICs, pools them, and sells the rights to the payment stream.](#)

[15. GICs acquired in a security structure that qualify under the bond definition as an issuer obligation or asset-backed security shall follow the accounting guidance within SSAP No. 26R or SSAP No. 43R as applicable.](#)

The Revisions Shown in this Document are Effective January 1, 2025

~~15,16.~~ Purchases of GIC investments that do not meet the definition of a security, but for which all contractual rights and ownership of the GIC result in an investment similar to a corporate bond, shall be reported at amortized cost and ~~accounted for in accordance with the guidance in SSAP No. 26R—Bonds included on Schedule BA: Other Long-Term Invested Assets.~~ If, in accordance with SSAP No. 5R, it is probable that the carrying value of a GIC is not fully recoverable the investment shall be considered impaired. Accordingly, the cost basis of the investment shall be written down to the undiscounted estimated cash flows and the amount of the write down shall be accounted for as a realized loss. The new cost basis shall not be changed for subsequent recoveries in fair value.

~~16.—An investment in a GIC payment stream is created when an intermediary purchases individual GICs, pools them, and sells the rights to the payment stream. These investments shall be reported as other long-term invested assets and shall be carried at amortized cost.~~

~~17.—If, in accordance with SSAP No. 5R, it is probable that the carrying value of a GIC is not fully recoverable the investment shall be considered impaired. Accordingly, the cost basis of the investment shall be written down to the undiscounted estimated cash flows and the amount of the write down shall be accounted for as a capital loss. The new cost basis shall not be changed for subsequent recoveries in fair value.~~

SSAP No. 36—Troubled Debt Restructuring (No Changes)

29. Although FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases* (FAS 91) was rejected in SSAP No. 26R—Bonds, this statement is consistent with paragraph 14 of FAS No. 91.

SSAP No. 43R—Asset-Backed Securities

Disclosures

51. In addition to the disclosures required for invested assets in general, the following disclosures regarding loan-backed and structured securities shall be made in the financial statements. Regardless of the allowances within paragraph 63 of the Preamble, the disclosures in paragraph 51.f., 51.g. and 51.h. of this statement are required in separate, distinct notes to the financial statements:

- m. The items in the scope of this statement are also subject to the annual audited disclosures in SSAP No. 26R—Bonds, paragraphs ~~39.e., 30.e., 39.f., 30.f.~~ and ~~39.g., 30.g.~~

SSAP No. 86—Derivatives

5. Derivative instruments include, but are not limited to; options, warrants used in a hedging transaction and not attached to another financial instrument, caps, floors, collars, swaps, forwards, futures, structured notes with risk of principal/original investment loss based on the terms of the agreement (in addition to default risk), and any other agreements or instruments substantially similar thereto or any series or combination thereof.

- g. “Structured Notes” ~~in scope of this statement are instruments defined in SSAP No. 26R—Bonds (often in the form of debt instruments),~~ in scope of this statement are instruments in which the amount of principal repayment or return of original investment is contingent on an underlying variable/interest⁵ ~~where the terms of the agreement make it possible that the reporting entity could lose all or a portion of its original investment amount (for other than failure of the issuer to pay the contractual amounts due).~~ ~~Structured notes that are~~

The Revisions Shown in this Document are Effective January 1, 2025

~~“mMortgage-referenced securities”~~ issued by a government sponsored enterprise in the form of credit-risk transfers where an issue security is tied to a referenced pool are mortgages are captured in *SSAP No. 43R—Loan-Backed and Structured Securities*.

Footnote 5 - ~~The “structured notes” captured within scope of this statement is specific to instruments in which the terms of the agreement make it possible that the reporting entity could lose all or a portion of its original investment amount (for other than failure of the issuer to pay the contractual amounts due).~~ These instruments incorporate both the credit risk of the issuer, as well as the risk of an underlying variable/interest (such as the performance of an equity index or the performance of an unrelated security). Securities that are labeled “principal-protected notes” are captured within scope of this statement if the “principal protection” involves only a portion of the principal and/or if the principal protection requires the reporting entity to meet qualifying conditions in order to be safeguarded from the risk of loss from the underlying linked variable. Securities that may have changing positive interest rates in response to a linked underlying variable or the passage of time, or that have the potential for increased principal repayments in response to a linked variable (such as U.S. Treasury Inflation-Indexed Securities) that do not incorporate risk of original investment/principal loss (outside of default risk) are not captured as structured notes in scope of this statement. A replication (synthetic asset) transaction addressed within this standard may reproduce the investment characteristics of an otherwise permissible investment that would not meet the principles-based bond definition (e.g., is distinct from a “structured note” as defined here); the admissibility, classification and measurement of a replication (synthetic asset) transaction are not preemptively determined by the principles-based bond definition, and should be evaluated in accordance with the guidance on replication (synthetic asset) transactions within this standard.

SSAP No. 95—Nonmonetary Transactions

6. Fair value of assets received or transferred in a nonreciprocal transfer shall be measured based on statutory accounting principles for the type of asset transferred. Accordingly, the value shall be determined in accordance with *SSAP No. 26R—Bonds*, *SSAP No. 30R—Unaffiliated Common Stock*, *SSAP No. 32R—Preferred Stock*, *SSAP No. 37—Mortgage Loans*, *SSAP No. 39—Reverse Mortgages*, *SSAP No. 40R—Real Estate Investments*, *SSAP No. 43R—~~Loan-Backed and Structured~~Asset-Backed Securities*, *SSAP No. 90—Impairment or Disposal of Real Estate Investments* or other applicable statements. The guidance provided in *SSAP No. 25* shall be followed in accounting for nonreciprocal transactions with affiliates and other related parties as defined in that statement.

SSAP No. 100—Fair Value (No Changes)

48. For each class of assets and liabilities measured and reported³ at fair value or NAV in the statement of financial position after initial recognition. The reporting entity shall determine appropriate classes of assets and liabilities in accordance with the annual statement instructions.

Footnote 3: The term “reported” is intended to reflect the measurement basis for which the asset or liability is classified within its underlying SSAP. For example, a bond with an NAIC designation of 2 is considered an amortized cost measurement and is not included within this disclosure even if the amortized cost and fair value measurement are the same. An example of when such a situation may occur includes a bond that is written down as other-than-temporarily impaired as of the date of financial position. The amortized cost of the bond after the recognition of the other-than-temporary impairment may agree to fair value, but under *SSAP No. 26R* this security is considered to still be reported at amortized cost.

SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

2. This statement focuses on the issues of accounting for transfers and servicing of financial assets and extinguishments of liabilities. This statement establishes statutory accounting principles for transfers and servicing of financial assets, including asset securitizations and securitizations of policy acquisition costs, extinguishments of liabilities, repurchase agreements, repurchase financing and reverse repurchase agreements, including dollar repurchase and dollar reverse repurchase agreements that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts). This statement discusses generalized situations. Facts and circumstances and specific contracts need to be considered carefully in applying this statement. Securitizations of nonfinancial assets are outside

The Revisions Shown in this Document are Effective January 1, 2025

the scope of this statement. Transfers of financial assets that are in substance real estate shall be accounted for in accordance with *SSAP No. 40R—Real Estate Investments*. Additionally, retained beneficial interests from the sale of ~~loan-backed or structured asset-backed~~ securities are to be accounted for in accordance ~~with the statutory accounting statement that is applicable to the investment retained with SSAP No. 43R—Loan-Backed and Structured Securities, Revised.~~ If the retained security does not qualify for reporting as a bond under the bond definition detailed in SSAP No. 26R, it shall be reported as a debt security that does not qualify as a bond in scope of SSAP No. 21R—Other Admitted Assets.

11. Upon completion of a transfer of an entire financial asset or a group of entire financial assets that satisfies the conditions to be accounted for as a sale (see paragraph 8), the transferor (seller) shall:

- a. Derecognize the transferred financial assets;
- b. Recognize and initially measure at fair value servicing assets, servicing liabilities, and any other assets obtained (including a transferor's beneficial interest in the transferred financial assets) and liabilities incurred¹ in the sale (paragraphs 60 and 62-66).
- c. For reporting entities required to maintain an Interest Maintenance Reserve (IMR), the accounting for realized and unrealized capital gains and losses shall be determined per the guidance in the SSAP for the specific type of investment ~~(e.g., SSAP No. 43R for loan-backed and structured securities)~~, or if not specifically stated in the related SSAP, in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. For reporting entities not required to maintain an IMR, realized capital gains and losses shall be reported as net realized capital gains or losses in the statement of income, and unrealized capital gains and losses shall be reported as net unrealized gains and losses in unassigned funds (surplus).

The transferee shall recognize all assets obtained and any liabilities incurred, and initially measure them at fair value.

Footnote 1: Some assets that might be obtained and liabilities that might be incurred include cash, put or call options that are held or written (for example, guarantee or recourse obligations), forward commitments (for example, commitments to deliver additional receivables during the revolving periods of some securitizations) and swaps (for example, provisions that convert interest rates from fixed to variable).

Financial Assets Subject to Prepayment

18. Financial assets, except for instruments that are within the scope of *SSAP No. 86—Derivatives*, that can contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment shall be assessed in accordance with the bond definition captured in SSAP No. 26R—Bonds to determine appropriate accounting and reporting. Securities that do not qualify for bond reporting shall be captured as debt securities that do not qualify as bonds in scope of SSAP No. 21R—Other Admitted Assets. subsequently measured in accordance with the statutory accounting statement that is applicable to the financial asset. subsequently measured like investments in debt securities and loan-backed and structured securities in accordance with SSAP No. 43R. ~~Examples of such financial assets include, but are not limited to, interest-only strips, other beneficial interests, loans, or other receivables.~~

INT 01-25: Accounting for U.S. Treasury Inflation-Indexed Securities

- No Change – Applies to SSAP No. 26R.

The Revisions Shown in this Document are Effective January 1, 2025

INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)

5. For Issue 1, the Working Group came to a consensus that reporting entities should account and report for investments in CAPCO's consistent with the agreement structure within the guidance provided below:

- h. Investment in a debt instrument of a CAPCO shall be reported as a bond in accordance with the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and the designation assigned in the *NAIC Valuations of Securities* product prepared by the NAIC Securities Valuation Office (Valuations of Securities manual) as stated in SSAP No. 26R, paragraph ~~20~~11.
- i. Investment in an equity interest of a CAPCO shall be reported as common stock and reported at fair value as stated in SSAP No. 30R, paragraph 8.
- j. Investment in preferred stock interest of a CAPCO shall be reported as preferred stock in accordance with the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and the designation assigned in the *NAIC Valuations of Securities* product prepared by the NAIC Securities Valuation Office (Valuations of Securities manual) as stated in SSAP No. 32R, paragraphs 19-22.
- k. Investment in a Joint Venture, Partnership and Limited Liability Company (LLC) shall be reported in accordance with SSAP No. 48, paragraphs 5-6. The reported value of the investment shall be decreased in proportion to the premium tax credits utilized.
- l. The tax credits shall be recognized as a reduction of the tax liabilities as they are utilized. Tax credits received are not to be included in investment income.

INT 06-07: Definition of Phrase "Other Than Temporary"

- Update interpreted SSAP list to reference to *SSAP No. 43R—Asset-Backed Securities*

INT 07-01: Application of the Scientific (Constant) Yield Method in Situations of Reverse Amortizations

1. SSAP No. 26R and SSAP No. 43R both reference the use of the scientific or constant yield method of amortization of a premium or a discount. ~~SSAP No. 26R—Bonds provides the following (bolding added for emphasis):~~

Amortized Cost

~~9. Amortization of bond premium or discount shall be calculated using the scientific (constant yield) interest method taking into consideration specified interest and principal provisions over the life of the bond. Bonds containing call provisions (where the issue can be called away from the reporting entity at the issuer's discretion) shall be amortized to the call or maturity value/date which produces the lowest asset value (yield to worst).~~

~~SSAP No. 43R—Loan Backed and Structured Securities provides the following (bolding added for emphasis):~~

The Revisions Shown in this Document are Effective January 1, 2025

Amortization

~~8. Amortization of premium or discount shall be calculated using the scientific (constant yield) interest method and shall be recorded as an adjustment to investment income. The interest method results in a constant effective yield equal to the prevailing rate at the time of purchase or at the time of subsequent adjustments to book value. The amortization period shall reflect estimates of the period over which repayment of principal of the loan-backed securities is expected to occur, not the stated maturity period.~~

Collection of All Contractual Cashflows is Probable

~~12. The following guidance applies to loan-backed and structured securities for which it is probable that the investor will be able to collect all contractually required payments receivable. (Paragraphs 17-19 provide guidance for securities in which collection of all contractual cash flows is not probable and paragraphs 20-24 provide guidance for beneficial interests.) Prepayments are a significant variable element in the cash flow of loan-backed securities because they affect the yield and determine the expected maturity against which the yield is evaluated. Falling interest rates generate faster prepayment of the mortgages underlying the security, shortening its duration. This causes the reporting entity to reinvest assets sooner than expected at potentially less advantageous rates. This is called prepayment risk. Extension risk is created by rising interest rates which slow repayment and can significantly lengthen the duration of the security. Differences in cash flows can also result from other changes in the cash flows from the underlying assets. If assets are delinquent or otherwise not generating cash flow, which should be reflected in the cash flow analysis through diminishing security cash flows, even if assets have not been liquidated and gain/losses have not been booked.~~

~~13. Changes in currently estimated cash flows, including the effect of prepayment assumptions, on loan-backed securities shall be reviewed periodically, at least quarterly. The prepayment rates of the underlying loans shall be used to determine prepayment assumptions. Prepayment assumptions shall be applied consistently across portfolios to all securities backed by similar collateral (similar with respect to coupon, issuer, and age of collateral). Reporting entities shall use consistent assumptions across portfolios for similar collateral within controlled-affiliated groups. Since each reporting entity may have a unique method for determining the prepayment assumptions, it is impractical to set standard assumptions for the industry. Relevant sources and rationale used to determine each prepayment assumption shall be documented by the reporting entity.~~

~~14. Loan-backed securities shall be revalued using the currently estimated cash flows, including new prepayment assumptions, using either the prospective or retrospective adjustment methodologies, consistently applied by type of securities. However, if at any time during the holding period, the reporting entity determines it is no longer probable that they will collect all contractual cashflows, the reporting entity shall apply the accounting requirements in paragraphs 17-19.~~

~~15. The prospective approach recognizes, through the recalculation of the **effective yield** to be applied to future periods, the effects of all cash flows whose amounts differ from those estimated earlier and the effects and changes in projected cash flows. Under the prospective method, the recalculated effective yield will equate the carrying amount of the investment to the present value of the anticipated future cash flows. The recalculated yield is then used to accrue income on the investment balance for subsequent accounting periods. There are no accounting changes in the current period unless the security is determined to be other than temporarily impaired.~~

~~16. The retrospective methodology changes both the yield and the asset balance so that expected future cash flows produce a return on the investment equal to the return now expected over the life of the investment as measured from the date of acquisition. Under the retrospective method, the recalculated **effective yield** will equate the present value of the actual and anticipated cash flows with the original cost of the investment. The current balance is then increased or~~

The Revisions Shown in this Document are Effective January 1, 2025

~~decreased to the amount that would have resulted had the revised yield been applied since inception, and investment income is correspondingly decreased or increased.~~

2. ~~This interpretation~~~~The following~~ identifies three situations where, using a constant yield methodology for determining amortization or accretion, changes in amortized value move in the opposite direction of what is expected. That is, if a security is purchased at a premium, the constant yield methodology will, in certain cases, cause the amortized value to move to a discount during the life of the security. Conversely, if the security were purchased at a discount, the constant yield methodology will, in certain cases, cause the amortized value to move to a premium during the life of the security.

INT 19-02: Freddie Mac Single Security Initiative

- Update interpreted SSAP list to reference to *SSAP No. 43R—Asset-Backed Securities*
 1. This interpretation has been issued to provide a limited-scope exception to the exchange and conversion guidance in *SSAP No. 26R—Bonds* as well as prescribe guidance in *SSAP No. 43R—~~Asset-Backed Loan-Backed and Structured~~ Securities* (SSAP No. 43R) for instruments converted in accordance with the Freddie Mac Single Security Initiative. Under this initiative, reporting entities will be permitted to exchange “45-day securities” for “55-day securities” without any material change to the securities, or to the loans that back the securities. (With the exchange, there would be a 10-day delay in payment cycle.)

INT 22-01: Freddie Mac When Issued K-Deal (WI Trust) Certificates

- Update interpreted SSAP list to reference to *SSAP No. 43R—Asset-Backed Securities*
 1. This interpretation is to address questions on the accounting and reporting for Freddie Mac “When-Issued K-Deal (WI Trust) Certificates” (WI Program). Ultimately, the question is whether the structure should be initially captured in scope of *SSAP No. 43R—~~Loan-Backed and Structured~~Asset-Backed Securities* or as a forward contract in scope of *SSAP No. 86—Derivatives*.

Summary of SAP Guidance Revisions:

SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments

Cash Equivalents

6. Cash equivalents are short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash, and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Only investments with original maturities¹ of three months or less can qualify under this definition, with the exception of money market mutual funds, as detailed in paragraph 8, and cash pooling, as detailed in paragraph 9. Regardless of maturity date, the following investments are not permitted to be reported as cash equivalents and shall be reported on the investment schedule that corresponds to the SSAP for which the investment is applicable:

¹ Original maturity means original maturity to the entity holding the investment. For example, both a three-month U.S. Treasury bill and a three-year Treasury note purchased three months from maturity qualify as cash equivalents. However, a Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months.

The Revisions Shown in this Document are Effective January 1, 2025

- a. Asset-backed securities captured in scope of SSAP No. 43R.
- b. All debt securities that do not qualify as bonds which are in scope of SSAP No. 21R.
- ~~a-c. , d~~ Derivative instruments in scope of SSAP No. 86 or SSAP No. 108 ~~shall not be reported as cash equivalents and shall be reported as derivatives on Schedule DB.~~
- d. Working capital finance investments in scope of SSAP No. 105R.
- ~~b.e.~~ Securities with terms that are reset at predefined dates (e.g., an auction-rate security that has a long-term maturity and an interest rate that is regularly reset through a Dutch auction) or have other features an investor may believe results in a different term than the related contractual maturity shall be accounted for based on the contractual maturity at the date of acquisition, except where other specific rules within the statutory accounting framework currently exist.

Short-Term Investments

14. Short-term investments are investments that do not qualify as cash equivalents with remaining maturities (or repurchase dates under reverse repurchase agreements) of one year or less at the time of acquisition. Short-term investments can include, but are not limited to bonds, commercial paper, reverse repurchase agreements, and collateral and mortgage loans which meet the noted criteria. Short-term investments shall not include investments specifically classified as cash equivalents as defined in this statement, certificates of deposit, or derivatives. Regardless of maturity date, the following investments are not permitted to be reported as cash equivalents and shall be reported on the investment schedule that corresponds to the SSAP for which the investment is applicable:

- a. Asset-backed securities captured in scope of SSAP No. 43R.
- b. All debt securities that do not qualify as bonds which are in scope of SSAP No. 21R.
- c. ~~d~~ Derivative instruments in scope of SSAP No. 86 or SSAP No. 108 ~~shall not be reported as short term investments and shall be reported as derivatives on Schedule DB.~~
- ~~a.d.~~ Working capital finance investments in scope of SSAP No. 105R.

https://naiconline.sharepoint.com/sites/naicsupportstaffhub/member_meetings/e_cmte/apptf/2023-2_summer/summary_and_minutes/sapwg/attachments/att1q-2019-21_other_ssap_changes.docx

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

Issue: Conceptual Framework – Updates

Check (applicable entity):

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

Description of Issue: In December 2021, the Financial Accounting Standards Board (FASB) issued two new chapters of its conceptual framework. The conceptual framework is a body of interrelated objectives and fundamentals that provides the FASB with a foundation for setting standards and concepts to consider when it resolves questions or develops/modifies accounting and reporting guidance.

It is important to note that the Statements of Financial Accounting Concepts are not authoritative and do not establish new or change existing U.S. GAAP. Per the FASB chair, these concepts are “a tool for the Board to use in setting standards that improve the understandability of information entities provide to existing and potential investors, lenders, donors, and other resource providers.”

This agenda item reviews and summarizes each of the two newly issued concept chapters and reviews their potential impact on statutory accounting. Again, while the conceptual framework statements are not authoritative, they are the guiding principles for standard setting and these new updates have superseded chapters currently referenced in the *Accounting Practices and Procedures Manual (AP&P Manual)*. In addition, and most notably, in the case of one of these chapters, FASB changed certain key fundamental definitions, specifically the definition of an asset and a liability, which have historically been mirrored by statutory accounting.

Update 1:

FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements* introduced updated definitions of certain key elements used in financial reporting – the definition of an asset and liability. The chapter states that assets and liabilities have conceptual and definitional primacy because assets and liabilities (and changes in those elements) are foundational to all the other items reported in the financial statements. To correctly identify and represent an asset or liability is the beginning basis for all financial reporting and due to their importance, updates to both financial statement elements have been adopted. A summary of each, comparing the historical and current definitions, is provided below:

Changes regarding the definition of an ASSET:

- **Historical definition:** a probable future economic benefit obtained or controlled by a particular entity as a result of past transactions or events.
- **Historical Characteristics: Three essential characteristics:**
 1. it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows,
 2. a particular enterprise can obtain the benefit and control others' access to it, and
 3. the transaction or other event giving rise to the enterprise's right to or control of the benefit has already occurred.

- **New Definition:** a present right of an entity to an economic benefit.
- **Current Characteristics: Two essential characteristics:**
 1. it is a present right, and
 2. the right is to an economic benefit.

The combination of these two characteristics allows an entity to obtain the economic benefit and control others' access to the benefit. A present right of an entity to an economic benefit entitles the entity to the economic benefit and the ability to restrict others' access to the benefit to which the entity is entitled. For clarity, an "economic benefit" represents services or other items of economic value and generally result in net cash inflows to the entity.

Commentary regarding definitional changes:

The current definition of an asset no longer includes the term *probable* or the phrases *future economic benefit* and *past transactions or events*. The FASB concluded that the term *probable* has historically been misunderstood as implying that a future benefit must be probable to a certain threshold before the definition of an asset was met. Thus, if the probability of a future benefit was low, an asset could not be recognized. FASB also struck the phrase *future economic benefit* as this phrase often was interpreted that the asset must represent a certain future economic benefit (such as eventual cash inflows), however with this update, FASB clarified that the asset represents the rights to the benefit, not the actual benefit itself – nor the probability of realization.

Finally, FASB struck the phrase as the result of *past transactions or events*. It was concluded that if the asset represents a *present right*, by default, the right must have occurred as the result of a past transaction or event and thus this phraseology was deemed redundant and unnecessary.

Changes regarding **the definition of a LIABILITY:**

- **Historical definition:** are [certain or] probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.
- **Historical Characteristics: Three essential characteristics:**
 1. it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand,
 2. the duty or responsibility obligates a particular enterprise, leaving it little or no discretion to avoid the future sacrifice, and
 3. the transaction or other event obligating the enterprise has already happened.
- **New Definition:** a present obligation of an entity to transfer an economic benefit.
- **Current Characteristics: Two essential characteristics:**
 1. it is a present obligation, and
 2. the obligation requires an entity to transfer or otherwise provide economic benefit to others. (For the purposes of this characteristic, *transfer* is typically used to describe obligations to pay cash or convey assets, while the term *provide* is used to describe obligations to provide services or stand by to do so).

Commentary regarding definitional changes:

The current definition of a liability no longer includes the term *probable* or the phrase *in the future as a result of past transactions or events*. The FASB concluded that the term *probable* has historically been understood as implying that a future obligation must meet a probability to a certain threshold before the definition of a liability was met. Thus, if the probability of a future transfer of an asset (or the requirement to provide a service) was low, a liability would likely not be recognized. In removing the term *probable* (and replacing it with “present obligation”), FASB concluded that in almost all situations, the presence of an obligation will be apparent. It stated that most present obligations are legally enforceable, including obligations arising from binding contracts, agreements, statutes, or other legal or contractual means. Chapter 4 also discusses the prevalence of certain business risks and how to assess if they result in the recognition of a liability. It concluded that while certain businesses pose risk of future events occurring that will cause them to transfer an economic benefit (an asset), the risk itself does not represent a present obligation because exposure to a potential negative consequence does not constitute a present obligation.

However, FASB also stated situations lacking clear legal or contractual evidence of a present obligation may pose particular challenges that may make it difficult to discern whether a present obligation exists. In these settings, the FASB stated that constructive obligations or other noncontractual obligations are created by circumstance rather than by explicit agreement. In the absence of an explicit agreement, sufficient information to distinguish a present obligation is likely only available at the specific standards level. Thus, the FASB concluded that the specific facts and circumstances at the standards level (or in the case of statutory accounting, at the SAP level) must be utilized to determine whether the entity has created a constructive obligation and must recognize a liability.

FASB also struck the phrase as the result of *past transactions or events*. It was concluded that if the liability represents a *present right*, by default, the right must have occurred as the result of a past transaction or event and thus this phraseology was deemed redundant and unnecessary.

Update 2:

FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7, Presentation* identifies factors that the FASB will consider when deciding **how** items should be displayed on the financial statements. Chapter 7 describes the information to be included in the financial statements and how appropriate presentation can contribute to the objective of financial reporting – to communicate financial information about an entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources (goods and services) to the entity. These decisions typically involve buying or selling of goods/services or holding equity and debt instruments as well as providing or settling loans or other forms of credit. This chapter articulates that the financial statements meet a “general purpose” and should not be considered to meet all purposes for possible users – and thus a common set of conceptual standards is appropriate.

Chapter 7 also describes the importance of financial statement notes, or supplementary information so that financial statement users are provided with a more complete picture of an entity’s accounting policy or any particular unique circumstance or event. In terms of general reporting, the conceptual statement relays that a distinction between nonhomogeneous items should be depicted in the financial statements with different reporting line items and subtotals and that the information should be provided based on recognition and measurement standards. In essence, reporting should be sufficiently aggregated, but not aggregated to a level in which the information is too consolidated for general use and understanding. Once reported, then any significant accounting policy or circumstance would further be defined with accompanying notes.

The chapter broadly states that to meet the objectives of financial reporting, line items should be distinct based on the information being provided – as the information should distinguish between various types of transactions/events

and should assist users in their estimates in the amounts and timing of future cash flows or the entity's ability to provide other economic value. The financial statements should depict the results of different types of transactions, including changes in events or other circumstances that may vary the frequency or predictability of performance based on many items, including changes in economic conditions.

In summary, while Chapter 7 does supersede sections of *Statement of Financial Accounting Concept 5*, it did not result in fundamental changes to the principal concepts of financial reporting. The chapter articulates the need for complete financial reporting, describes the interconnectedness of a 'complete set of financial statements' and relays the importance of these documents as the information in the financial statements is the primary (and typically the sole) source for analyzing current and potential future performance of an organization and its ability to meet its long-term financial objectives. At a high level, the chapter discusses what information should broadly be categorized as revenues, expenses, gains, and losses and to the extent equity is impacted by operations as well as changes in owners' equity through investments or distributions.

In terms of the impact to statutory accounting, the updated concepts in this chapter are not expected to modify current guidance, other than to update references to superseded accounting concepts.

Existing Authoritative Literature:

NAIC Staff Note – the Preamble contains reference to certain concept statements in footnotes 2 and 4 and have been bolded below for ease of identification. It is important to note that while these footnotes currently reference superseded conceptual statements, the conceptual statements noted do not represent adopted guidance - they are noted as reference for overarching guiding principles regarding financial reporting.

Preamble

IV. Statutory Accounting Principles Statement of Concepts

25. This document states the fundamental concepts on which statutory financial accounting and reporting standards are based. These concepts provide a framework to guide the National Association of Insurance Commissioners (NAIC) in the continued development and maintenance of statutory accounting principles ("SAP" or "statutory basis") and, as such, these concepts and principles constitute an accounting basis for the preparation and issuance of statutory financial statements by insurance companies in the absence of state statutes and/or regulations.

26. The NAIC and state insurance departments are primarily concerned with statutory accounting principles that differ from GAAP reflective of the varying objectives of regulation. Recodification of areas where SAP and GAAP are parallel is an inefficient use of limited resources.

27. SAP utilizes the framework established by GAAP. **FN2** This document integrates that framework with objectives exclusive to statutory accounting. The NAIC's guidance on SAP is comprehensive for those principles that differ from GAAP based on the concepts of statutory accounting outlined herein. Those GAAP pronouncements that are not applicable to insurance companies will not be adopted by the NAIC. For those principles that do not differ from GAAP, the NAIC must specifically adopt those GAAP Pronouncements to be included in statutory accounting. GAAP Pronouncements do not become part of SAP until and unless adopted by the NAIC.

28. The body of statutory accounting principles is prescribed in the statutory hierarchy of accounting guidance. This hierarchy provides the framework for judging the presentation of statutory financial statements in conformance with statutory accounting principles.

29. Statutory requirements vary from state to state. While it is desirable to minimize these variations, to the extent that they exist it is the objective of NAIC statutory accounting principles to provide the standard against which the exceptions will be measured and disclosed if material.

FN 2 - The GAAP framework applicable to insurance accounting is set forth in *Statements of Financial Accounting Concepts One, Two, Five, and Six*. These documents, promulgated by the Financial Accounting Standards Board, set forth the objectives and concepts which are used in developing accounting and reporting standards.

V. Statutory Hierarchy

42. The following Hierarchy is not intended to preempt state legislative and regulatory authority.

Level 1

SSAPs, including U.S. GAAP reference material to the extent adopted by the NAIC from the FASB Accounting Standards Codification (FASB Codification or GAAP guidance)

Level 2

Consensus positions of the Emerging Accounting Issues (E) Working Group as adopted by the NAIC (INTs adopted before 2016)

Interpretations of existing SSAPs as adopted by the Statutory Accounting Principles (E) Working Group (INTs adopted in 2016 or beyond)

Level 3

NAIC Annual Statement Instructions

Purposes and Procedures Manual of the NAIC Investment Analysis Office

Level 4

Statutory Accounting Principles Preamble and Statement of Concepts FN4

Level 5

Sources of nonauthoritative GAAP accounting guidance and literature, including: (a) practices that are widely recognized and prevalent either generally or in the industry, (b) FASB Concept Statements, (c) AICPA guidance not included in FASB Codification, (d) International Financial Reporting Standards, (e) Pronouncements of professional associations or regulatory agencies, (f) Technical Information Service Inquiries and Replies included in the AICPA Technical Practice Aids, and (g) Accounting textbooks, handbooks and articles

43. If the accounting treatment of a transaction or event is not specified by the SSAPs, preparers, regulators and auditors of statutory financial statements should consider whether the accounting treatment is specified by another source of established statutory accounting principles. If an established statutory accounting principle from one or more sources in Level 2 or 3 is relevant to the circumstances, the preparer, regulator or auditor should apply such principle. If there is a conflict between statutory accounting principles from one or more sources in Level 2 or 3, the preparer, regulator or auditor should follow the treatment specified by the source in the higher level—that is, follow Level 2 treatment over Level 3. Revisions to guidance in accordance with additions or revisions to the NAIC statutory hierarchy should be accounted for as a change in accounting principle in accordance with SSAP No. 3—*Accounting Changes and Corrections of Errors*.

44. Because of developments such as new legislation or the evolution of a new type of business transaction, there sometimes are no established statutory accounting principles for reporting a specific transaction or event. In those instances, it might be possible to report the event or transaction on the basis of its substance by selecting a statutory accounting principle that appears appropriate when applied in a manner similar to the application of an established statutory principle to an analogous transaction or event. In the absence of a SSAP or another source of established statutory accounting principles, the preparer, regulator or auditor of statutory financial statements may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes the Statutory Accounting Principles Statement of Concepts and GAAP reference material and accounting literature identified in Level 5. The appropriateness of other accounting literature depends on its relevance to the particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, the Statutory Accounting Principles Statement of Concepts would be more authoritative than any other sources of accounting literature. Similarly, FASB Concepts Statements would normally be more influential than other sources of nonauthoritative GAAP pronouncements.

FN 4 - The Statutory Accounting Principles Statement of Concepts incorporates by reference FASB Concepts Statements One, Two, Five and Six to the extent they do not conflict with the concepts outlined in the statement. However, for purposes of applying this hierarchy the FASB Concepts Statements shall be included in Level 5 and only those concepts unique to statutory accounting as stated in the statement are included in Level 4.

SSAP No. 4—Assets and Nonadmitted Assets

NAIC Staff Note – this SAP contains the definition of the financial statement element of an **Asset**. Relevant items have been bolded below for ease of identification.

2. For purposes of statutory accounting, **an asset shall be defined as: probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.** These assets shall then be evaluated to determine whether they are admitted. The criteria used is outlined in paragraph 3.

3. 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.

4. Transactions which do not give rise to assets as defined in paragraph 2 shall be charged to operations in the period the transactions occur. Those transactions which result in amounts which may meet the definition of assets, but are specifically identified within the *Accounting Practices and Procedures Manual* as not giving rise to assets (e.g., policy acquisition costs), shall also be charged to operations in the period the transactions occur.

5. The reporting entity shall maintain a capitalization policy containing the predefined thresholds for each asset class to be made available for the department(s) of insurance.

FN1 - FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, 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, paragraph 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.

FN2 - If assets of an insurance entity are pledged or otherwise restricted by the action of a related party, the assets are not under the exclusive control of the insurance entity and are not available to satisfy policyholder obligations due to these encumbrances or other third-party interests. Thus, pursuant to paragraph 2(c), such assets shall not be recognized as an admitted asset on the balance sheet. Additional guidance for assets pledged as collateral is included in INT 01-31.

SSAP No. 5—Liabilities, Contingencies and Impairments of Assets

NAIC Staff Note – this SAP contains the definition of the financial statement element of a **Liability**. Relevant items have been bolded below for ease of identification.

2. A liability is defined as certain or probable FN1 future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).

3. A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable FN1 future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statements when incurred.

4. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies.

FN1 - FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement 5, Accounting for Contingencies, paragraph 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.

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): While slightly different, the updated FASB asset & liability definitions closely align with IFRS definitions. While IFRS retains the phrase “as a result of past events,” it also explicitly retains the term “control,” which is now implicit with the FASB updates. The elimination of the explicit term “control” was a deliberate action of the FASB as they noted that the notion of control has been historically misunderstood (control is to the right that gives rise to the economic benefit rather than to the economic benefits themselves). For reference *IFRS Chapter 4 – The Elements of Financial Statements*, defines an **asset** as a present economic resource controlled by the entity as a result of past events; with the economic resource representing a right that has the potential to produce economic benefits. Additionally, the chapter defines a **liability** as a present obligation of an entity to transfer an economic resource as a result of past events.

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to the Preamble, *SSAP No. 4—Assets and Nonadmitted Assets* and *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*, as illustrated below and in the issue papers, to incorporate updates from *Chapter 4, Elements of Financial Statements* and *Chapter 7, Presentation of the FASB’s Conceptual Framework for Financial Reporting*.

Proposed edits to the Preamble: proposed modifications reflect updates for superseded FASB Financial Accounting Concepts.

IV. Statutory Accounting Principles Statement of Concepts

25. This document states the fundamental concepts on which statutory financial accounting and reporting standards are based. These concepts provide a framework to guide the National Association of Insurance Commissioners (NAIC) in the continued development and maintenance of statutory accounting principles (“SAP” or “statutory basis”) and, as such, these concepts and principles constitute an accounting basis for the preparation and issuance of statutory financial statements by insurance companies in the absence of state statutes and/or regulations.

26. The NAIC and state insurance departments are primarily concerned with statutory accounting principles that differ from GAAP reflective of the varying objectives of regulation. Recodification of areas where SAP and GAAP are parallel is an inefficient use of limited resources.

27. SAP utilizes the framework established by GAAP. **FN2** This document integrates that framework with objectives exclusive to statutory accounting. The NAIC’s guidance on SAP is comprehensive for those principles that differ from GAAP based on the concepts of statutory accounting outlined herein. Those GAAP pronouncements that are not applicable to insurance companies will not be adopted by the NAIC. For those principles that do not differ from GAAP, the NAIC must specifically adopt those GAAP Pronouncements to be included in statutory accounting. GAAP Pronouncements do not become part of SAP until and unless adopted by the NAIC.

28. The body of statutory accounting principles is prescribed in the statutory hierarchy of accounting guidance. This hierarchy provides the framework for judging the presentation of statutory financial statements in conformance with statutory accounting principles.

29. Statutory requirements vary from state to state. While it is desirable to minimize these variations, to the extent that they exist it is the objective of NAIC statutory accounting principles to provide the standard against which the exceptions will be measured and disclosed if material.

FN 2 - The GAAP framework applicable to insurance accounting is set forth in *Statements of Financial Accounting Concepts ~~One, Two, Five, and Six~~Eight*. These documents, promulgated by the Financial Accounting Standards Board, set forth the objectives and concepts which are used in developing accounting and reporting standards.

V. Statutory Hierarchy

42. The following Hierarchy is not intended to preempt state legislative and regulatory authority.

Level 1

SSAPs, including U.S. GAAP reference material to the extent adopted by the NAIC from the FASB Accounting Standards Codification (FASB Codification or GAAP guidance)

Level 2

Consensus positions of the Emerging Accounting Issues (E) Working Group as adopted by the NAIC (INTs adopted before 2016)

Interpretations of existing SSAPs as adopted by the Statutory Accounting Principles (E) Working Group (INTs adopted in 2016 or beyond)

Level 3

NAIC Annual Statement Instructions

Purposes and Procedures Manual of the NAIC Investment Analysis Office

Level 4

*Statutory Accounting Principles Preamble and Statement of Concepts **FN4***

Level 5

Sources of nonauthoritative GAAP accounting guidance and literature, including: (a) practices that are widely recognized and prevalent either generally or in the industry, (b) FASB Concept Statements, (c) AICPA guidance not included in FASB Codification, (d) International Financial Reporting Standards, (e) Pronouncements of professional associations or regulatory agencies, (f) Technical Information Service Inquiries and Replies included in the AICPA Technical Practice Aids, and (g) Accounting textbooks, handbooks and articles

FN 4 - The Statutory Accounting Principles Statement of Concepts incorporates by reference FASB Concepts Statements ~~One, Two, Five and Six~~Eight to the extent they do not conflict with the concepts outlined in the statement. However, for purposes of applying this hierarchy the FASB Concepts Statements shall be included in Level 5 and only those concepts unique to statutory accounting as stated in the statement are included in Level 4.

Proposed edits SSAP No. 4—Assets and Nonadmitted Assets: proposed modifications reflect an updated definition of the term **Asset** – to match the newly issued definition in FASB Statement of Financial Accounting Concepts No. 8

2. For purposes of statutory accounting, an asset shall be defined as: [a present right of an entity to an economic benefit](#), ~~probable **FN1** future economic benefits obtained or controlled by a particular entity as a result of past transactions or events~~. An asset has ~~two~~three essential characteristics: (a) it [is a present right](#) ~~embodies a probable future benefit that involves a capacity, singly or in combination with other assets,~~

~~to contribute directly or indirectly to future net cash inflows, and (b) the right is to an economic benefit, a particular entity can obtain the benefit and control others' access to it FN1 FN2, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.~~ These assets shall then be evaluated to determine whether they are admitted. The criteria used is outlined in paragraph 3.

3. 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.

4. Transactions which do not give rise to assets as defined in paragraph 2 shall be charged to operations in the period the transactions occur. Those transactions which result in amounts which may meet the definition of assets, but are specifically identified within the *Accounting Practices and Procedures Manual* as not giving rise to assets (e.g., policy acquisition costs), shall also be charged to operations in the period the transactions occur.

5. The reporting entity shall maintain a capitalization policy containing the predefined thresholds for each asset class to be made available for the department(s) of insurance.

FN1 - *FASB Statement of Financial Accounting Concepts No. 86, Elements of Financial Statements*, states that the combination of these two characteristics allows an entity to obtain the economic benefit and control others' access to the benefit. A present right of an entity to an economic benefit entitles the entity to the economic benefit and the ability to restrict others' access to the benefit to which the entity is entitled. 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, paragraph 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.

FN2 - If assets of an insurance entity are pledged or otherwise restricted by the action of a related party, the assets are not under the exclusive control of the insurance entity and are not available to satisfy policyholder obligations due to these encumbrances or other third-party interests. Thus, pursuant to paragraph 2(c), such assets shall not be recognized as an admitted asset on the balance sheet. Additional guidance for assets pledged as collateral is included in INT 01-31.

Relevant Literature

9. This statement incorporates the definition of an asset from ~~adopts~~ *FASB Statement of Financial Accounting Concepts No. 86, Chapter 4, Elements of Financial Statements*, paragraphs E16-E18~~25-33~~.

References

Relevant Issue Papers

Issue Paper No. 4—Definition of Assets and Nonadmitted Assets

Issue Paper No. 119—Capitalization Policy, An Amendment to SSAP Nos. 4, 19, 29, 73, 79 and 82

Issue Paper No. 166—Updates to the Definition of an Asset

SSAP No. 5—Liabilities, Contingencies and Impairments of Assets: proposed modifications reflect an updated definition of the term **Liability** – to match the newly issued definition in FASB Statement of Financial Accounting Concepts No. 8

2. A liability is defined as a present obligation of an entity to transfer an economic benefit. ~~certain or probable FN1 future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).~~

3. A liability has ~~three~~ two essential characteristics: (a) it is a present obligation ~~embodies a present duty or responsibility to one or more other entities that entails settlement by probable FN1 future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, and~~ (b) the obligation requires an entity to transfer or otherwise provide economic benefit to others ~~duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and~~ (c) ~~the transaction or other event obligating the entity has already happened.~~ This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statements when incurred.

4. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies.

~~FN1—FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement 5, Accounting for Contingencies, paragraph 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.~~

Relevant Literature

39. This statement adopts *FASB Statement No. 5, Accounting for Contingencies* (FAS 5), *FASB Statement 114, Accounting by Creditors for Impairment of a Loan* only as it amends in part FAS 5 ~~and paragraphs 35 and 36 of FASB Statement of Financial Accounting Concepts No. 6—Elements of Financial Statements~~. *FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss, An Interpretation of FASB Statement No. 5* (FIN No. 14) is adopted with the modification to accrue the loss amount as the midpoint of the range rather than the minimum as discussed in paragraph 3 of FIN No. 14.

This statement adopts with modification ASU 2013-04, *Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date* with the same statutory modification adopted for FIN 14. [This statement incorporates the definition of a liability from FASB Statement of Financial Accounting Concepts No. 8, Chapter 4, Elements of Financial Statements, paragraphs E37 and E38.](#)

References

Relevant Issue Papers

Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets

Issue Paper No. 20—Gain Contingencies

Issue Paper No. 135—Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others

[Issue Paper No. 166—Updates to the Definition of an Asset](#)

Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to the Preamble, SSAP No. 4—Assets and Nonadmitted Assets and SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets, as illustrated in the agenda item and in the draft issue papers, to incorporate updates from Chapter 4, Elements of Financial Statements and Chapter 7, Presentation of the FASB’s Conceptual Framework for Financial Reporting.

Staff Review Completed by: Jim Pinegar– NAIC Staff, January – 2022; Robin Marcotte, NAIC Staff, December – 2022

Status:

On April 4, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to the Preamble, SSAP No. 4—Assets and Nonadmitted Assets and SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets to incorporate 1) updates from FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7, Presentation* which identifies factors to consider when deciding how items should be displayed on the financial statements, and 2) Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which updates the definitions of an asset and a liability. The Working Group also exposed two draft issue papers for historical documentation of these SAP clarifications.

On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to the Preamble and SSAP No. 4—Assets and Nonadmitted Assets. The revisions incorporate updates from FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7, Presentation*, which identifies factors to consider when deciding how items should be displayed on the financial statements, and Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which updates the definition of an asset. In addition, the Working Group adopted *Issue Paper No. 166—Updates to the Definition of an Asset*, which documents the revisions to SSAP No. 4.

Additionally, on August 10, 2022, the Working Group re-exposed the proposed revisions and draft issue paper related to the definition change of a liability in SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets. This exposure intends to provide additional time for industry to review the changes in accordance with statutory accounting statements. These revisions are also shown above under the SSAP No. 5R heading.

On December 13, 2022, the Working Group re-exposed the proposed revisions and draft *Issue Paper No. 16X—Updates to the Definition of a Liability* related to the definition change of a liability in *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*. This exposure intends to provide additional time for industry to review the changes in accordance with statutory accounting statements. NAIC staff were directed to collaborate with interested parties on proposed clarifying language.

On March 22, 2023, the Working Group exposed additional revisions to *Issue Paper No. 16X—Updates to the Definition of a Liability* related to the definition change of a liability in *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*. The revisions to: 1) add an additional footnote to the definition of a liability in *SSAP No. 5R* which defers to more topic specific contradictory guidance 2) revise the relevant literature section of *SSAP No. 5R* to note the modification and 3) note the additional exposure action in the Issue Paper paragraph 18.

These clarifications were because of the authoritative treatment that statutory accounting provides to the definition of an asset and a liability in *SSAP No. 4* and *SSAP No. 5R*. For GAAP, the FASB Conceptual statements definitions are not authoritative, but rather are concepts to consider when developing and applying guidance. The FASB basis for conclusions noted that some existing authoritative FASB literature regarding liabilities is inconsistent with the updates to Concepts Statement No. 8. Therefore, a modification regarding topic specific liabilities guidance was incorporated to address variations from the definition of a liability. Examples of existing SAP variations from the definition of a liability include but are not limited to:

- a. *SSAP No. 7—Asset Valuation Reserves and Interest Maintenance Reserves – AVR and IMR* establish liabilities for regulatory objectives.
- b. *SSAP No. 62R—Property and Casualty Reinsurance –* contains the provision for reinsurance liability guidance which results in a liability that is a regulatory valuation allowance for overdue and slow paying reinsurance and also enforces Credit for Reinsurance (Model No. 785) collateral requirements.
- c. *SSAP No. 92—Post Retirement Benefits Other than Pensions*, provides liability recognition, which adopts several GAAP standards with modifications.

The additional exposed revisions to *SSAP No. 168* and *SSAP No. 5R* are reflected in the Issue Paper and also shown below.

- **Exposed revisions – Topic Specific Footnote** - This language is proposed for incorporation as a footnote to the liability definition in *SSAP No. 5R* and its related and *Issue Paper No. 16X—Updates to the Definition of a Liability*.

New Footnote to paragraph 3 of *SSAP No. 5R*:

The guidance in this Statement regarding the definition of a liability is applicable unless another authoritative statement of statutory accounting principles (SSAP) provides more topic specific contradictory guidance. In such cases the topic specific guidance shall apply.

- Exposed revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets* and *Issue Paper No. 16X—Updates to the Definition of a Liability* (New language shaded):

Relevant Literature

39. This statement adopts *FASB Statement No. 5, Accounting for Contingencies* (FAS 5), *FASB Statement 114, Accounting by Creditors for Impairment of a Loan* only as it amends in part FAS 5 and

~~paragraphs 35 and 36 of FASB Statement of Financial Accounting Concepts No. 6—Elements of Financial Statements.~~ FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss, An Interpretation of FASB Statement No. 5* (FIN No. 14) is adopted with the modification to accrue the loss amount as the midpoint of the range rather than the minimum as discussed in paragraph 3 of FIN No. 14. This statement adopts with modification ASU 2013-04, *Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date* with the same statutory modification adopted for FIN 14. This statement incorporates the definition of a liability from FASB Statement of Financial Accounting Concepts No. 8, Chapter 4, Elements of Financial Statements, paragraphs E37 and E38 with modification reflected in this Statement regarding topic specific guidance.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated in *Issue Paper No. 168—Updates to the Definition of a Liability*, to the Preamble and SSAP No. 5R which revises the definition of a liability under statutory accounting.

[https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/MemberMinutes/SAPWG/Attachments/-2022-01 SSAP 5R.docx](https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/MemberMinutes/SAPWG/Attachments/-2022-01%20SSAP%205R.docx)

Meetings/E

CMTE/APPTF/2023-2

Summer/Summary

and

Statutory Issue Paper No. 168

Updates to the Definition of a Liability

STATUS

Finalized August 13, 2023

Original and Current Authoritative Guidance: SSAP No. 5R

Type of Issue:

Common Area

SUMMARY OF ISSUE

1. This issue paper documents the SAP clarification revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*. The intent of the revisions is to align current statutory accounting guidance, specifically the definition of a “liability,” with the term utilized by the Financial Accounting Standards Board (FASB).

SUMMARY CONCLUSION

2. The statutory accounting principle clarifications to SSAP No. 5R (illustrated in Exhibit A), reflect that for the purposes of statutory accounting, a liability shall be defined as: a present obligation of an entity to transfer an economic benefit. A liability has two essential characteristics: (1) it is a present obligation, and (2) the obligation requires an entity to transfer or otherwise provide economic benefit to others. For the purposes of these characteristics, *transfer* is typically used to describe obligations to pay cash or convey assets, while the term *provide* is used to describe obligations to provide services or stand by to do so. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity’s financial statements when incurred.

3. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies. (The definition and recognition requirements of loss contingencies under SSAP No. 5R are not proposed to be revised and will continue as statutory accounting guidance.)

DISCUSSION

4. In December 2021, FASB issued *Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which introduced updated definitions of certain key elements used in financial reporting – most notably updating the fundamental definition of a liability. Through the FASB’s adoption of Concept Statement No. 8, the original Concept Statement No. 6 has been superseded. As statutory accounting currently reflects FASB’s historical definition, this issue paper is to review the prior concept definition (currently utilized by statutory accounting) and compare it to FASB’s updated concept definition and assess whether the revised concept definition shall be reflected in statutory accounting.

5. FASB concept statements do not reflect authoritative U.S. GAAP guidance. Rather concept statements are intended to set forth objectives and fundamental concepts that will be the basis for development of financial accounting and reporting guidance. The term “liability” is not captured or defined in the FASB Accounting Standards Codification (which is the source of authoritative U.S. GAAP.) Furthermore, although the concept statement is intended to be used as a guide in establishing authoritative U.S. GAAP, the FASB is not restricted to the concepts when developing guidance, and the FASB may issue U.S. GAAP which may be inconsistent with the

objectives and fundamental concepts set forth in Concept Statements. A change in a FASB Concept Statement does not 1) require a change in existing U.S. GAAP, 2) amend, modify or interpret the Accounting Standards Codification, or 3) justify either changing existing generally accepted accounting and reporting practices or interpreting the Accounting Standards Codification based on personal interpretations of the objectives and concepts in the concepts statement.

6. Under the prior FASB concept statement, which was reflected in SSAP No. 5R, a liability was defined as a probable future sacrifice of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of past transactions or events. In addition, the historical definition possessed three essential characteristics in that (1) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (2) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (3) the transaction or other event obligating the entity has already happened.

7. Pursuant to the prior concept statement, and as incorporated in SSAP No. 5R, *probable*, as referenced both in the definition and essential characters, was used in a usual general meaning, rather than in a specific accounting or technical sense and referred to which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

8. With the new FASB conceptual framework chapter, a liability is now defined as a present obligation of an entity to transfer an economic benefit. In addition, the current definition has two essential characteristics in that the liability is (1) a present obligation, and (2) the obligation requires an entity to transfer or otherwise provide economic benefits to others.

9. The updated liability definition from Concept Statement No. 8 no longer includes the term *probable* or the phrase *in the future* and *as a result of past transactions or events*. The FASB concluded that the term *probable* has historically been misunderstood as implying that a future obligation must meet a probability to a certain threshold before the definition of a liability was met. Thus, if the probability of a future transfer of an asset (or the requirement to provide a service) was low, a liability would likely not be recognized. In removing the term *probable* (and replacing it with “present obligation”), FASB concluded that in almost all situations, the presence of an obligation will be apparent. It stated that most present obligations are legally enforceable, including obligations arising from binding contracts, agreements, statutes, or other legal or contractual means. Chapter 4 also discusses the prevalence of certain business risks and how to assess if they result in the recognition of a liability. The FASB concluded that while certain businesses have a risk that a future event will cause them to transfer an economic benefit (an asset), the risk itself does not represent a present obligation because exposure to a potential negative consequence does not constitute a present obligation.

10. However, the FASB also stated that situations lacking clear legal or contractual evidence of a present obligation may pose particular challenges that may make it difficult to discern whether a present obligation exists. In these settings, the FASB stated that constructive obligations or other noncontractual obligations are created by circumstance rather than by explicit agreement. In the absence of an explicit agreement, sufficient information to distinguish a present obligation is likely only available at the specific standards level. Thus, the FASB concluded that the specific facts and circumstances at the standards level (or in the case of statutory accounting, at the SSAP level) must be utilized to determine whether the entity has created a constructive obligation and must recognize a liability.

11. The FASB also struck the phrase *as the result of past transactions or events*. With this action, the FASB clarified that if the liability represents a *present obligation*, by default, the obligation must have occurred as the result of a past transaction or event and thus this phraseology was deemed redundant and unnecessary.

12. When reviewing the substance of the revisions, the FASB concluded that the updated definition resulted in a clearer and more precise definition. Furthermore, while it did not fundamentally change the historical concept of a liability, the revised definition potentially expands the population of liabilities to include certain obligations to issue or potentially issue an entity's own shares rather than settle an obligation exclusively with assets. In essence, clarifying that instruments with characteristics of both liabilities and equity may in fact be classified as liabilities in certain situations.

13. In general, the FASB did not anticipate that the liability definition revisions would result in any material changes in instrument reclassification (e.g., items now being classified as a liability when previously they were not considered liabilities). Again, FASB Concept Statements are not authoritative and thus the guidance in any specific standard will still be utilized for instrument measurement and classification. For statutory accounting purposes, the updated definition should be viewed similarly, that is it does not change fundamental concepts, change current practices, or introduce a new, original or a modified accounting principle. The revisions to the definition of a liability clarify the definitional language and do not modify the original intent of SSAP No. 5R and thus the changes are deemed to be a statutory accounting principle clarification.

14. The remaining concepts and guidance articulated in SSAP No. 5R (e.g., contingencies, impairments, guarantees, etc.) were not proposed for revision and thus are not further discussed in this issue paper.

Actions of the Statutory Accounting Principles (E) Working Group

15. During the 2022 Spring National Meeting, the Working Group exposed this issue paper for public comment.

16. During the 2022 Summer National Meeting, the Working Group re-exposed this issue paper for public comment.

17. At the 2022 Fall National Meeting, the Working Group re-exposed this issue paper related to the definition change of a liability in *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*. This exposure intends to provide additional time for industry to review the changes in accordance with statutory accounting statements. NAIC staff were directed to collaborate with interested parties on proposed clarifying language.

18. At the 2023 Spring National Meeting, the Working Group exposed this issue paper with revisions to: 1) add an additional footnote to the definition of a liability in SSAP No. 5R which defers to more topic specific contradictory guidance and 2) revise the relevant literature section of SSAP No. 5R to note the modification. These clarifications were because of the authoritative treatment that statutory accounting provides to the definition of an asset and a liability in SSAP No. 4 and SSAP No. 5R. For U.S. GAAP, the FASB Conceptual statements definitions are not authoritative, but rather are concepts to consider when developing and applying guidance. The FASB basis for conclusions noted that some existing authoritative FASB literature regarding liabilities is inconsistent with the updates to Concepts Statement No. 8. Therefore, a modification regarding topic specific liabilities guidance was incorporated to address variations from the definition of a liability. Examples of existing SAP variations from the definition of a liability include but are not limited to:

- a. *SSAP No. 7—Asset Valuation Reserves and Interest Maintenance Reserves – AVR and IMR* establish liabilities for regulatory objectives.
- b. *SSAP No. 62R—Property and Casualty Reinsurance* – contains the provision for reinsurance liability guidance which results in a liability that is a regulatory valuation allowance for overdue and slow paying reinsurance and also enforces credit for reinsurance (*Credit for Reinsurance Model Law (#785)*) collateral requirements.

- c. *SSAP No. 92—Post Retirement Benefits Other than Pensions*, provides liability recognition, which adopts several U.S. GAAP standards with modifications.

19. At the 2023 Summer National Meeting, the Working Group adopted the exposed revisions to SSAP No. 5R as documented in this issue paper and adopted this issue paper.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

20. Relevant excerpts of SSAP No. 5R, paragraphs 2-3 regarding the definition of a liability accounting are as follows:

2. A liability is defined as certain or probable¹ future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).

3. A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable¹ future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statements when incurred.

Generally Accepted Accounting Principles

21. Relevant paragraphs from *Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements* have been included below:

Liabilities

E37. A liability is a present obligation of an entity to transfer an economic benefit

Characteristics of Liabilities

E38. A liability has the following two essential characteristics: a. It is a present obligation. b. The obligation requires an entity to transfer or otherwise provide economic benefits to others.²

E39. Liabilities commonly have features that help identify them. For example, many liabilities require the obligated entity to pay cash to one or more identified other entities. Liabilities may not require an entity to pay cash but may require the entity to convey other assets, provide services, or transfer other economic benefits or to be ready to do so. Liabilities are based on a foundation of legal rights and duties.

¹ *FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements*, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in *FASB Statement 5, Accounting for Contingencies*, paragraph 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.

² This chapter continues the practice of describing liabilities as an obligation either to transfer or to provide economic benefits. For example, the term transfer has typically been used to describe obligations to pay cash or convey assets, and the term provide has typically been used to describe obligations to perform services or stand ready to do so.

E40. Entities routinely incur liabilities in exchange transactions to acquire the funds, goods, and services they need to operate. For example, borrowing cash (acquiring funds) obligates an entity to repay the amount borrowed, acquiring assets on credit obligates an entity to pay for the assets, and selling products with a warranty or guarantee obligates an entity to either pay cash or repair or replace any products that prove defective. Often, obligations incurred in exchange transactions are contractual based on written or oral agreements to pay cash or to provide goods or services to specified or determinable entities on demand at specified or determinable dates or on the occurrence of specified events.

Present obligation

E41. A liability requires that an entity be obligated to perform or act in a certain manner. In most cases it is apparent that liabilities are legally enforceable. Legally enforceable obligations include those arising from binding contracts, agreements, rules, statutes, or other requirements that would be upheld by a judicial system or government. Judicial systems vary in type and form, and the term judicial systems includes any such system that would enforce laws, statutes, and regulations. In the context most relevant to financial reporting, an obligation is any condition that binds an entity to some performance or action. In a financial reporting context, something is binding on an entity if it requires performance. Performance is what the entity is required to do to satisfy the obligation.

E42. Many obligations that qualify as liabilities stem from contracts and other agreements that are enforceable by courts or from governmental actions that have the force of law. Agreements, contracts, or statutory requirements often will specify or imply how an obligation was incurred and when and how the obligation is to be settled. For example, borrowing and lease agreements specify the amount of charges and the dates when the payments are due. The absence of a specified maturity date or event to require settlement may cast doubt that an obligation exists.

E43. Liabilities necessarily involve other parties, society, or law. The identity of the other party or recipient need not be known to the obligated entity before the time of settlement. An obligation of an entity to itself cannot be a liability. For example, in the absence of external requirements an entity is not obligated to repair the roof of its building or maintain its plant and equipment. Although those actions may be wise business moves, the entity may forgo or defer such activities because there is no present obligation to perform the activity.

E44. Certain obligations require nonreciprocal transfers from an entity to one or more other entities. Such obligations include taxes imposed by governments, donations pledged to charitable entities, and cash dividends declared but not yet paid.

E45. To have a liability, an entity must have a present obligation, that is, the obligation exists at the financial statement date. The settlement date of the liability may occur in the future, but the obligation must be present at the financial statement date. Transactions or other events or circumstances expected to occur in the future do not in and of themselves give rise to obligations today.

E46. An intention to purchase an item, for example, an asset, does not in and of itself create a liability. However, a contractual obligation that requires an entity to pay more than the fair value of the asset at the transaction date may create a liability before the asset is received, reflecting what the entity might have to pay to undo the unfavorable contract.

E47. Business risks result from the conduct of an entity's business activities. A business risk is not a present obligation, though at some point in the future an event may occur that creates a present obligation. Some businesses have the potential of carrying out activities and creating present obligations as a result of those activities. However, no present obligation exists even if it is virtually certain that an obligating event will occur, though at present no such event has occurred. The essence of distinguishing business risks from liabilities is determining the point in time when an entity has a present obligation.

E48. Some business risks result from an entity's transactions, for example, selling goods in overseas markets might expose an entity to the risk of future cash flow fluctuations because of changes in foreign exchange rates. Other business risks result from an entity's operating environment, for example, operating in a highly specialized industry might expose an entity to the risk that it will be unable to attract sufficient skilled staff to sustain its operating activities. Those risks are not liabilities.

E49. To be presently obligated, an entity must be bound, either legally or in some other way, to perform or act in a certain way. Most liabilities are legally enforceable, including those arising from contracts, agreements, rules, and statutes. An entity also can become obligated by other means that would be expected to be upheld by a judicial process. However, the existence of a present obligation may be less clear in those circumstances.

E50. Some liabilities rest on constructive obligations, including some that arise in exchange transactions. A constructive obligation is created, inferred, or construed from the facts in a particular situation rather than contracted by agreement with another entity or imposed by government. An entity may become constructively obligated through customary business practice. In the normal course of business, an entity conducting certain activities may not create a clear contractual obligation but may nonetheless cause the entity to become presently obligated. For example, policies and practices for sales returns and those for warranties in the absence of a contract may create a present obligation because the pattern of behavior may create an enforceable claim for performance that would be upheld in the ultimate conclusion of a judiciary process.

E51. An entity's past behavior also may give rise to a present obligation. Repeated engagement in a certain behavior may obligate the entity to perform or act in a certain way on the basis of that pattern of behavior. For example, the entity may create a constructive obligation to employees for vacation pay or year-end bonuses by paying them every year even though it is not contractually bound to do so and has not announced a policy to do so.

22. The most notable changes regarding the definition of a liability included removal of the term *probable* and the phrase *as a result of past transactions or events*. Rationale for these changes were documented in *Chapter 4, Elements of Financial Statements* commentary as follows:

BC4.11. The definitions of both an asset and a liability in Concepts Statement 6 include the term *probable* and the phrases *future economic benefit* and *past transactions or events*. The term *probable* in the definitions in Concepts Statement 6 has been misunderstood as implying that a future economic benefit or a future sacrifice of economic benefit must be probable to a certain threshold before the definition of an asset or a liability is met. In other words, if the probability of future economic benefit is low, the asset definition is not met under that interpretation. A similar interpretation could be made for liabilities. The footnotes to the Concepts Statement 6 definition of assets and liabilities also were not helpful in clarifying the application of the term *probable* as used in the definitions of assets and liabilities. Accordingly, the Board decided to eliminate that term from the definitions of both assets and liabilities.

BC4.12. The term *future* in the definitions in Concepts Statement 6 focused on identifying a future flow of economic benefits to demonstrate that an asset exists or identifying a future transfer of economic benefits to demonstrate that a liability exists. The definitions in Concepts Statement 6 were often misunderstood as meaning that the asset (liability) is the ultimate future inflow (outflow). For example, in the instance of trade receivables, the definition in Concepts Statement 6 could be misunderstood to indicate that the asset is the successful collection of the receivable in the future. When applied appropriately, however, the definition would conclude that the asset is the present right to collection. Similar misunderstandings occurred in applying the liability definition. As a result, the Board concluded that a focus on the term *present* would appropriately shift the focus from identifying a future occurrence. Therefore, the Board decided to include the term *present* right to demonstrate that an asset exists and emphasize the term *present* obligation to demonstrate that a liability exists.

BC4.13. The definitions of assets and liabilities in Concepts Statement 6 both include the phrase past transactions or events. The Board concluded that if an entity has a present right or a present obligation, one can reasonably assume that it was obtained from some past transaction or event. Therefore, that phrase is considered redundant and has been eliminated from the definitions.

23. The other significant change to the definition of a liability included changing *future sacrifices* to a *present obligation*. Rationale for these changes were documented in *Chapter 4, Elements of Financial Statements* commentary as follows:

BC4.25. The term present obligation is included in the definition of a liability, both in this chapter and in Concepts Statement 6. Because the application of the liability definition under Concepts Statement 6 did not give sufficient emphasis to the term present obligation, the definition in this chapter more appropriately emphasizes that term. Assessing whether a present obligation exists is the primary criterion in the definition of a liability in this chapter. The primacy of the term present obligation is made more evident through the removal of many of the problematic terms in the definition of a liability in Concepts Statement 6, as discussed in paragraphs BC4.11–BC4.13.

BC4.26. Almost always, the existence of a present obligation will be apparent. Most present obligations are legally enforceable, including obligations arising from binding contracts, agreements, statutes, or other legal or contractual means. However, situations lacking clear legal or contractual evidence of a present obligation pose particular challenges that may make it difficult to discern whether a present obligation exists.

BC4.27. Determining when a present obligation exists has caused confusion with the existence of business risks. Business risks result from the nature of the business and where, when, and how an entity conducts its business. While certain businesses pose risks of future events occurring that will cause a transfer of economic benefits, the Board decided that the risks themselves are not present obligations because exposure to a potential negative consequence does not constitute a present obligation. Rather than viewing all business risks as liabilities, the Board decided that an entity has a present obligation only after an event occurs that demonstrates that the inherent business risk has created a present obligation. Thus, distinguishing when a business risk makes an entity presently obligated requires analysis of the facts and circumstances at the standards level.

BC4.28. Determining the existence of a present obligation is particularly challenging in evaluating constructive obligations. Interpreting constructive obligations too narrowly will tend to exclude significant actual obligations of an entity, while interpreting them too broadly will effectively nullify the definition by including items that lack an essential characteristic of liabilities.

BC4.29. Given that constructive obligations and other noncontractual obligations are created by circumstance rather than explicit agreement, it can be unclear whether a present obligation exists. In the absence of an explicit agreement, sufficient information to distinguish a present obligation is likely only available at the specific standards level. Thus, the Board decided that specific facts and circumstances at the standards level must be assessed to determine whether an entity has created a constructive obligation.

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy

Generally Accepted Accounting Principles

- FASB Statement of Financial Accounting Concepts No. 8, Conceptual Framework for Financial Reporting – Chapter 4, Elements of Financial Statements

Effective Date

24. As issue papers are not authoritative and are not represented in the Statutory Hierarchy (see Section V of the Preamble), the consideration and adoption of this issue paper will not have any impact on the SAP clarifications adopted to SSAP No. 5R by the Working Group on August 13, 2023.

EXHIBIT A – SAP Clarification Revisions to SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets the other paragraphs of SSAP No. 5R are unchanged.

Statement of Statutory Accounting Principles No. 5 - Revised

Liabilities, Contingencies and Impairments of Assets

SCOPE OF STATEMENT

1. This statement defines and establishes statutory accounting principles for liabilities, contingencies and impairments of assets.

SUMMARY CONCLUSION

Liabilities

2. A liability is defined as a present obligation of an entity to transfer an economic benefit~~certain or probable FNI future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).~~

3. A liability¹ has ~~three~~two essential characteristics: (a) it is a present obligation~~embodies a present duty or responsibility to one or more other entities that entails settlement by probable FNI future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, and~~ (b) the obligation required an entity to transfer or otherwise provide economic benefit to others~~duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and~~ (c) ~~the transaction or other event obligating the entity has already happened.~~ This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statements when incurred.

4. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies.

¹ The guidance in this statement regarding the definition of a liability is applicable unless another authoritative statement of statutory accounting principles (SSAP) provides more topic specific contradictory guidance. In such cases the topic specific guidance shall apply.

~~FN1—FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement 5, Accounting for Contingencies, paragraph 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.~~

Relevant Literature

39. This statement adopts *FASB Statement No. 5, Accounting for Contingencies* (FAS 5), *FASB Statement 114, Accounting by Creditors for Impairment of a Loan* only as it amends in part FAS 5 ~~and paragraphs 35 and 36 of FASB Statement of Financial Accounting Concepts No. 6—Elements of Financial Statements~~. *FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss, An Interpretation of FASB Statement No. 5* (FIN No. 14) is adopted with the modification to accrue the loss amount as the midpoint of the range rather than the minimum as discussed in paragraph 3 of FIN No. 14. This statement adopts with modification *ASU 2013-04, Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date* with the same statutory modification adopted for FIN 14. [This statement incorporates the definition of a liability from FASB Statement of Financial Accounting Concepts No. 8, Chapter 4, Elements of Financial Statements, paragraphs E37 and E38 with modification reflected in this Statement regarding topic specific guidance.](#)

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*
- *Issue Paper No. 20—Gain Contingencies*
- *Issue Paper No. 135—Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*
- [Issue Paper No. 168—Updates to the Definition of a Liability](#)

[https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/APPTF/2023-2 Summer/Summary and Minutes/SAPWG/Attachments/ IP 168.docx](https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member%20Meetings/E%20CMTE/APPTF/2023-2%20Summer/Summary%20and%20Minutes/SAPWG/Attachments/IP%20168.docx)

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

Issue: Negative IMR

Check (applicable entity):

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

Description of Issue: This agenda item has been developed to discuss the interest maintenance reserve (IMR) within statutory accounting, specifically the current guidance for the nonadmittance of disallowed negative IMR. Although the statutory accounting guidance has been in place for several years, the rising interest rate environment has created an increased likelihood for reporting entities to move to a negative IMR position. This agenda item intends to provide information on the background of IMR, current accounting guidance, recent discussions of the Life Actuarial (A) Task Force and some broad financial results from year-end 2021 and interim 2022 financial statements. The intent is to provide this information to facilitate Working Group discussion.

The following provides a high-level overview of the use of the terms positive IMR and negative IMR for entities filing the Life, Accident & Health / Fraternal annual statement blank:

- A positive IMR means that the net realized interest related gains which are amortized in the IMR calculation are greater than net realized interest related losses which are being amortized in the IMR calculation. A positive IMR is reported as a statutory liability and amortized to income over time.
- A negative IMR means that net realized interest related losses which are amortized in the IMR calculation are greater than net realized interested related gains which are amortized in the IMR calculation. A disallowed negative IMR is reported as a nonadmitted asset and amortized to income as a loss over time.

As IMR occurs in the general and separate account, there are specific guidelines in determining whether the IMR reflects a net disallowed negative or position in the annual statement instructions. These are on page 5.

A letter from the American Council of Life Insurers (ACLI) dated Oct. 31, 2022, raised concerns with existing statutory accounting requirements on the nonadmittance of disallowed negative IMR noting negative ramifications for insurers. Key summarized positions from this ACLI letter include:

- In general, rising interest rates are favorable to the financial health of the insurance industry and policyholders. However, with negative IMR, there is an inappropriate perception of decreased financial strength through lower surplus and risk-based capital.
- Negative IMR could impact the rating agency view of the industry or incentivize companies to avoid prudent investment transactions that are necessary to avoid mismatches between assets and liabilities. In either scenario, negative IMR encourages short-term non-economic activity that is not in the best long-term interest of a reporting entity’s financial health or its policyholders.

Background of IMR

The IMR was first effective in statutory accounting in 1992 and requires that a realized fixed income gains or losses attributable to changes in interest rates (excluding gains/losses that are credit related), be amortized into income over the remaining term to maturity of the fixed-income investments (and related hedging programs) sold rather than being reflected in income immediately.

Minutes, including adopted materials – in the Blue Book (Life Statement), from the 2002 4th Quarter NAIC Proceedings discussing IMR are provided below. Please note the last section that includes “Future Directions” which identifies recognition of negative IMR as a major area of effort.

Description and other components of IMR from the Blue Book, captured in the 2002 4th Quarter NAIC Proceedings, provides the following definition and other details: (*Only key excerpts included.*)

The Interest Maintenance Reserve (IMR): captures for all types of fixed income investments, all of the realized capital gains and losses which result from changes in the overall level of interest rates as they occur. Once captured, these capital gains or losses are amortized into income over the remaining life (period to maturity) of the investments sold. Realized gains and losses on derivative investments, which alter the interest rate characteristics of assets/liabilities, also are allocated to the IMR and are to be amortized into income over the life of the associated assets/liabilities. Note: certain significant unusual transactions may require immediate recognition of any realized capital gains or losses, as described in a later section. This reserve is not subject to any maximum.

VII. IMR MINIMUMS/MAXIMUMS: A. Minimums: **The IMR can be negative for any line of business as long as the aggregate IMR for the Company is not less than zero. Any otherwise negative IMR value is carried over to subsequent years.** B. Maximums: There is no maximum of the IMR

VIII. BACKGROUND/PERSPECTIVE: To insure solvency of a company, its assets should be invested so that the company has a very high probability of paying its contractual liabilities when they become due. In order to assess whether a company is able to fulfill its obligations, it must present its liabilities and assets on a financially integrated basis. Since the accounting practices prescribed for the life insurance annual statement are an important element in this discipline, it is imperative that the accounting practices be consistent for assets and liabilities. If they are inconsistent, then the annual statement will not reveal whether assets exceed liabilities; more importantly, neither regulators nor management can determine the risk of insolvency for the company.

The Valuation Actuary’s Opinion includes a statement that the assets backing the liabilities make adequate provision for the company’s liabilities. That is, the Actuary must look beyond the statutory valuation formulas and satisfy himself that the cash flows generated by the assets will probably be sufficient to discharge the liabilities. Prior to the AVR and IMR, there were many circumstances under which the statutory formula valuation methods gave rise to inappropriate results. Some examples were:

- Changes in values due to interest rate swings were recognized inconsistently on the asset and liability sides of the balance sheet. Liabilities are valued using interest rates fixed at issue while some assets may be valued using current interest rates through trading activity.
- When the assets are poorly matched to the liabilities, a significant adverse swing in the interest rates will reduce financial strength and could lead to insolvency even though the balance sheet value of the assets exceeds the balance sheet value of the liabilities. Using long term assets to back demand liabilities is dangerous if there is a significant upswing in interest rates. In addition, individual insurance premiums are received and invested for many years after the issue date on which the reserve interest rate is determined, creating a potential for inadequate yields that is not reflected in standard accounting procedures.

- The potential for future asset losses was not well reflected in the balance sheet or earnings statement.

It is desirable that the valuation of the assets and liabilities be made as consistent as possible to 1) minimize the instances where, in order to render a clean opinion, the actuary must establish extra reserves due to interest rate gains or potential for defaults and 2) increase the likelihood that assets supporting liabilities are sufficient even in the absence of an Actuarial Opinion. The development of an AVR and IMR will correct many of these deficiencies in consistency.

XII. AVR AND IMR BUILT ON AND COMPLEMENT EXISTING VALUATION PRACTICES: The existing framework of asset and liability valuation practices, as augmented by the NAIC Model Standard Valuation Law, played a key role in designing the AVR and IMR, including:

A. Reserve valuation standards should contain a provision for future losses. Although it is well understood that in cash flow testing provision must be made for future asset losses, it may not be as well understood that historically the minimum valuation standards implicitly contained such a provision.

B. Interest assumptions in reserve valuation generally recognize the potential for mismatch. Dynamic valuation rates are lower for ordinary life than for guaranteed investment contracts, for example, because the mismatch is almost inevitable on the former. In addition, it is required in other regulations, and in the NAIC Model Standard Valuation Law, that cash flow testing should be used and may result in the adoption of lower than the dynamic valuation rates if mismatch exists. Hence, with the one exception noted in section (c), there is no need for the IMR reserves to make provision for the risk of mismatch.

C. Asset valuations for fixed interest securities usually reflect the outlook at the time of purchase of an asset. In particular, bond amortization tends to reflect the yields available at time of purchase and the expected cash flow. Liabilities are established at the same time, and the interest rate assumptions on them are those appropriate to the outlook at that time. **But if securities are traded, a new amortization schedule is established that may be based on an entirely different yield environment, which may not be consistent with the liabilities that have been established. Using the IMR to absorb trading gains is desirable and appropriate to eliminate this subsequently created mismatch.**

D. Equities present special valuation problems. Common stocks are valued at market rather than amortized value; hence they require different treatment. Real estate and similar investments, although usually valued at depreciated value, require special consideration because of the great likelihood of major changes in yield and yield expectation after purchase.

XXII. RESERVE MAXIMUM AND MINIMUM LEVELS: No maximum is placed on the Interest Maintenance Reserve. The aggregate minimum value for the IMR for the Company is zero. The IMR may be negative for any Line of Business as long as the aggregate for all lines equals zero. Provision is made in the accounting rules that if an aggregate negative IMR is developed in the absence of the zero minimum, that negative value is carried over to subsequent years.

The basic rationale for the IMR would conclude that neither a maximum nor a minimum is appropriate. If the liability values are based on the assumption that the assets were purchased at about the same time as the liabilities were established, then there should be no bounds to the reserve which corrects for departures from that assumption; if a company has to set up a large reserve because of trading gains, it is in no worse position than if it had held the original assets. As for negative values of the IMR, the same rationale applies. However, the concept of a negative reserve in the aggregate has not been adopted.

XXVIII. EXCESSIVE WITHDRAWALS:

- A. Background: Major book-value withdrawals or increases in policy loans can occur at a time of elevated interest rates. If these withdrawals or increases are far in excess of the withdrawals provided for in the company's reserving and cash flow testing, and **if asset sales at this point are, in effect, forced sales to fund liabilities that are no longer on the books, the allocation of a negative amount to the IMR is not correct.**

A company may also experience a "run on the bank" due to adverse publicity. This could occur even during a period of low interest rates, and the sale of assets to meet a run would conceivably produce gains. It is appropriate to register the gains immediately.

If the withdrawals were scheduled payments under a GIC, then there is a presumption that any gains or losses that might occur at the time of withdrawal should be added to the IMR since the gains or losses would be spurious if the company has followed a policy of matching its assets to its liabilities. Note that many of the situations where an upsurge in withdrawal activity generates real losses arise when a company has a severe mismatch between its assets and its liabilities. Such losses can be present even in the absence of any realized gains or losses. The primary protection as to the adequacy of reserves in these circumstances is the requirement for an actuary's opinion.

- B. IMR Exclusions: All realized interest-related gains or losses which arise from the sale of investments required to meet "Excess Withdrawal Activity" as defined below will be excluded from the IMR and will be reflected in net income.

STANDARDS FOR ACTUARIAL RESERVES WITH AN IMR AND AN AVR

LXX. IMR RESERVE STANDARD The Interest Maintenance Reserve is a true actuarial reserve, and actuaries should use the assets supporting the Interest Maintenance Reserve when opining that the assets supporting the company's reserves make adequate provision for the company's obligations. **In the case of a negative IMR, the actuarial opinion should include an explicit statement that the impact of the negative IMR on reserve adequacy has been considered and that the reserves after deduction of the negative IMR still make adequate provision for the liabilities.**

LXXI. GENERAL EXPLANATION The IMR is designed to work with minimum statutory reserves based on formulas contained in laws or regulations. Where, for example, the valuation rate is based on the interest rate conditions prevailing in the year of deposit, the assets supporting the liabilities will be consistent with the liability assumptions. Disposal of the assets during a period of declining interest rates will produce interest-related gains, but these gains will be needed to support the liabilities that are still valued at the interest rate levels prevailing at time of deposit. Thus, it is appropriate in the case of positive IMR to treat the IMR as an additional reserve requirement above and beyond formula minimums.

In cash-flow-testing actuaries take future cash flows into account from existing assets. In an example such as described above, existing assets may well have been purchased at rates below those prevailing at the time reserves were established. The positive IMR that has been built up has captured the gains and not allowed them to be available for distribution. The IMR is recognized as part of the reserves available to meet future obligation cash flows.

Thus from either point of view a positive IMR is treated as a true actuarial reserve. The same arguments should apply equally well in the case of a negative IMR, but some concern has been expressed that in this case the net reserves are in effect lower than statutory formulas minimums, and therefore special considerations are required.

FUTURE DIRECTIONS

In late 2002, the interested persons (as its name had become) considered refinements of the AVR/IMR for the next several years, from that vantage point, some of the major areas of effort appear to be as follows:

1. **There should be recognition of negative values of the IMR. The group had long recognized that the philosophical basis for the IMR supports negative values of the reserve as well as positive. There is a need to have investment return match the liabilities associated with the investment; and a need to remove the incentive for a company to make investment decisions based on the short term balance sheet effect; and these needs exist also on the negative side of the IMR.**

No doubt there are concerns that a negative reserve of this type could somehow lead to an unsound condition, so there has been appended to this report a discussion entitled “Why Are Negative Values For the IMR Necessary?” It also seems as though there should be additional safeguards in the case of a negative IMR. Rather than put arbitrary limits on the amount of the negative reserve, however, consideration is being given to an actuary’s statement that an asset adequacy analysis has been carried out that demonstrates the soundness of the reserves.

(Staff Note: The NAIC library does not have a record of the report noted in the above paragraph.)

Current Accounting Guidance

The statutory accounting guidance for IMR (and the Asset Valuation Reserve – AVR) is within *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*, but the guidance within that SSAP is very limited. It provides a general description, identifies that IMR/AVR shall be calculated and reported per the guidance in the applicable SSAP, and if not explicit in the SSAP, in accordance with the Annual Statement Instructions. The SSAPs most often simply direct allocation to (or between) IMR and AVR, with the bulk of the guidance within the Annual Statement Instructions.

The guidance in the Annual Statement instructions provides information on the net IMR balance, which takes into consideration both the positive and negative balances in the general and separate accounts. As detailed, disallowed negative IMR is reported so that it is a direct reduction to surplus on the Summary of Operations, page 4, line 41 change in nonadmitted assets:

Line 6 – Reserve as of December 31, Current Year

Record any positive or allowable negative balance in the liability line captioned “Interest Maintenance Reserve” on Page 3, Line 9.4 of the General Account Statement and Line 3 of the Separate Accounts Statement. A negative IMR balance may be recorded as a negative liability in either the General Account or the Separate Accounts Statement of a company only to the extent that it is covered or offset by a positive IMR liability in the other statement.

If there is any disallowed negative IMR balance in the General Account Statement, include the change in the disallowed portion in Page 4, Line 41 so that the change will be appropriately charged or credited to the Capital and Surplus Account on Page 4. If there is any disallowed negative IMR balance in the Separate Accounts Statement, determine the change in the disallowed portion (prior year less current year disallowed portions), and make a direct charge or credit to the surplus account for the “Change in Disallowed Interest Maintenance Reserve” in the write-in line, in the Surplus Account on Page 4 of the Separate Accounts Statement.

The following information is presented to assist in determining the proper accounting:

| General Account IMR Balance | Separate Account IMR Balance | Net IMR Balance |
|--------------------------------|---------------------------------|-----------------------|
| Positive | Positive | Positive (See rule a) |
| Negative | Negative | Negative (See rule b) |
| Positive | Negative | Positive (See rule c) |
| Positive | Negative | Negative (See rule d) |
| Negative | Positive | Positive (See rule e) |
| Negative | Positive | Negative (See rule f) |

Rules:

- a. If both balances are positive, then report each as a liability in its respective statement.
- b. If both balances are negative, then no portion of the negative balances is allowable as a negative liability in either statement. Report a zero for the IMR liability in each statement and follow the above instructions for handling disallowed negative IMR balances in each statement.
- c. If the general account balance is positive, the separate accounts balance is negative and the combined net balance is positive, then all of the negative IMR balance is allowable as a negative liability in the Separate Accounts Statement.
- d. If the general account balance is positive, the separate account balance is negative, and the combined net balance is negative, then the negative amount not covered by the positive amount is not allowable. Report only the allowable portion as a negative liability in the Separate Accounts Statement and follow the above instructions for handling the disallowed portion of negative IMR balances in the Separate Accounts Statement.
- e. If the general account balance is negative, the separate account balance is positive, and the combined net balance is positive, then all of the negative IMR balance is allowable as a negative liability in the General Account Statement.
- f. If the general account balance is negative, the separate account balance is positive, and the combined net balance is negative, then the negative amount not covered by the positive amount is not allowable. Report only the allowable portion as a negative liability in the General Account Statement and follow the above instructions for handling the disallowed portion of negative IMR balances in the General Account Statement.

The Statutory Accounting Statement of Concepts in the Preamble to the AP&P provides the following on Recognition:

Recognition

35. The principal focus of solvency measurement is determination of financial condition through analysis of the balance sheet. However, protection of the policyholders can only be maintained through continued monitoring of the financial condition of the insurance enterprise. Operating performance is another indicator of an enterprise's ability to maintain itself as a going concern. Accordingly, the income statement is a secondary focus of statutory accounting and should not be diminished in importance to the extent contemplated by a liquidation basis of accounting.

36. 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 but rather should be charged against surplus when acquired or when availability otherwise becomes questionable.

37. Liabilities require recognition as they are incurred. Certain statutorily mandated liabilities may also be required to arrive at conservative estimates of liabilities and probable loss contingencies (e.g., interest maintenance reserves, asset valuation reserves, and others).

Life Actuarial (A) Task Force 2022 Guidance

The Life Actuarial (A) Task Force considered comments from the ACLI that the inclusion of a negative IMR balance in asset adequacy testing, the disallowance of a negative IMR could result in double counting of losses (i.e., through the disallowance on the balance sheet and the potential AAT-related reserve deficiency). The Task Force identified that VM-20 Section 7.D.7.b notes that "...the company shall use a reasonable approach to allocate any portion of the total company balance that is disallowable under statutory accounting procedures (i.e., when the total company balance is an asset rather than a liability)." Question 22 of the AAA's Asset Adequacy Practice Note (Attachment 2) states that "... a negative IMR is not an admitted asset in the annual statement. So, some actuaries do not reflect a negative value of IMR in the liabilities used for asset adequacy analysis." However, Question 22 also notes a 2012 survey data that showed varying practices across companies, including some companies that allocated negative IMR.

On Nov. 17, 2022, in order to assist state regulators in achieving uniform outcomes for year-end 2022, the Task Force exposed guidance until November 30, 2022:

Recommendation In order to assist state regulators in achieving uniform outcomes for year-end 2022, we have the following recommendation: the allocation of IMR in VM-20, VM-21, and VM-30 should be principle-based, "appropriate", and "reasonable". Companies are not required to allocate any non-admitted portion of IMR (or PIMR, as applicable) for purposes of VM-20, VM-21, and VM-30, as being consistent with the asset handling for the nonadmitted portion of IMR would be part of a principle-based, reasonable and appropriate allocation. However, if a company was granted a permitted practice to admit negative IMR as an asset, the company should allocate the formerly non-admitted portion of negative IMR, as again a principle-based, reasonable and appropriate IMR allocation would be consistent with the handling of the IMR asset. This recommended guidance is for year-end 2022, to address the current uncertainty and concerns with the "double-counting" of losses. This recommended guidance will help ensure consistency between states and between life insurers in this volatile rate environment. Refinement of this guidance may be considered beyond year-end 2022.

The Oct. 31, 2022 ACLI Letter also identified the following references to IMR in the valuation manual and Risk-Based Capital Calculations:

| Regulation | Use | IMR references |
|---|--|--|
| Actuarial Opinion and Memorandum Regulation (VM-30) | Asset adequacy analysis for annual reserve opinion | An appropriate allocation of assets in the amount of the IMR, whether positive or negative, shall be used in any asset adequacy analysis. |
| Life principle-based reserves (VM-20) | Calculation of deterministic reserve | Calculate the deterministic reserve equal to the actuarial present value of benefits, expenses, and related amounts less the actuarial present value of premiums and |

| | | |
|---|---|--|
| | | related amounts, less the positive or negative pre-tax IMR balance at the valuation date allocated to the group of one or more policies being modeled |
| Life principle-based reserves (VM-20) | Calculation of stochastic reserve | Add the CTE amount (D) plus any additional amount (E) less the positive or negative pre-tax IMR balance allocated to the group of one or more policies being modeled |
| Variable annuities principle-based reserves (VM-21) | Reserving for variable annuities | The IMR shall be handled consistently with the treatment in the company's cash-flow testing, and the amounts should be adjusted to a pre-tax basis. |
| C3 Phase 1 (Interest rate risk capital) | RBC for fixed annuities and single premium life | IMR assets should be used for C3 modeling. |

Assessment of 2020-2022 IMR Balances:

Note – The following amounts reflect the general account IMR Reserve balance. (This is the amount shown as a liability and shows the decrease in the positive IMR reported since 2020.) This detail does not show the disallowed negative IMR reported as an asset and nonadmitted. Also, information on the separate account IMR, which is a factor in determining in disallowed negative IMR, will not be known until the year-end financial statements are filed (March 1, 2023).

| | GA 2022 – Q3 | GA 2022 – Q2 | GA 2022 – Q1 | GA YE – 2021 | GA YE – 2020 |
|-------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Aggregate IMR | 27,601,001,445 | 31,859,274,989 | 37,697,176,149 | 40,598,068,038 | 35,229,578,726 |
| Change from Prior | (4,258,273,544) | (5,837,901,160) | (2,900,891,889) | 5,368,489,312 | |
| % Change | (13.4%) | (21.5%) | (7.1%) | 15.2% | |

Review of GA IMR Reserve Decrease:

- From the first quarter (Q1) to second quarter (Q2), 25 companies had decreases in the IMR reserve balance over \$50M totaling \$4,717,657,986, representing 80% of the overall change. 13 of these companies had decreases of IMR over \$100M, totaling \$3,959,569,339, representing 68% of the change. Four of these companies had decreases of IMR over \$400M. One of these companies reported a zero IMR liability and reported a disallowed IMR on the asset page of approx. \$570M.
- From the first quarter (Q1) to second quarter (Q2), 49 companies increased their prior reported positive IMR by \$61,390,564. From the second quarter (Q2) to third quarter (Q3), 56 companies increase their prior reported positive IMR by \$60,316,403
- From the second quarter (Q2) to third quarter (Q3), 16 companies had decreases in the IMR reserve balance over \$50M totaling \$3,161,570,362, representing 74% of the change. 8 of these companies had decreases of IMR over \$100M, totaling \$2,580,832,015, representing 60% of the change. All of these companies were still in a net positive IMR position.
- For the 30 companies that reflected the largest decline in reported IMR between the first to second quarter and then the second to third quarter, the following key details are noted.
 - From the first (Q1) to second quarter (Q2), the top 30 companies reflected a decrease in \$4,923,166,733, which is 84% of the total decrease.
 - From the second (Q2) to third quarter (Q3), the top 30 companies reflected a decrease in \$3,642,088,165, which is 85.5% of the total decrease.
 - 19 companies were noted as being in the population for both periods. 29 of the 30 companies reported a net positive IMR in the third quarter. One company reported a zero IMR in Q3.
- For the 15 companies that had the largest declines between the first quarter (Q1) to second quarter (Q2), eight of those companies also had the largest declines from second quarter (Q2) to third quarter (Q3).
- A limited number of companies are reporting a negative IMR on the liabilities side. Seven companies reported a net negative IMR balance in the third quarter (Q3) for a total of 11,031,998. One company made up \$10.5M of the aggregate balance and this company initially went negative in the second quarter (Q2). Six companies reported a net negative IMR balance for Q2 for a total of \$9,815,594. (The other companies

with negative IMR were immaterial amounts.) *(Under the guidance in the A/S instructions, these companies should stop at zero and report the negative as disallowed nonadmitted asset.)*

Review of Disallowed IMR:

Although the assessment of the liability balance shows the decrease in positive IMR, it no longer tracks the decline for companies that go negative, as the reserve balance on the liability page should stop at zero. (This info may be identifiable from the IMR schedule, but not within the quarterly financials from a review of the IMR reported on the liability page.) As such, NAIC staff completed a review of the data to identify the companies that moved to a zero balance (from a prior positive balance) at year-end 2021 or in the 2022 quarters:

Companies that moved from a positive IMR (liability) to a zero balance:

- Initially went to zero in 2022 – Q3: 20 companies
- Initially went to zero in 2022 – Q2: 20 companies
- Initially went to zero in 2022 – Q1: 11 companies
- Initially went to zero YE 2021 – 20 companies (This is a comparison to YE 2020.)

For these 71 companies, NAIC staff has completed a manual review to the 2022 third quarter financial statements to determine if a disallowed IMR was reported as an aggregate write-in on the asset page. For these companies, 60 were identified with a disallowed IMR for a total of \$1 Billion as of the third quarter 2022.

Existing Authoritative Literature:

SSAP Authoritative Guidance:

- *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*
- Life Annual Statement Instructions

(Guidance included as part of discussion.)

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):

- Nov. 17, 2022, Discussion by Life Actuarial (A) Task Force as discussed above.

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

Convergence with International Financial Reporting Standards (IFRS): NA

Recommendation:

NAIC staff recommend that the Working Group include this item on their maintenance agenda as a New SAP Concept for discussion to assess the current guidance for disallowed negative IMR. NAIC staff recommend that at the Working Group's conclusion, documentation of the discussion, and resulting decisions, be captured for historical purposes in an Issue Paper.

Staff Review Completed by: Julie Gann - NAIC Staff, November 2022

Status:

On December 13, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a New SAP Concept and exposed the agenda item with a request for comments by

industry on potential guardrails and details on unique considerations. The Working Group directed NAIC staff to coordinate with the Life Actuarial (A) Task Force and request regulator-only sessions with industry to receive specific company information.

On March 22, 2023, the Statutory Accounting Principles (E) Working Group directed NAIC staff regarding the consideration of negative interest maintenance reserve (IMR) with an intent to work on both a 2023 solution and a long-term solution as follows:

- a. Draft a referral to the Life Actuarial (A) Task Force on further consideration of the asset adequacy implications of negative IMR. Items to include: 1) developing a template for reporting within asset adequacy testing (AAT); 2) considering the actual amount of negative IMR that is admitted to be used in the AAT; 3) better consideration of cash flows within AAT (and documentation), as well as any liquidity stress test (LST) considerations; 4) ensuring that excessive withdrawal considerations are consistent with actual data (sales of bonds because of excess withdrawals should not use the IMR process); and 5) ensuring that any guardrails for assumptions in the AAT are reasonable and consistent with other aspects.
- b. Draft a referral to the Capital Adequacy (E) Task Force for the consideration of eliminating any admitted net negative IMR from total adjusted capital (TAC) and the consideration of sensitivity testing with and without negative IMR.
- c. Develop guidance for future Working Group consideration that would allow the admission of negative IMR up to 5% of surplus using the type of limitation calculation similar to that used for goodwill admittance. The guidance should also provide for a downward adjustment if RBC ratio is less than 300.
- d. Review and provide updates on any annual statement instructions for excess withdraws, related bond gains/losses and non-effective hedge gains/losses to clarify that those related gains/losses are through asset valuation reserve (AVR), not IMR.
- e. Develop accounting and reporting guidance to require the use of a special surplus (account or line) for net negative IMR.
- f. Develop governance related documentation to ensure sales of bonds are reinvested in other bonds.
- g. Develop a footnote disclosure for quarterly and annual reporting.

On April 10, 2023, the Working Group exposed a limited-time, optional INT to allow admittance of net negative (disallowed) IMR in the general account up to 5% of adjusted capital and surplus. The exposed INT proposed restrictions on what is permitted to be captured in the net negative IMR balance eligible for admittance as well as reporting and disclosure requirements.

On June 28, 2023, the Working Group discussed comments received on the exposed INT and directed NAIC staff to incorporate several revisions to the INT. The revised INT reflects the following:

- Requirement for RBC over 300% after adjustment to remove admitted positive goodwill, EDP equipment and operating system software, DTAs and admitted IMR.

- Allowance to admit up to 10% of adjusted capital and surplus – first in the GA, and then if all disallowed IMR in the GA is admitted and the percentage limit is not reached, then to the SA account proportionately between insulated and non-insulated accounts. *(The adjustments are the same that occur for the RBC adjustment and reduce capital and surplus before applying the 10% percentage limit.)*
- There is no exclusion for derivatives losses included in negative IMR if the company can demonstrate historical practice in which realized gains from derivatives were also reversed to IMR (as liabilities) and amortized.
- Inclusion of a new reporting entity attestation.
- Effective date through Dec. 31, 2025, with a note that it could be nullified earlier or extended based on WG actions to establish specific guidance on net negative (disallowed) IMR.
- Application guidance for admitting / recognizing IMR in both the general and separate accounts.

On July 5, 2023, the Working Group exposed via evote the revised INT for a shortened comment period ending July 21, 2023.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed INT 23-01 which provides optional, limited-time guidance, which allows the admittance of net negative (disallowed) interest maintenance reserve (IMR) up to 10% of adjusted capital and surplus. INT 23-01 is effective through December 31, 2025.

[https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/APPTF/2023-2 Summer/Summary and Minutes/SAPWG/Attachments/Att1T-2022-19 Negative IMR.docx](https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member%20Meetings/E%20CMTE/APPTF/2023-2%20Summer/Summary%20and%20Minutes/SAPWG/Attachments/Att1T-2022-19%20Negative%20IMR.docx)

Interpretation of the Statutory Accounting Principles (E) Working Group

Net Negative (Disallowed) Interest Maintenance Reserve

INT 23-01 Dates Discussed

April 10, 2023, June 28, 2023, August 13, 2023

INT 23-01 References

Current:

*SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve
Annual Statement Instructions*

INT 23-01 Issue

1. The statutory accounting guidance for interest maintenance reserve (IMR) and the asset valuation reserve (AVR) is within *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*, but the guidance within *SSAP No. 7* is very limited. It provides a general description, identifies that IMR/AVR shall be calculated and reported per the guidance in the applicable SSAP, and if not explicit in the SSAP, in accordance with the annual statement instructions. The SSAPs most often simply direct allocation to (or between) IMR and AVR, with the bulk of the guidance residing within the annual statement instructions.

2. As detailed in *SSAP No. 7*, paragraph 2, the guidance for IMR and AVR applies to life and accident and health insurance companies and focuses on IMR and AVR liability recognition and distinguishing between IMR and AVR:

2. Life and accident and health insurance companies shall recognize liabilities for an AVR and an IMR. The AVR is intended to establish a reserve to offset potential credit-related investment losses on all invested asset categories excluding cash, policy loans, premium notes, collateral notes and income receivable. The IMR defers recognition of the realized capital gains and losses resulting from changes in the general level of interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the investments sold. The IMR also applies to certain liability gains/losses related to changes in interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the liability released.

3. The IMR guidance in the annual statement instructions provides information on the net balance. A positive IMR represents net interest rate realized gains and is reported as a liability on a dedicated reporting line. A negative disallowed IMR represents net interest rate realized losses and is reported as a miscellaneous other-than-invested write-in asset in the general account and nonadmitted.

4. IMR balances between the general account and separate accounts are separate and distinct. Meaning, a net negative IMR in the general account only represents activity that occurred in the general account that was allocated to IMR. However, the net positive or negative balance of the general account influences how the net positive or negative balances are reported in separate account statements (and vice versa). (A net negative IMR balance in the general account may not be disallowed if there is a covering net positive IMR in the separate account. Negative IMR that is not disallowed is reported as a contra-liability.) The instructions for reporting the net negative and positive balances are detailed in the annual statement instructions:

Line 6 – Reserve as of December 31, Current Year

Record any positive or allowable negative balance in the liability line captioned “Interest Maintenance Reserve” on Page 3, Line 9.4 of the General Account Statement and Line 3 of the Separate Accounts Statement. A negative IMR balance may be recorded as a negative liability in either the General Account or the Separate Accounts Statement of a company only to the extent that it is covered or offset by a positive IMR liability in the other statement.

If there is any disallowed negative IMR balance in the General Account Statement, include the change in the disallowed portion in Page 4, Line 41 so that the change will be appropriately charged or credited to the Capital and Surplus Account on Page 4. If there is any disallowed negative IMR balance in the Separate Accounts Statement, determine the change in the disallowed portion (prior year less current year disallowed portions), and make a direct charge or credit to the surplus account for the “Change in Disallowed Interest Maintenance Reserve” in the write-in line, in the Surplus Account on Page 4 of the Separate Accounts Statement. The following information is presented to assist in determining the proper accounting:

| General Account IMR Balance | Separate Account IMR Balance | Net IMR Balance |
|--------------------------------|---------------------------------|-----------------------|
| Positive | Positive | Positive (See rule a) |
| Negative | Negative | Negative (See rule b) |
| Positive | Negative | Positive (See rule c) |
| Positive | Negative | Negative (See rule d) |
| Negative | Positive | Positive (See rule e) |
| Negative | Positive | Negative (See rule f) |

Rules:

- a. If both balances are positive, then report each as a liability in its respective statement.
- b. If both balances are negative, then no portion of the negative balances is allowable as a negative liability in either statement. Report a zero for the IMR liability in each statement and follow the above instructions for handling disallowed negative IMR balances in each statement.
- c. If the general account balance is positive, the separate accounts balance is negative and the combined net balance is positive, then all of the negative IMR balance is allowable as a negative liability in the Separate Accounts Statement.
- d. If the general account balance is positive, the separate account balance is negative, and the combined net balance is negative, then the negative amount not covered by the positive amount is not allowable. Report only the allowable portion as a negative liability in the Separate Accounts Statement and follow the above instructions for handling the disallowed portion of negative IMR balances in the Separate Accounts Statement.
- e. If the general account balance is negative, the separate account balance is positive, and the combined net balance is positive, then all of the negative IMR balance is allowable as a negative liability in the General Account Statement.
- f. If the general account balance is negative, the separate account balance is positive, and the combined net balance is negative, then the negative amount not covered by the positive amount is not allowable. Report only the allowable portion as a negative liability in the General Account Statement and follow the above instructions for handling the disallowed portion of negative IMR balances in the General Account Statement.

5. In October 2022, the ACLI requested the Statutory Accounting Principles (E) Working Group to reassess the guidance for net negative (disallowed) IMR, with a request to consider admittance of those amounts. The ACLI noted that the nonadmittance of disallowed negative IMR can have adverse negative ramifications for insurers with two key themes:

- a. In general, rising interest rates are favorable to the financial health of the insurance industry and policyholders. However, with negative IMR, there is an inappropriate perception of decreased financial strength through lower surplus and risk-based capital.
- b. Negative IMR could impact the rating agency view of the industry or incentivize companies to avoid prudent investment transactions that are necessary to avoid mismatches between assets and liabilities. In either scenario, negative IMR encourages short-term non-economic activity that is not in the best long-term interest of a reporting entity's financial health or its policyholders.

6. In considering the request, the Working Group concluded that, for year-end 2022, there would be no change to statutory accounting guidance and deviations from statutory accounting principles would need to be approved via a permitted or prescribed practice. The Working Group then held company-specific educational sessions in January 2023 to receive detailed information regarding negative IMR and received a subsequent comment letter from the ACLI.

7. During the 2023 Spring National Meeting, the Working Group further discussed the topic of negative IMR and directed NAIC staff to proceed with drafting guidance for a 2023 solution and to begin work towards a long-term solution.

INT 23-01 Discussion

8. This interpretation prescribes limited-time, optional, statutory accounting guidance, as an exception to the existing guidance detailed in SSAP No. 7 and the annual statement instructions that requires nonadmittance of net negative (disallowed) IMR as a short-term solution. Specifically, this interpretation impacts the annual statement instruction rules regarding disallowed negative IMR detailed in rules 'b,' 'd' and 'f' shown in paragraph 4.

9. Reporting entities are permitted to admit net negative (disallowed) IMR with the following restrictions:

- a. Reporting entities that qualify pursuant to paragraph 9.b., are permitted to admit net negative (disallowed) IMR up to 10% of the reporting entity's adjusted general account¹ 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. The capital and surplus shall be adjusted to exclude any net positive goodwill, EDP equipment and operating system software, net deferred tax assets and admitted² net negative (disallowed) IMR.
- b. Reporting entities applying this interpretation are required to have a risk-based capital (RBC) greater than 300% authorized control level (ACL) after an adjustment to total adjusted capital (TAC) that reflects a reduction to remove any net positive goodwill, EDP equipment and operating

¹ The general account capital and surplus includes surplus reflected in the separate account; therefore, an aggregation of general account and separate account surplus is not necessary.

² As the separate account does not have "admitted" assets, broad reference to "admitted net negative (disallowed) IMR" throughout this interpretation includes what is admitted in the general account and what is recognized as an asset in the separate accounts.

system software, net deferred tax assets and admitted net negative (disallowed) IMR. Compliance with this adjusted RBC calculation shall be affirmed for all quarterly and annual financial statements for which net negative (disallowed) IMR is reported as an admitted asset in the general account or recognized as an asset in the separate accounts. Reporting entities shall provide documentation to illustrate compliance with this requirement upon state regulator request. Reporting entities with an adjusted RBC calculation of 300% ACL or lower are not permitted to admit net negative (disallowed) IMR in the general account or recognize IMR assets in the separate accounts.

- c. The net negative (disallowed) IMR permitted for admittance shall not include losses from derivatives that were reported at fair value prior to derivative termination³ unless the reporting entity has historically followed the same process for interest-rate hedging derivatives that were terminated in a gain position. In other words, there is a requirement for documented, historical evidence illustrating that unrealized gains from derivatives reported at fair value were reversed to IMR (as a liability) and amortized as part of IMR. Reporting entities that do not have evidence of this past application are required to remove realized losses from derivatives held at fair value from the net negative (disallowed) IMR balance to determine the amount permitted to be admitted. Reporting entities that begin a new process for the use of hedging derivatives, perhaps with a theoretical process to treat derivative losses and derivative gains similarly, but do not have evidence illustrating the historical treatment of derivative gains through IMR are not permitted to include derivative losses in the net negative (disallowed) IMR permitted to be admitted. This evidence is required separately for the general account, insulated separate account and non-insulated separate account if losses from derivatives previously reported at fair value are currently being allocated to IMR in those accounts.

10. Reporting entities that admit net negative (disallowed) IMR shall follow the following process:

- a. All net negative (disallowed) IMR in the general account shall first be admitted until the capital and surplus percentage limit, as detailed in paragraph 9.a., is reached.
- b. If all general account net negative (disallowed) IMR has been fully admitted, and the reporting entity is still below the paragraph 9.a. capital and surplus limit, then the reporting entity can report net negative (disallowed) IMR as an asset in the separate accounts. Reporting entities that have both insulated and non-insulated separate accounts shall recognize IMR assets proportionately between the insulated and non-insulated statements until the aggregated amount recognized as an admitted asset in the general account and as an asset in the insulated and non-insulated statements reaches the percentage limit of capital and surplus detailed in paragraph 9.a.

11. Reporting entities that admit net negative (disallowed) IMR in the general account shall report the admittance in the balance sheet as follows:

- a. Reporting entities shall report the net negative (disallowed) IMR as an aggregate write-in to miscellaneous other-than-invested assets (line 25) (named as “Admitted Disallowed IMR”) on the asset page. The net negative (disallowed) IMR shall be admitted to the extent permitted per paragraph 9.a., with the remaining net negative (disallowed) IMR balance nonadmitted.

³ Reference to derivative termination throughout this interpretation includes all actions that close out a derivative, including, but not limited to, termination, expiration, settlement, or sale.

- b. Reporting entities shall allocate an amount equal to the general account admitted net negative (disallowed) IMR from unassigned funds to an aggregate write-in for special surplus funds (line 34) (named as “Admitted Disallowed IMR”). Although dividends are contingent on state specific statutes and laws, the intent of this reporting is to provide transparency and preclude the ability for admitted negative IMR to be reported as funds available to dividend.

12. Reporting entities that record net negative (disallowed) IMR as an asset in the separate account shall report the recognition in the balance sheet as follows:

- a. Reporting entities shall report the permitted net negative (disallowed) IMR as an aggregate write-in to miscellaneous other-than-invested assets (line 15) (named as “Recognized Disallowed IMR”) on the asset page.
- b. Reporting entities shall allocate an amount from surplus equal to the asset recognized as disallowed IMR as an aggregate write-in for special surplus funds (line 19) (named as “Recognized Disallowed IMR”) on the liabilities and surplus page.

13. Reporting entities admitting net negative (disallowed) IMR are required to complete the following disclosures in the annual and quarterly financial statements for IMR:

- a. Reporting entities that have allocated gains/losses to IMR from derivatives that were reported at fair value prior to the termination of the derivative shall disclose the unamortized balances in IMR from these allocations separately between gains and losses.
- b. Reporting entities shall complete a note disclosure that details the following:
 - i. Net negative (disallowed) IMR in aggregate and allocated between the general account, insulated separate account and non-insulated account,
 - ii. Amounts of negative IMR admitted in the general account and reported as an asset in the separate account insulated and non-insulated blank,
 - iii. The calculated adjusted capital and surplus per paragraph 9.a., and
 - iv. Percentage of adjusted capital and surplus for which the admitted net negative (disallowed) IMR represents (including what is admitted in the general account and what is recognized as an asset in the separate account).
- c. Reporting entities shall include a note disclosure that attests to the following statements:
 - i. Fixed income investments generating IMR losses comply with the reporting entity’s documented investment or liability management policies,
 - ii. IMR losses for fixed income related derivatives are all in accordance with prudent and documented risk management procedures, in accordance with a reporting entity’s derivative use plans and reflect symmetry with historical treatment in which unrealized derivative gains were reversed to IMR and amortized in lieu of being recognized as realized gains upon derivative termination.

- iii. Any deviation to 13.c.i was either because of a temporary and transitory timing issue or related to a specific event, such as a reinsurance transaction, that mechanically made the cause of IMR losses not reflective of reinvestment activities.
- iv. Asset sales that were generating admitted negative IMR were not compelled by liquidity pressures (e.g., to fund significant cash outflows including, but not limited to excess withdrawals and collateral calls).

INT 23-01 Status

14. The consensuses in this interpretation were adopted on August 13, 2023, to provide limited-time exception guidance to SSAP No. 7 and the annual statement instruction for the reporting of net negative (disallowed) IMR. The provisions within this interpretation are permitted as a short-term solution until December 31, 2025, and will be automatically nullified on January 1, 2026.

15. The effective date of this interpretation may be adjusted (nullified earlier or with an extended effective date timeframe) in response to Statutory Accounting Principles (E) Working Group actions to establish statutory accounting guidance specific to net negative (disallowed) IMR.

16. No further discussion is planned.

Application Guidance for Admitting / Recognizing Net Negative (Disallowed) IMR

General Account:

1. Net negative IMR in the general account that exceeds net positive IMR in the separate accounts is considered “disallowed” general account IMR. (Determination of the disallowed IMR in the general account shall be compared against the aggregate IMR balance in all separate accounts.)
2. Net negative disallowed IMR in the general account shall be reported as an aggregate write-in for other-than-invested assets as “Admitted Disallowed IMR” on line 25 of the asset page and nonadmitted. The change in nonadmittance shall be reported on line 41 in the summary of operations.
3. To the extent the reporting entity is permitted to admit net negative disallowed IMR pursuant to the provisions in this interpretation, the reporting entity shall admit the disallowed IMR reported on line 25 of the asset page to the extent permitted, with the change in nonadmittance reflected on line 41 in the summary of operations.
4. Reporting entities shall report an amount equal to the general account admitted net negative (disallowed) IMR as an aggregate write-in for special surplus funds (line 34 of the Liabilities, Surplus and Other Funds page) named as “Admitted Disallowed IMR.”
5. Reporting entities shall include note disclosures in the quarterly and annual financial statements as required in paragraph 13 of the interpretation.

Separate Account:

6. Net negative IMR in the separate account (aggregated IMR in both insulated and non-insulated separate accounts) that exceeds net positive IMR in the general account is considered “disallowed” separate account IMR. If the aggregate separate account IMR is positive, with a negative IMR in the insulated separate account and positive IMR in non-insulated separate account (or vice versa), then the negative IMR in the insulated separate account is not permitted to be reported as an asset. In those situations, the separate account has an aggregate positive IMR balance.
7. Net negative (disallowed) IMR in the separate account permitted to be recognized as an asset, as the admittance in the general account did not utilize the full percentage of adjusted capital and surplus permitted within this interpretation, shall be proportionately divided between insulated and non-insulated separate accounts if both separate accounts are in a negative position. If the separate account IMR is an aggregate net negative, but only one separate account blank is in a negative position, then only the separate account blank with a net negative position can recognize disallowed IMR as an asset.
8. If negative IMR in the separate account has previously been recognized as a direct charge to surplus, the reporting entity shall recognize an asset as an aggregate write-in for other-than-invested assets as “Recognized Disallowed IMR” on line 15 of the separate account asset page, with an offsetting credit to surplus. This credit to surplus shall reverse the charge previously recognized. This process shall continue in subsequent quarters if additional separate account IMR is permitted as an asset to the extent IMR was previously taken as a direct charge to surplus. Once prior surplus impacts have been fully eliminated, then the entity shall follow the guidance for new net negative (disallowed) IMR as detailed in the following paragraph. If subsequent quarters result with a decline in the permitted IMR asset in the separate account, then the asset shall be credited with an offsetting charge to surplus.

9. If the reporting entity enters a net negative (disallowed) IMR position (meaning, there has not been a prior charge to surplus for net negative (disallowed) IMR), then the entity shall recognize the asset as an aggregate write-in for other-than-invested assets as “Disallowed IMR” on line 15 of the separate account balance sheet, with an offsetting credit to IMR (line 3 of the liability page) until the IMR liability equals zero. This process shall continue in subsequent quarters if additional net negative IMR is generated from operations and is permitted as an asset under the provisions of this interpretation. If subsequent quarters result with a decline in the permitted IMR asset in the separate account, then the asset shall be credited with an offsetting charge to surplus.
10. Reporting entities shall report an amount equal to the asset recognized reflecting net negative (disallowed) IMR as an aggregate write-in for special surplus funds (line 19) (named as “Recognized Disallowed IMR.” This shall be included in each separate account statement (insulated and non-insulated) if net negative disallowed IMR is recognized as an asset in that statement.
11. Reporting entities shall include note disclosures in the quarterly and annual financial statements as required in paragraph 13 of the interpretation.

[https://naiconline.sharepoint.com/sites/naicsupportstaffhub/member meetings/e cmte/apptf/2023-2 summer/summary and minutes/sapwg/attachments/att1u-2022-19 int 23-01.docx](https://naiconline.sharepoint.com/sites/naicsupportstaffhub/member%20meetings/e%20cmte/apptf/2023-2%20summer/summary%20and%20minutes/sapwg/attachments/att1u-2022-19%20int%2023-01.docx)

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

Issue: Additional Updates on ASU 2021-10, Government Assistance

Check (applicable entity):

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

Description of Issue:

On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted, revisions to *SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items* in agenda item 2022-04: ASU 2021-10, Government Assistance. The revisions incorporate certain disclosures, adopted with modification from ASU 2021-10, to supplement existing disclosures regarding unusual or infrequent items.

This agenda item is to provide additional clarifications to SSAP No. 24, regarding follow-up questions, that NAIC staff received regarding the adoption of the disclosures about government assistance in ASU 2021-10. The primary questions were regarding whether the adoption with modification of the ASU disclosures intended to allow insurers to use the grant and contribution model. If the intent was not to allow for the use of the grant and contribution model, then the question becomes in what situation would these disclosures be required. Because NAIC staff understanding is that the grant and contribution model is not intended to be permitted for statutory accounting, additional modifications to clarify this point have been proposed which reject ASU 2021-10 but still incorporate government assistance disclosures.

In November 2021, the Financial Accounting Standards Board (FASB) issued *Accounting Standards Update (ASU) 2021-10, Government Assistance, Disclosures by Business Entities about Government Assistance* to increase financial statement transparency regarding certain types of government assistance by increasing the disclosure of such information in the notes to the financial statements.

The new disclosure aims to increase transparency by enhancing the identification of 1) the types of assistance received, 2) an entity’s accounting for said assistance, and 3) the effects of the assistance in an entity’s financial statements. The disclosures will contain information about the nature of the transactions, which includes a general description of the transaction and identification of the form (cash or other) in which the assistance was received. In terms of the effects on the financial statement, disclosure will include identification of the specific line items in both the balance sheet and income statement and a description of the extent to which they have been impacted by any government assistance. In addition, an entity will be required to disclose information about any significant terms of the transaction with a government entity, with items including durations of such agreements and any provisions for potential recapture.

ASU 2021-10 defines “government assistance,” in a comprehensive manner to capture most types of assistance from governmental entities and includes examples of tax credits, cash grants, or grants of other assets. ASU 2021-10 does not apply to not-for-profit entities or benefit plans, and only applies to government assistance transactions analogizing either a grant or contribution model.

With the specificity of these additional disclosures only applying in certain circumstances (only applicable in cases where the government assistance is not accounted for in accordance with other accounting standards – i.e., revenue

in the normal course of business or debt), NAIC staff believe the occurrence of such items requiring disclosure per ASU 2021-10 will likely be relatively infrequent.

NAIC Staff Note – as mentioned above, NAIC staff believe that as these additional disclosures are not applicable for transactions that are in scope of other accounting standards, and only apply when the transaction is accounted for by analogy using the grant or contribution model, the prevalence of such items will be infrequent. As such, the most appropriate location for these items is reflected in SSAP No. 24.

Existing Authoritative Literature:

The following revisions were adopted to *SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items* in agenda item 2022-04

Disclosures [Unusual/Infrequent Items]

16. The nature, including a general description of the transactions, and financial effects of each unusual or infrequent event or transaction shall be disclosed in the notes to the financial statements. Gains or losses of a similar nature that are not individually material shall be aggregated. This disclosure shall include the line items which have been affected by the event or transaction considered to be unusual and/or infrequent. If the unusual or infrequent item is as the result of government assistance (as defined in ASU 2021-10, *Government Assistance, Disclosures by Business Entities about Government Assistance*) disclosure shall additionally include the form in which the assistance has been received (for example, cash or other assets), and information regarding significant terms and conditions of the transaction, with items including, to the extent applicable, the duration or period of the agreement, and commitments made by the reporting entity, provisions for recapture, or other contingencies.

Relevant Literature

24. This statement adopts ASU 2021-10, *Government Assistance: Disclosure by Business Entities about Government Assistance*, with modification to require disclosure by all entity types.

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 2022-04: ASU 2021-10, Government Assistance was adopted on August 10, 2022.

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

None.

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

Staff Review Completed by: Robin Marcotte – NAIC Staff

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to SSAP No. 24 as illustrated below. These revisions will clarify the rejection of ASU 2021-10, Government Assistance and the incorporation of disclosures regarding government assistance.

17. The nature, including a general description of the transactions, and financial effects of each unusual or infrequent event or transaction shall be disclosed in the notes to the financial statements. Gains or losses of a similar nature that are not individually material shall be aggregated. This disclosure shall include the line items

which have been affected by the event or transaction considered to be unusual and/or infrequent. If the unusual or infrequent item is as the result of government assistance, ~~(as defined in ASU 2021-10, Government Assistance, Disclosures by Business Entities about Government Assistance)~~ disclosure shall additionally include the form in which the assistance has been received (for example, cash or other assets), and information regarding significant terms and conditions of the transaction, with items including, to the extent applicable, the duration or period of the agreement, and commitments made by the reporting entity, provisions for recapture, or other contingencies.

Relevant Literature

24. This statement ~~adopts~~ rejects ASU 2021-10, *Government Assistance: Disclosure by Business Entities about Government Assistance*. However, it does incorporate general disclosures about government assistance for all reporting entity types. ~~-, with modification to require disclosure by all entity types.~~

Status:

On March 22, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 24 to specify rejection of *ASU 2021-10, Government Assistance* but that the statutory guidance does incorporate general disclosures regarding government assistance for all entity types.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to SSAP No. 24 which specifies the rejection of ASU 2021-10 but incorporates general disclosures regarding government assistance for all entity types.

[https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/APPTF/2023-2 Summer/Summary and Minutes/SAPWG/Attachments/Att1V-2023-06 SSAP 24.docx](https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member%20Meetings/E%20CMTE/APPTF/2023-2%20Summer/Summary%20and%20Minutes/SAPWG/Attachments/Att1V-2023-06%20SSAP%2024.docx)

Summer National Meeting - Review of GAAP Exposures for Statutory Accounting:

Pursuant to a 2014 direction from the SAPWG chair, there is a desire for the Statutory Accounting Principles (E) Working Group to be more proactive in considering FASB exposures that may be significant to statutory accounting and reporting. Historically, the SAPWG has commented on limited, key FASB exposures – mostly pertaining to insurance contracts and financial instruments. To ensure consideration of all FASB exposures, staff has prepared this memorandum to highlight the current exposures, comment deadlines, and to provide a high-level summary of the exposed item’s potential impact to statutory accounting. It is anticipated that this information would assist the Working Group in determining whether a comment letter should be submitted to the FASB on the issues. Regardless of the Working Group’s election to submit comments to the FASB on proposed accounting standards, under the NAIC Policy Statement on Statutory Accounting Principles Maintenance Agenda Process, issued US GAAP guidance noted in the hierarchy within Section V of the Preamble to the *Accounting Practices and Procedures Manual* must be considered by the Statutory Accounting Principles (E) Working Group.

FASB Exposures: [Exposure Documents and Public Comment Documents \(fasb.org\)](https://www.fasb.org/exposure-documents-and-public-comment-documents)

| Exposed FASB Guidance | Comment Deadline & Initial Staff Comments |
|--|---|
| Proposed Accounting Standards Update— Compensation— <i>Stock Compensation (Topic 718): Scope Application of Profits Interest Awards</i> | July 10, 2023 |
| Proposed Accounting Standards Update—Financial Instruments— <i>Credit Losses (Topic 326): Purchased Financial Assets</i> | August 28, 2023 |

Proposed Accounting Standards Update—Compensation—*Stock Compensation (Topic 718): Scope Application of Profits Interest Awards*

The FASB is issuing the amendments in this proposed Update to improve generally accepted accounting principles (GAAP) by adding an illustrative example to demonstrate how an entity would apply the scope guidance in paragraph 718- 10-15-3 to determine whether profits interest and similar awards (“profits interest awards”) should be accounted for in accordance with Topic 718, Compensation— Stock Compensation.

Certain entities provide employees or other service providers with profits interest awards to align compensation with an entity’s operating performance and provide those holders with the opportunity to participate in future profits and/or equity appreciation of the entity. The term profits interest is not defined in GAAP but differentiates those interests from capital interests held by investors that provide those holders with rights to the existing net assets in a partnership. Because profits interest holders only participate in future profits and/or equity appreciation and have no rights to the existing net assets of the partnership, stakeholders have indicated that it can be complex to determine whether a profits interest award should be accounted for as a share-based payment arrangement (Topic 718) or similar to a cash bonus or profit-sharing arrangement (Topic 710, Compensation— General, or other Topics). As a result, stakeholders have highlighted existing diversity in practice.

Currently, entities evaluate the terms, conditions, and characteristics of a profits interest award and apply judgment to determine whether to account for the award under Topic 718 or Topic 710. However, stakeholders have indicated that there is diversity in practice even when evaluating similar fact patterns. Therefore, stakeholders requested examples to clarify when the guidance in Topic 718 should be applied to profits interest awards (referred to herein

as the “scope application issue”). In addition, entities accounting for economically similar awards consistently would benefit investors and other allocators of capital.

The scope application issue, along with other related issues, was identified and discussed by the Private Company Council (PCC) because of the prevalence of profits interest awards among private companies. However, given that the PCC research indicated that certain public business entities (PBEs) also may be required to account for profits interest awards, the PCC recommended that the Board add a project to address the scope application issue for PBEs and entities other than PBEs (that is, all reporting entities). The Board added that project, Scope Application of Profits Interests Awards: Compensation—Stock Compensation (Topic 718), to its technical agenda in December 2022.

The amendments in this proposed Update would apply to all reporting entities that account for profits interest awards as compensation to employees in return for goods or services.

The amendments in this proposed Update would improve GAAP by adding an illustrative example that includes four fact patterns to demonstrate how an entity would apply the scope guidance in paragraph 718-10-15-3 to determine whether a profits interest award should be accounted for in accordance with Topic 718. The fact patterns in the proposed illustrative example focus on the scope conditions in paragraph 718-10-15-3. The proposed illustrative example is intended to reduce (1) complexity in determining whether a profits interest award is subject to the guidance in Topic 718 and (2) existing diversity in practice.

The amendments in this proposed Update would be applied either (1) retrospectively to all prior periods presented in the financial statements or (2) prospectively to profits interest awards granted or modified on or after the effective date. If the proposed amendments are applied prospectively, an entity would be required to disclose the nature of and reason for the change in accounting principle. The effective date and whether early adoption of the proposed amendments should be permitted will be determined after the Board considers stakeholder feedback on the proposed amendments.

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1: Do you agree that the amendments in this proposed Update should apply to all reporting entities (including PBEs and entities other than PBEs)? Please explain why or why not.

Question 2: Is the proposed illustrative example included in paragraphs 718-10- 55-138 through 55-148 to determine whether a profits interest award should be accounted for in accordance with Topic 718 clear and operable? Please explain why or why not. Should the illustrative example include other considerations or exclude any considerations? If yes, please explain how you would change the proposed illustrative example.

Question 3: An entity would be required to apply the proposed amendments either (a) retrospectively to all prior periods presented in the financial statements or (b) prospectively to awards granted or modified on or after the effective date with an associated disclosure that describes the nature of and reason for the change in accounting principle. Do you agree with the proposed transition provisions? If not, why not, and what basis would be more appropriate and why?

Question 4: Regarding the effective date, how much time would be needed to implement the proposed amendments? Should the amount of time needed to implement the proposed amendments by entities other than PBEs be different from the amount of time needed by PBEs? Should early adoption be permitted? Please explain your response.

Staff Review and Commentary:

Comment deadline was July 10, 2023

NAIC staff recommend that ASU be reviewed under the SAP Maintenance Process as detail in *Appendix F—Policy Statements*.

Proposed Accounting Standards Update—Financial Instruments—*Credit Losses (Topic 326): Purchased Financial Assets*

Since the issuance of Accounting Standards Update No. 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, the Board has monitored and assisted stakeholders with the implementation of Topic 326. Post-Implementation Review (PIR) activities included forming a Credit Losses Transition Resource Group (TRG); conducting outreach with a broad range of stakeholders on costs, benefits, and operability; developing educational materials and staff guidance; conducting educational workshops; and performing an archival review of financial reports.

One area that stakeholders have highlighted in connection with the PIR of Topic 326 is the accounting for acquired financial assets. Financial assets acquired through (1) a business combination, (2) an asset acquisition, and (3) the consolidation of a variable interest entity (VIE) that is not a business are initially recorded at fair value, and an allowance for expected credit losses (ACL or allowance) is separately recognized in accordance with Topic 326. Any purchase discount or premium (the difference between the purchase price and the par value of an acquired financial asset) is subsequently accreted or amortized to interest income in accordance with Topic 310, Receivables.

Topic 326 provides criteria for identifying purchased financial assets with credit deterioration (PCD or PCD assets). PCD assets have experienced a more-than insignificant deterioration in credit quality since origination based on an assessment by the acquirer as of the date of acquisition. That assessment is subjective because Topic 326 does not define what constitutes a “more-than insignificant” deterioration in credit quality. However, the Board clarified in Update 2016-13 its intent that a broad population of purchased financial assets should be eligible for PCD classification—not limited to nonaccrual loans or other “impaired” assets. Acquired financial assets that do not meet the PCD criteria (non-PCD) are accounted for in a manner consistent with originated financial assets. For non-PCD assets, the amount embedded in the purchase price that is attributable to expected credit losses is recognized as a “Day-1” credit loss expense in the income statement.

Under the PCD model, an entity records an allowance and also records the offsetting entry as an addition to the amortized cost basis. Thus, the initial amortized cost basis for PCD assets is an amount equal to the sum of the purchase price and the ACL (commonly referred to as the gross-up approach). The difference, if any, between the amortized cost basis and the par value is a noncredit 2 discount which is accreted or amortized to interest income. Applying the gross-up approach results in the amount embedded in the purchase price attributable to expected credit losses being excluded from interest income.

The initial amortized cost basis for non-PCD assets is equal to the purchase price. An ACL is separately recorded through a charge to credit loss expense equal to the total amount of expected credit losses in the period of acquisition. The purchase discount or premium, if any, is subsequently recognized as interest income using the effective interest rate as of the acquisition date.

Investors, lenders, creditors, and other allocators of capital (collectively, “investors”) and preparers noted that two acquisition accounting approaches (PCD and non-PCD) create unnecessary complexity and reduce comparability. The accounting for non-PCD assets, specifically, has been described by stakeholders as unintuitive because a loss is recorded upon the acquisition of financial assets without more-than-insignificant deterioration in credit quality since origination (non-PCD), whereas no loss is recorded upon the acquisition of financial assets with more-than-insignificant deterioration in credit quality since origination (PCD), which results in accounting that is not economically neutral. To the extent a credit discount is reflected in the fair value and again through a Day-1 allowance for non-PCD assets, the portion reflected in fair value is ultimately reversed as enhanced yield. To compensate for this result, many preparers provide supplemental non-GAAP information that excludes the acquisition accounting accretion effect on yield. In addition, investors explained that the criteria for identifying PCD assets are difficult to understand and are not applied consistently in practice. The majority of feedback (substantially all investors and a majority of practitioners and preparers) from the PIR process suggested that a uniform approach should be applied in the accounting for acquired financial assets and preferred the gross-up approach that is currently applied to PCD assets.

The amendments in this proposed Update would address the comparability and complexity concerns expressed by stakeholders by eliminating the credit deterioration criterion that currently limits the use of the gross-up approach to PCD assets. The proposed Update would require the application of that single accounting approach to all acquired financial assets (with certain limited exceptions, such as available-for-sale [AFS] debt securities).

The amendments in this proposed Update would apply to all entities subject to the guidance in Topic 326 including public business entities, private companies, and not-for-profit entities.

The amendments in this proposed Update would expand the population of financial assets subject to the gross-up approach in Topic 326 that is currently applied to PCD assets. Specifically, an acquirer no longer would be required to determine whether an acquired financial asset is a PCD or non-PCD asset upon acquisition based on the degree of credit deterioration since origination. Instead, the gross-up approach would be applied to all financial assets that are part of a business acquired in a business combination. For financial assets recognized through (1) an asset acquisition or (2) the consolidation of a VIE that is not a business, the acquirer would identify purchased financial assets on the basis of certain criteria that are intended to account for similar transactions in a similar manner. The criteria include a bright-line time-based threshold and a qualitative assessment by the acquirer of its involvement with the origination of the financial asset. When a financial asset is acquired after the bright-line time-based threshold and the acquirer was not involved with the origination, the acquired asset would be accounted for using the gross-up approach.

An acquirer’s assessment of involvement with the origination of a financial asset would consider qualitative characteristics that, if present, indicate that the transaction is economically similar to the acquirer originating the financial asset and, therefore, is required to be accounted for by the acquirer in a manner consistent with originated financial assets. The amendments in this proposed Update expand the use of the gross-up approach without affecting the measurement, presentation, or disclosure requirements.

The effective date and whether early adoption of the amendments in this proposed Update would be permitted will be determined after the Board considers stakeholders’ feedback on the proposed amendments. The proposed amendments would be applied on a modified retrospective basis to the beginning of the fiscal year that an entity has adopted the amendments in Update 2016-13. A cumulative-effect adjustment, if necessary, would be recorded as of the later of (1) the beginning of that reporting period and (2) the beginning of the earliest period presented.

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1: The amendments in this proposed Update would expand the population of acquired financial assets accounted for under the gross-up approach, which currently applies only to PCD assets. Should certain classes of financial assets or specific transactions be included (for example, AFS debt securities) or excluded (for example, credit cards or similar revolving credit arrangements)? Please explain why or why not.

Question 2: Would the proposed amendments enhance comparability and improve the decision usefulness of financial information? Are there specific disclosures related to these proposed amendments that would be useful to investors? Please explain why or why not.

Question 3: Do you foresee operability or auditing concerns in applying the grossup approach to certain classes of financial assets (for example, credit cards or other revolving arrangements), certain types of transactions (for example, business combinations, asset acquisitions, or the consolidation of a VIE that is not a business), or certain classes of financial assets in specific transactions (for example, credit cards or other revolving arrangements in an asset acquisition)? Please describe the nature of those concerns and the magnitude of associated costs, differentiating between one-time costs and recurring costs. Are there practical expedients or implementation guidance that would mitigate your concerns? Are there practical expedients or implementation guidance that would enhance comparability? For any proposed practical expedients suggested, please explain your reasoning.

Question 4: There are no proposed amendments to the gross-up approach as it is currently applied to PCD assets; rather, there are proposed amendments that would expand the population of financial assets that apply the gross-up approach at acquisition. Do you agree that no amendments are needed to the existing gross up approach? Please explain why or why not.

Question 5: Do you agree with the proposed seasoning criteria in paragraph 326- 20-30-15 and 30-16? If not, please explain why or why not and describe any potential alternatives for the Board's consideration.

Question 6: Do you agree with the modified retrospective transition guidance in this proposed Update? Should early adoption be permitted? Please explain why or why not.

Question 7: How much time would be needed to implement the proposed amendments? Is additional time needed for entities other than public business entities? Please explain your response.

Staff Review and Commentary:

Comment deadline is Aug. 28, 2023

NAIC staff recommend that ASU's be reviewed under the SAP Maintenance Process as detail in *Appendix F—Policy Statements*.

[https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/APPTF/2023-2 Summer/Summary and Minutes/SAPWG/ Attachments/Att1W-GAAP Exposures.docx](https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member%20Meetings/E%20CMTE/APPTF/2023-2%20Summer/Summary%20and%20Minutes/SAPWG/Attachments/Att1W-GAAP%20Exposures.docx)